Final Course
Study Material
(Modules 1 to 4)

Paper 4

Direct Tax Laws & International Taxation

[Direct Tax Laws as amended by the Finance Act, 2025]
Assessment Year 2026-27

Module – 1

(Relevant for May 2026, September 2026 and January 2027 examinations)

BOARD OF STUDIES (ACADEMIC)
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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BEFORE WE BEGIN ...

Direct Tax Laws & International Taxation: Dynamic Subject Area

Direct Tax Laws & International Taxation is one of the dynamic subjects of the chartered accountancy course. The direct tax laws of the country undergo significant changes every year with the passing of the annual Finance Act. Apart from these significant amendments ushered in every year through the Finance Act, notifications and circulars are also issued from time to time by the Central Board of Direct Taxes (CBDT), the statutory authority in charge with the administration of direct taxes, to implement the provisions of the Act and clarify issues regarding the meaning and scope of certain provisions. Further, decisions are pronounced by various Courts interpreting the provisions of tax laws.

With increased cross border transactions and the whole world virtually becoming one market, there is a need for chartered accountants to enhance their knowledge base in international taxation. Countries across the globe are entering into tax treaties to avoid double taxation of a single transaction. In a highly advanced IT enabled business scenario where an entity operates from many establishments spread throughout the globe, chartered accountants have to be well versed with the nuances of international taxation to be able to give an informed and correct advice and ensure compliance with tax laws. Accordingly, international taxation has been included as an integral part of this paper.

The contents of the syllabi of this paper is divided into three parts –

1. Chapters based on substantive law of direct taxes including tax planning and tax avoidance;
2. Chapters based on the compliance and procedural law of direct taxes; and
3. Chapters based on international taxation.

The relevant Finance Act and Assessment Year

This Study Material is based on the provisions of direct tax laws, as amended by the Finance Act, 2025, and the Taxation Laws (Amendment) Act, 2025 and the significant notifications, circulars issued and other legislative amendments made upto 31st July, 2025. The computational problems have been solved on the basis of the provisions of direct tax laws applicable for A.Y.2026-27. The Study Material is, therefore, relevant for May 2026, September, 2026 and January, 2027 examinations. In this Study Material, the amendments made by the Finance Act, 2025 and the

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Taxation Laws (Amendment) Act, 2025 and latest notifications and circulars issued have been indicated in *italics*/***bold italics***.

The significant circulars and notifications issued and other legislative amendments, if any, made upto 31.10.2025, 28.2.2026 and 30.6.2026 but not covered in this material, relevant for May, 2026, September, 2026 and January, 2027 examinations, respectively, will be webhosted as Statutory Update at the BoS Knowledge Portal.

Read the Bare Act & Rules along with Study Material

At the Final level, along with the Study Material, students are also advised to read the Income-tax Act, 1961 and Income-tax Rules, 1962, available at the website of the income-tax department www.incometaxindia.gov.in. This will help understand the language of law and sequence of sections and rules. The circulars and notifications issued by CBDT, the income-tax return forms, important provisions relating to firms, companies, trusts, FAQs etc. are also available at this website. Students are advised to visit the income-tax department's website and enhance their knowledge.

Framework of Chapters: Uniform Structure comprising of specific components

Efforts have been made to present the complex direct tax laws in a lucid manner. Care has been taken to present the chapters in a logical sequence to facilitate easy understanding by the students. The Study Material has been divided into four modules for ease of handling by students. The first three modules are on direct tax laws and the fourth module is on international taxation.

Each chapter of the Study Material has been structured uniformly and comprises of the following components:

	Components of each Chapter	About the component
1	**Learning Outcomes**	Learning outcomes which you need to demonstrate after learning each topic have been detailed in the first page of each chapter. Demonstration of these learning outcomes would help you achieve the desired level of technical competence
2	**Content**	The concepts and provisions of direct tax laws and international taxation are explained in a student-friendly manner with the aid of examples/illustrations/diagrams/flow charts. Diagrams and Flow charts would help you understand and retain the concept/ provision learnt in a better manner. Examples and illustrations would help you understand the application of concepts/provisions. These value additions would, thus, help you develop conceptual clarity and get a good grasp of the topic.

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3	**Significant Select Cases**	The summary of recent significant select Supreme Court and High Court rulings have been tabulated at the end of each chapter capturing the gist of the Court decisions interpreting the provisions of tax laws. In addition, case laws (including recent case laws) also form part of the discussion of topics in the content as well as in the questions and answers in "Test Your Knowledge" component. Questions on "Significant Select Cases" in direct tax laws have been given at the end of Module 3 to enable you to apply the rationale of court rulings in addressing issues.
4	**Test Your Knowledge**	The questions and answers at the end of each chapter would help you to analyse the provisions of direct tax laws and international taxation and apply the same in problem solving, thus, sharpening your application skills. In effect, these questions would test your ability to analyse and apply the concepts/provisions learnt in solving problems and addressing issues.

We hope that these student-friendly features in the Study Material improves your learning curve and sharpens your analytical and interpretational skills.

Happy Reading and Best Wishes!

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PAPER – 4 : DIRECT TAX LAWS & INTERNATIONAL TAXATION

(One paper — Three hours –100 Marks)

Objective:

(a) To acquire the ability to analyse and interpret the provisions of direct tax laws and recommend optimal solutions to practical problems in a tax efficient manner; and

(b) To apply the provisions of direct tax laws and the concepts, principles and provisions of international taxation to recommend solutions to issues involved in cross border transactions.

Contents:

I. (i) Comprehensive computation of income-tax liabilities of companies and other entities under the alternative tax regimes under the Income-tax Act, 1961 to optimise tax liability

- General provisions under the Act for computation of total income and tax liability for companies and other entities
- Special tax regimes under the Act for companies and other entities
- Optimisation of tax liability of companies and other entities through tax planning

(ii) Special Provisions relating to charitable and religious trust and institutions, political parties and electoral trusts, business trusts, securitisation trusts, investment funds and other funds/trusts

(iii) Anti-avoidance provisions under the Act

(iv) Provisions to address tax challenges on digitalization

II. Tax Administration and Appellate Mechanism

Deduction, Collection and Recovery of Tax

Income-tax Authorities

Assessment Procedures

Appeals and Revision; and Dispute Resolution

Provisions to counteract unethical tax practices

- Taxation of undisclosed income under the Income-tax Act, 1961

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- Taxation of undisclosed foreign income and assets
- Penalties and offences and prosecution

Miscellaneous Provisions

Tax Audit and Ethical Compliances

III. International Taxation

(i) Taxation of cross border transactions and Non-resident taxation under the Income-tax Act, 1961, including

- Transfer Pricing
- Non-resident Taxation
- Double Taxation Relief
- Advance Ruling

(ii) Other Aspects of International Taxation, namely,

- Significant articles of OECD and UN Model Tax Conventions
- Fundamentals of BEPS
- Application and Interpretation of Tax Treaties
- Latest developments in international taxation

Note: If any new legislation(s) are enacted in place of an existing legislation(s), the syllabus will accordingly include the corresponding provisions of such new legislation(s) in the place of the existing legislation(s) with effect from the date to be notified by the Institute. Similarly, if any existing legislation(s) on direct tax laws ceases to be in force, the syllabus will accordingly exclude such legislation(s) with effect from the date to be notified by the Institute.

Further, the specific inclusions/exclusions in any topic covered in the syllabus will be effected by way of Study Guidelines every year, if required. Specific inclusions/exclusions in a topic may also arise due to additions/deletions made every year by the Annual Finance Act.

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Overview of selected key amendments made by the Finance Act, 2025 and the Taxation Laws (Amendment) Act, 2025

This edition of the study material on Direct Tax Laws and International Taxation has been meticulously updated in line with the Direct tax Laws, as amended by the Finance Act, 2025 and the Taxation Laws (Amendment) Act, 2025 along with significant Notifications and Circulars issued upto 31.07.2025. It is specifically designed for A.Y. 2026-27 and is applicable for May 2026, September 2026 and January 2027 examinations.

The amendments made by the Finance Act, 2025, the Taxation Laws (Amendment) Act, 2025 and significant Notifications and Circulars issued upto 31.7.2025 have been incorporated in this material. Accordingly,

- the content including tabular presentations, diagrams, flow charts etc. have been added, deleted, modified on the basis of provisions of direct tax laws applicable for A.Y. 2026-27.
- Additionally, examples, illustrations given during the discussion, significant select cases of Supreme Court and High Court rulings forming part of the discussion or contained in the questions and tabulated at the end of each chapter and "Test Your Knowledge" questions have been updated, deleted or modified in accordance with these amendments.

While the amended provisions are distinctly highlighted in *italics/**bold and italics*** throughout the material for easy access and quick reference, the concise summary of some of the **key amendments** introduced by the Finance Act, 2025 and the Taxation Laws (Amendment) Act, 2025 are given here below:

- **Default Tax Regime [Section 115BAC] -** The tax slabs under the Default Tax Regime have been restructured as follows:

Total income	Rate of tax
Upto ₹ 4,00,000	Nil
From ₹ 4,00,001 to ₹ 8,00,000	5%
From ₹ 8,00,001 to ₹ 12,00,000	10%
From ₹ 12,00,001 to ₹ 16,00,000	15%
From ₹ 16,00,001 to ₹ 20,00,000	20%
From ₹ 20,00,001 to ₹ 24,00,000	25%
Above ₹ 24,00,000	30%

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- **Increase in limit of rebate under section 87A:** The limit of total income for claiming rebate under section 87A is increased from ₹ 7 lakhs to ₹ 12 lakhs and corresponding, the limit of rebate from ₹ 25,000 to ₹ 60,000. It implies that the tax liability of a resident individual who is paying tax under default tax regime having total income upto ₹ 12 lakhs excluding income taxable at special rates u/s 111A, 112, 112A etc. will be Nil. Marginal relief will still be applicable for income marginally higher than ₹ 12 lakhs.

- **Income on redemption of Unit Linked Insurance Policy:** To rationalise the provisions for unit-linked insurance policies, ULIPs to which exemption under clause (10D) of section 10 does not apply, is classified as capital assets under section 2(14) and the profit and gains from the redemption of such ULIPs shall be charged to tax as capital gains under section 45(1B). Definition of equity-oriented fund is also amended to include all ULIPs to which exemption under clause (10D) of section 10 does not apply.

- **Revamping of Capital Gain -** The provisions of period of holding for classifying capital asset as long term or short term, indexation benefit, tax rates for capital gains taxable u/s 112, 111A and 112A etc. have been amended by the Finance (No. 2) Act, 2024. Certain amendments were applicable with effect from certain date like 23.7.2024. Accordingly, both pre and post amended provisions were discussed in this unit. However, for May 2026, September 2026 and January 2027 examinations, the relevant previous year is P.Y. 2025-26. Therefore, this chapter has been revamped to reflect only post amended provisions.

- **Exemption from withdrawals from National Savings Scheme (NSS):** Section 80CCA provides for a deduction for any amount deposited in the NSS. No deduction would be allowed in relation to such amount deposited on or after 1.4.1992.

  The NSS 1987 accounts are still operational, however due to the notification G.S.R.538E dated 29.8.2024 issued by Ministry of Finance through National Savings Scheme (Amendment) Rules, 2024, the balances at the credit of the subscribers of the National Savings Scheme on or after 1st October, 2024, would not earn any interest.

  Consequent to this notification, depositors who had intended to leave their NSS balances untouched for future use will lose interest benefit and be compelled to withdraw the balances, making these amounts taxable.

  Section 80CCA has been amended to provide exemption to the withdrawals made from National Savings Scheme (NSS) on or after 29th August, 2024, for any amount deposited

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under the scheme and the interest accrued thereon in respect of which a deduction has been allowed.

- **Parity in provisions related to carry forward of losses in case of amalgamation:** In order to bring parity with the provisions of carry forward of business losses, section 72A and section 72AA has been amended to provide that any loss forming part of the accumulated loss of the predecessor entity, to be carried forward for not more than eight assessment years immediately succeeding the assessment year for which such loss was first computed for original predecessor entity.

- **Deduction u/s 80CCD for contributions made to the NPS Vatsalya:** Section 80CCD(1B) provides for an additional deduction of upto ₹ 50,000 in respect of contributions made by an individual to the National Pension System (NPS). The scope of this sub-section has been extended to include contributions made to NPS Vatsalya accounts. The NPS Vatsalya Scheme, enables parents and guardians to start a National Pension Scheme (NPS) account for their children. However, the aggregate deduction under section 80CCD(1B), including contributions to both regular NPS and NPS Vatsalya accounts, shall not exceed ₹ 50,000 in a financial year.

  Clause (12BA) is inserted in section 10 to provide that any income received on partial withdrawal made out of the minor's account, would not be included in the total income of the parent/guardian to the extent it does not exceed 25% of the amount of contributions made by him.

- **Deduction u/s 80CCD for Unified Pension Scheme**: The Unified Pension Scheme (UPS) has been introduced as an option under the National Pension System (NPS) by the Central Government for the Central Government employees covered under NPS so that they may receive an assured payout after their retirement. It is a 'fund-based' payout system which relies on the regular and timely accumulation and investment of applicable contributions (from both the employee and the employer (the Central Government) for grant of monthly payout to the retiree.

  To align the tax treatment of the UPS with the NPS, sub-section (3A) and (6) in section 80CCD and clause (12AA) and (12AB) in section 10 has been inserted by the Taxation Law (Amendment) Act, 2025.

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- **Extension of terminal date for setting up of start-ups eligible for claiming deduction under section 80-IAC:** The eligible start-up is required to be incorporated between 1.4.2016 and 31.3.2025 in order to be eligible for deduction under section 80-IAC. The outer time limit for incorporation is extended from 31.3.2025 to 31.3.2030.

- **Expansion of Tonnage Tax Scheme Benefits to Inland Vessels**: To promote inland water transportation in the country and to attract investments in the sector, the benefits of tonnage tax scheme is extended to Inland Vessels registered under Inland Vessels Act, 2021.

- **Increase in period of registration for smaller trusts or institutions:** The validity of registration of trust or institution was 5 years. To reduce the compliance burden for the smaller trusts or institutions, the period of validity of registration of trust or institution has been increased from 5 years to 10 years. Smaller trusts or institutions would mean such trusts or institutions whose total income, without giving effect to the provisions of sections 11 and 12, does not exceed ₹ 5 crores during each of the two previous year, preceding to the previous year in which such application is made.

- **List of persons specified under section 13(3) rationalised–** Section 13 provides that the provisions of sections 11 and 12 will not apply *inter alia* if the income or property of a trust or institution applied for the benefit of certain specified persons. These specified persons include any person who has made substantial contribution to the trust or institution i.e., any person whose total contribution upto the end of the relevant previous year exceeds ₹ 50,000 and his relative and any concern in which such person has a substantial interest.

  To address difficulties in reporting details of contributors other than founders, trustees, or managers, section 13(3) is amended to provide that the specified person would include a person whose contribution during the relevant previous year exceeds ₹ 1 lakh or in aggregate up to the end of the relevant previous year exceeds ₹ 10 lakhs. Further, the relatives of such contributors will no longer be considered as specified persons and concerns in which these contributors have a substantial interest is also excluded from meaning of specified persons.

- **Registration not be cancelled for minor default –** *Explanation* to section 12AB(4) *inter alia* provides that where registration or provisional registration of a trust or an institution has been granted and subsequently, the Principal Commissioner or Commissioner has noticed occurrence of one or more specified violations including incomplete application or it contains false or incorrect information, then, registration of such trust or institution can be cancelled.

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Explanation to section 12AB(4) has been amended to provide that the situations where the application for registration of trust or institution is not complete, shall not be treated as specified violation and hence, registration would not be cancelled for such a minor default.

- **Abolishment of equalization levy –** W.e.f. 1.4.2025, the 6% equalization levy on online advertisement has been abolished.

- **Reduction in tax deduction at source (TDS) and tax collection at source (TCS) rates:** The TDS and TCS rates in the following sections have been brought down:

S. No	Section	Existing TDS/TCS Rate	Revised TDS/TCS Rate
1.	194D - Insurance Commission	5%	2%
2.	Section 194LBC - Income in respect of investment in securitization trust	25% if payee is Individual or HUF and 30% otherwise	10%
3.	206C(1) - TCS on timber or any other forest produce (not being tendu leaves) obtained under a forest lease and - TCS on timber obtained by any mode other than under a forest lease	2.5%	2%
4.	Section 206C(1G) – TCS on remittance under LRS for purpose of education, financed by loan from financial institution referred to in section 80E	0.5% after ₹ 7 lakhs	Nil

- **Increase in threshold limit for deduction or collection of tax at source:** The threshold limit for requirement to deduct tax at source or collect tax at source under the following sections have been increased:

S. No	Section	Existing Threshold limit (₹)	Revised Threshold limit (₹)
1.	193 - Interest on securities	Nil	10,000
2.	194 – Dividend for an individual shareholder	5,000	10,000
3.	194A - Interest other than Interest on securities	(i) ₹ 50,000 for senior citizen; (ii) ₹ 40,000 in case of others	(i) ₹ 1,00,000 for senior citizen (ii) ₹ 50,000 in case of others

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		when payer is bank, cooperative society and post office (iii) ₹ 5,000 in other cases	when payer is bank, co-operative society and post office (iii) ₹ 10,000 in other cases
4.	194B - Winnings from lottery, crossword puzzle etc.	Aggregate of amounts exceeding ₹ 10,000 during the financial year	₹ 10,000 in respect of a single transaction
5.	194BB - Winnings from horse race	Aggregate of amounts exceeding ₹ 10,000 during the financial year	₹ 10,000 in respect of a single transaction
6.	194D - Insurance commission	15,000	20,000
7.	194G - Income by way of commission, prize etc. on lottery tickets	15,000	20,000
8.	194H - Commission or brokerage	15,000	20,000
9.	194-I Rent	₹ 2,40,000 during the financial year	₹ 50,000 per month or part of a month
10.	194J - Fee for professional or technical services	30,000	50,000
11.	194K - Income in respect of units of a mutual fund or specified company or undertaking	5,000	10,000
12.	194LA - Income by way of enhanced compensation	2,50,000	5,00,000
13.	206C(1G) – Remittance under LRS and overseas tour program package	7,00,000	10,00,000

- **No TCS on sale of goods:** TCS provisions under section 206C(1H) were applicable if conditions specified thereunder are satisfied and where the provisions of section 194Q (relating to tax deduction at source by the buyer) were not attracted. However, with effect from April 1, 2025, the provisions of section 206C(1H), which required the collection of tax at source (TCS) on the sale of goods, has been abolished. Consequently, only section 194Q will now be relevant.

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As per section 194Q, the buyer is required to deduct tax at source at the rate of 0.1% on value of goods exceeding ₹ 50 lakhs in a financial year for the purchase of goods from a resident seller, provided the buyer's turnover exceeds ₹ 10 crores in the preceding financial year.

- **Removal of higher TDS/TCS for non-filers of return of income:** Section 206AB and 206CCA which requires deduction/ collection of tax at higher rate when the deductee specified therein is a non-filer of income-tax return have been omitted.

- **Extending the time-limit to file the updated return:** Earlier, an updated return can be filed under section 139(8A) upto 24 months from the end of the relevant assessment year. The time limit for filing updated return has been extended to 48 months from the end of the relevant assessment year.

Rate of additional tax payable in the above case

Updated return filed after expiry of 24 months and upto 36 months from the end of relevant assessment year	60% of the aggregate of tax and interest payable
Updated return filed after expiry of 36 months and upto 48 months from the end of relevant assessment year	70% of the aggregate of tax and interest payable

- **Non applicability of section 271AAB of the Act:** The existing section 271AAB(1A) relates to penalty in respect of searches initiated after 15.12.2016. After introduction of 'Block Assessment' (Chapter XIV-B) for searches initiated under section 132 on or after 1st September, 2024, the provisions of the section 271AAB(1A) shall not to applicable to a case where search has been initiated under section 132 on or after 1st September, 2024.

- **Amendments in provisions of Block assessment for search and requisition cases under Chapter XIV-B:** Vide Finance (No. 2) Act, 2024, the concept of block assessment was introduced by amending provisions of Chapter XIV-B (Sections 158B to 158BI) to be made applicable where a search under section 132 is initiated or requisition under section 132A is made, on or after 1st September, 2024.

  The term "virtual digital asset" has been added to the definition of undisclosed income of the block period which is defined under section 158B. The time-limit for completion of block assessment is changed from twelve months from end of the month to twelve months from end of the quarter in which the last of the authorisations for search or requisition has been executed.

- **Time limit to impose penalties rationalized:** The existing provisions of section 275, *inter-alia,* provide for the bar of limitation for imposing penalties. It is amended to provide that any order imposing a penalty shall not be passed after the expiry of six months from the end of

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the quarter in which the connected proceedings are completed, or the order of appeal is received, or the order of revision is passed.

- **Exemption from prosecution for delayed payment of TCS:** Section 276BB provides for prosecution in case of failure to pay the tax collected at source to the credit of Central Government. Section 276BB is amended to provide exemption from prosecution to a person who has failed to pay tax collected at source (TCS) to the credit of the Central Government, if such payment is made at any time on or before the time prescribed for filing the quarterly TCS statement.
- **Obligation to furnish information on transaction of crypto-asset:** New section 285BAA has been inserted to provide that a reporting entity is required to furnish information with respect to transaction of crypto asset in a statement within such time and in such form as may be prescribed.
- **Parity in rates of long-term capital gain on transfer of securities by FIIs:** At present, FIIs are liable to tax @10% on long-term capital gains on transfer of securities (other than referred to in section 112A). To bring parity between the taxation of capital gains on transfer of capital assets between residents and non-residents, being Foreign Institutional investors, section 115AD has been amended to provide tax rate of 12.5% on such long-term capital gains.
- **Rationalization of transfer pricing provisions for carrying out multi-year arm's length price determination:** Transfer pricing provisions enable computation of income arising from an international transaction or a specified domestic transaction with regard to an arm's length price. It is amended to provide that the ALP determined in relation to an international transaction or a specified domestic transaction for any previous year to apply to the similar transaction for the two consecutive previous years immediately following such previous year.
- **Introduction of presumptive taxation scheme for non-resident providing services for electronics manufacturing facility:** A new section 44BBD has been inserted to provide presumptive taxation regime @25% for non-resident engaged in the business of providing services or technology in India, for the purposes of setting up an electronics manufacturing facility or in connection with manufacturing or producing electronic goods, article or thing in India.

The above coverage provides only a concise overview of the significant select amendments made by the Finance Act, 2025. To fully grasp the scope and application of the amendments introduced by the Finance Act, 2025, the Taxation Laws (Amendment) Act, 2025 along with Notification and Circulars, it is imperative to refer to the detailed discussions including tabular presentations, flow charts, examples, illustrations, significant select cases, test your knowledge questions provided in the respective chapters. Therefore, students are advised to refer the chapters thoroughly for comprehensive study and effective preparation for their examinations.

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CHAPTER 1

BASIC CONCEPTS

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **recap** the basic concepts of income-tax law, its components and the meaning of important terms used;
- **interpret** the provisions of income-tax law by applying the rules of interpretation;
- **examine** whether a receipt is capital or revenue in nature, in the context of the provisions of income-tax law;
- **appreciate** the difference between application of income and diversion of income by overriding title;
- **examine** the circumstances when income of the previous year would be assessed to tax in the previous year itself;
- **appreciate** the differences in the rates of tax and surcharge applicable to different categories of persons;
- **apply** the rates of tax applicable to different components of the total income of a person and the rates of surcharge, wherever applicable, and health and education cess for the purpose of determining the tax liability of such person.

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CHAPTER OVERVIEW

- Components of Income-tax Law
- Rules of Interpretation
- Important Definitions
- Charge of Income-tax
- Rates of Tax & Surcharge

1.1 OVERVIEW OF INCOME TAX LAW IN INDIA

The Constitution of India, in Article 265 lays down that *"No tax shall be levied or collected except by authority of law."* Accordingly, both the levy of tax as well as its collection shall be made under a law framed by the government.

Constitution of India gives the power to levy and collect taxes, whether direct or indirect, to the Central and State Government. The Parliament and State Legislatures are empowered to make laws on the matters enumerated in the Seventh Schedule by virtue of Article 246 of the Constitution of India.

The Seventh Schedule to Article 246 contains three lists which enumerate the matters under which the Parliament and the State Legislatures have the authority to make laws for the purpose of levy of taxes.

The following are the lists:

(i) **Union List or List I:** Parliament has the exclusive power to make laws on the matters contained in Union List.

(ii) **State List or List II:** The Legislatures of any State has the exclusive power to make laws on the matters contained in the State List.

(iii) **Concurrent List or List III:** Both Parliament and State Legislatures have the power to make laws on the matters contained in the Concurrent List.

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Income-tax is the most significant direct tax. ***Entry 82 of the Union List*** *i.e., List I in the Seventh Schedule to Article 246 of the Constitution of India has given the power to the Parliament to make laws on taxes on income other than agricultural income.*

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

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

Income-tax Act, 1961

The levy of income-tax in India is governed by the Income-tax Act, 1961. In this material we shall briefly refer to this as the Act.

- It extends to the whole of India.
- It came into force on 1st April, 1962.
- It contains sections 1 to 298 and schedules I to XIV.
- It undergoes a change every year by the Annual Finance Act passed by Parliament, and other legislations like the Taxation Laws (Amendment) Act.

The Finance Act

Every year, the Finance Minister of the Government of India introduces the Finance Bill in the Parliament's Budget Session. When the Finance Bill is passed by both the houses of the Parliament and gets the assent of the President, it becomes the Finance Act. New provisions are inserted; existing provisions are substituted or amended every year in the Income-tax Act, 1961 and other tax laws by the Finance Act.

The First Schedule to the Finance Act contains four parts which specify the rates of tax -

- **Part I** of the First Schedule to the Finance Act specifies the rates of tax applicable to the current Assessment Year. Accordingly, Part I of the First Schedule to the Finance Act, 2025 specifies the rates of tax for A.Y. 2025-26 i.e., F.Y. 2024-25.

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- **Part II** specifies the rates at which tax is deductible at source for the current Financial Year. Accordingly, Part II of the First Schedule to the Finance Act, 2025 specifies the rates at which tax is deductible at source for F.Y. 2025-26.
- **Part III** gives the rates for calculating income-tax for deducting tax from income chargeable under the head "Salaries" and computation of advance tax for F.Y. 2025-26 where the assessee exercises the option to shift out of the default tax regime provided under section 115BAC(1A).
- **Part IV** contains the rules for computing net agricultural income.

Income-tax Rules, 1962

The administration of direct taxes is looked after by the Central Board of Direct Taxes (CBDT).

- The CBDT is empowered to make rules for carrying out the purposes of the Act.
- For the proper administration of the Income-tax Act, 1961, the CBDT frames rules from time to time. These rules are collectively called **Income-tax Rules, 1962.**
- Rules also have sub-rules, provisos and *Explanations*. The proviso to a Rule/ Sub-rule spells out the exception to the limits, conditions, guidelines, basis of valuation, as the case may be, spelt out in the Rule/ Sub-rule. The *Explanation* gives clarification for the purposes of the Rule.
- It is important to keep in mind that along with the Income-tax Act, 1961, these rules should also be studied.

Circulars and Notifications

Circulars

- Circulars are issued by the CBDT from time to time to deal with certain specific problems and to clarify doubts regarding the scope and meaning of certain provisions of the Act.
- Circulars are issued for the guidance of the officers and/or assessees.
- The department is bound by the circulars. While such circulars are not binding on the assessees, they can take advantage of beneficial circulars.

Notifications

- Notifications are issued by the Central Government to give effect to the provisions of the Act.

  Example: Under section 10(15)(iv)(h), interest payable by any public sector company in respect of such bonds or debentures and subject to such conditions as the Central

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Government may, by notification in the Official Gazette, specify in this behalf would be exempt. Therefore, the bonds and debentures, interest on which would qualify for exemption under this section are specified by the Central Government through Notifications.

- The CBDT is also empowered to make and amend rules for the purposes of the Act by issuing notifications which are binding on both department and assessees.

  Example: Under section 35CCD, the CBDT is empowered to prescribe guidelines for notification of skill development project. Accordingly, the CBDT has, *vide Notification No. 54/2013 dated 15.7.2013*, prescribed Rule 6AAF laying down the guidelines and conditions for approval of skill development project under section 35CCD.

Case Laws

The study of case laws is an important and unavoidable part of the study of Income-tax law. It is not possible for Parliament to conceive and provide for all possible issues that may arise in the implementation of any Act. Hence the judiciary will hear the disputes between the assessees and the department and give decisions on various issues.

The Supreme Court is the Apex Court of the Country and the law laid down by the Supreme Court is the law of the land. The decisions given by various High Courts will apply in the respective states in which such High Courts have jurisdiction.

Rules of Interpretation

Rules of Interpretation are principles that have evolved over the years, on account of interpretation of provisions of law by various Courts. These rules help in interpretation of law. The object behind use of these rules is to ascertain the intention of the lawmakers. These rules are not static and keep on evolving. At times, there may be more than one rule of interpretation which appear to applicable to a given situation. The Courts then decide the most appropriate one in the given situation considering the facts of the case.

In the ensuing paragraphs, we have made an attempt to discuss the Rules of Interpretation, largely in the context of income-tax law, citing appropriate instances.

I. Significant rules of interpretation used by Courts:

- **Rule of literal interpretation -** This rule is based on the age-old doctrine that *"judges do not legislate, they only interpret law*". It stipulates that the intention of the legislation must be found in the words used by the legislature itself. Attention must be given to what has been said and also what has not been said. Nothing should be added or subtracted. If the

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provision is unambiguous and if from that provision the legislative intent is clear, the other rules of construction of statutes need not be called into aid.

- **Mischief rule -** The mischief rule originated in 16th century in the Heydon's case in the United Kingdom. It is commonly known as the Heydon's Rule or Purposive construction. Under this rule, the position before an amendment or enactment of an Act is examined to find out the mischief sought to be remedied to determine the rationale for the remedy. In order to do so, the following aspects are looked at:

  - What was law before the provision was introduced or amended?
  - What was the mischief or the defect for which the earlier provision of law did not provide a remedy?
  - What remedy has the Parliament effected in the provisions of law to cure the mischief or defect?
  - What is the intended effect of such remedy?

  Courts then have to make a construction that suppresses the mischief and advances the remedy.

- **The Golden rule** – It allows a judge to depart from a word's normal meaning in order to avoid an absurd result. It is a compromise between the literal rule and the mischief rule. Like the literal rule, it gives the words of a statute their plain, ordinary meaning. However, if this leads to an irrational result which is unlikely to be the legislature's intention, the court can depart from this meaning.

  In such a case, the Court would also look at the context in which a provision appears. The same words may mean one thing in one context and another in a different context. While ascertaining the true intention of the Legislature, the court must not only look at the words used by the Legislature but also have regard to the context and the setting in which they occur. The meaning of words in an enactment is not to be ascertained by reading them in isolation.

- **Rule of Harmonious construction -** The entire statute must be read as a whole. Further, all parts of a section should be read harmoniously. Construction should be such that it provides meaning to all parts of a statute. A construction which creates inconsistency or repugnancy between the various sections or parts of the statute should be avoided.

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- **Principle of beneficial construction -** If the court finds that two views are possible construction which is most beneficial to the taxpayer should be adopted. This principle is also widely used in case of interpretation of fiscal laws.

Apart from these rules, there are several other rules such as *ejusdem generis, nocitur a sociius* and *stare decisis* which are often used by Courts.

- **Rule of *ejusdem generis*** is used when particular words pertaining to a class, category or genus are followed by general words. In that case general words are construed as limited to things of the same kind.
- The principle of ***nocitur a sociius*** implies that meaning of a word may be ascertained by reference to words associated with it. Words derive colour from the surrounding words.
- The principle of ***stare decisis*** stipulates that a view which is operating for long and is accepted and acted upon should not be easily departed from.

II. Interpretation of different provisions of the Income-tax Act, 1961

In context of the Income-tax Act, 1961, the ensuing table summarizes how different types of provisions are typically construed by Courts.

Type of provision	Interpretation
Charging provisions	Tax is levied by a charging section i.e., it imposes a charge or liability to pay tax. If a person has been brought to tax within the ambit of the charging section by clear words, he has to be taxed, subject to specific exemption/ deduction, if any, available under the provisions of the Act. Charging sections should be strictly construed.
Machinery provisions	Machinery provisions provide machinery for assessment and collection of charge created by the charging section. Machinery and charging provisions constitute an integrated code. The machinery provisions should be construed in a way that makes the machinery workable.
Penal provisions	Penal provisions are required to be construed in a strict manner. In case of ambiguity, the taxpayer should be entitled to the benefit of doubt.
Deeming provisions	Deeming provision is intended to enlarge the scope of chargeability of income under a particular head or scope of coverage of a certain provision. It includes matters which otherwise may or may not fall within the provision. Deeming provision should be strictly construed. It should be given its full effect and carried to its logical conclusion.

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Appeal and refund provisions	The taxpayer has a right to appeal only if there is a statutory provision for the same. It cannot be implied. Appeal provision should be liberally construed in a reasonable and practical manner. Similarly, provisions granting refund must also be read liberally, in favor of the taxpayer.
Provisions giving exemptions and reliefs	Provisions giving deduction, exemption or relief should be interpreted liberally and in favor of taxpayers. They should be construed to effectuate the object of legislature and not to defeat it.

III. Aids to interpretation

An aid is a device that helps or assists Courts in interpretation of statues. They can be broadly classified as:

- **Internal Aids**
- **External Aids**

Internal aids to construction

Internal aids of construction refer to aids present within the statue itself, such as the long title, the preamble, heading, marginal notes, punctuations, definition sections, provisos and explanations. Let us now examine some of these:

- **Explanations –** Explanation is generally meant to explain or clarify the meaning of certain words and expressions contained in the main provision. Explanation appended to a section is an integral part of the section. It does not have independent existence apart from the section. In exceptional cases an explanation may widen the scope of the main section by introducing a legal fiction.
- **Provisos –** Generally the function of a proviso is to carve out an exception/ condition to qualify a provision. A proviso cannot control the enactment. A proviso is not applicable unless the main provision is applicable to the facts of the case. It must be construed harmoniously with the main provision.

> ***Example:*** *Sections 80GGB and 80GGC provides for deduction from gross total income in respect of contributions made by companies and other persons, respectively, to political parties or an electoral trust.*
>
> *The proviso to sections 80GGB and 80GGC provides that no deduction shall be allowed under those sections in respect of any sum contributed by cash to political parties or an electoral trust. Thus, the provisos to these sections spell out the circumstance when deduction would not be available thereunder in respect of contributions made.*

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The Explanation below section 80GGC provides that for the purposes of sections 80GGB and 80GGC, "political party" means a political party registered under section 29A of the Representation of the People Act, 1951. Thus, the Explanation clarifies that the political party has to be a registered political party.

- **Non-obstante clause –** Non-obstante clause is a clause which begins with **the phrase** "notwithstanding anything contained in any other provision of the Act" or "notwithstanding anything contained in a particular provision(s) of the Act". Use of this phrase shows that the intent of lawmakers is to give it an overriding effect, in case of a conflict, over the other provisions of the statute mentioned in the provision.

Example: *Section 43B provides deduction of certain specified sums for computing of income under the head "Profits and gains from business or profession" on actual payment basis. It begins with the phrase "notwithstanding anything contrary in any other provision of this Act". Thus, it overrides the other provisions of the Act and provides deduction of payments or expenditures specified therein* ***only on the basis of actual payment****.*

- **Marginal notes and headings -** Headings may be prefixed to a section or a group of sections. Marginal notes are the notes which are inserted at the side of the sections in a statute and express the effect of the sections stated. Headings and marginal notes cannot control the plain words of the provisions. Only in the case of ambiguity they may be referred to throw light on intention of legislature.

- **Definition clauses and undefined words -**The object of a definition clause is to avoid the necessity of frequent repetitions in describing the subject matter in the statute. When the statute defines a particular word, the same should be used, unless the context otherwise requires. A word occurring more than once in a statute should be generally given the same meaning, unless the context requires otherwise. Words not specifically defined must be taken in their legal sense, dictionary meaning, commercial or common meaning. Definition from any other statute cannot be borrowed and used ignoring the definition contained in the statute itself.

  In the Income-tax Act, 1961, definitions contained in section 2 are for the purposes of the Income-tax Act, 1961. However, definitions contained in a particular Chapter of the Income-tax Act, 1961 are generally relevant only in the context of the provisions relating to that Chapter, unless reference to such definition(s) has been made in any other provision(s)/ Chapter of the Act.

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External aids to construction

External aids refer to aids which are external to the statue such as legislative history, dictionaries, foreign decisions, reference to other statues. Let us examine some of them:

- **Legislative history -** Historical setting cannot be used as an aid if the words are plain and clear. If the wordings are ambiguous, one can look at the historical facts and circumstances that prevailed at the time when the law was passed for determining the object and purpose. Reports of Commissions including Law Commission or Committees including Parliamentary Committees preceding the introduction of a bill can also be referred to as evidence of historical facts, surrounding circumstances or mischief intended to be remedied.
- **Circulars -** CBDT Circulars issued under section 119 of the Income-tax Act, 1961 are binding on the tax officers and persons employed in the execution of the Income-tax Act 1961. They express the views of CBDT on any issue. They are, however, not binding on the Appellate Authorities, Tribunal, Courts or the taxpayer. Taxpayers can however take benefit of the beneficial circulars.
- **Speech -** The speech made by the mover of the Bill can also be used to ascertain the mischief sought to be remedied, the object and purpose of the legislation. However, speeches made by the Members of the Parliament at the time of consideration of a Bill, are not admissible as an aid.
- **Explanatory Memorandum -** Notes on clauses and memorandum explaining the provisions of the Finance Bill can also aid in construction, in case of ambiguity.
- **Dictionary meaning -** The dictionary meaning of a word should not be looked at where the word has been statutorily defined or judicially interpreted. However, when there is no such interpretation or definition, the Court may take aid of dictionaries to ascertain a meaning of the word.

1.2 IMPORTANT DEFINITIONS

In order to understand the provisions of the Act, one must have a thorough knowledge of the meanings of certain key terms like 'assessment year', 'person', 'assessee', 'income', etc. To understand the meanings of these terms we have to first check whether they are defined in the Act.

Terms defined in the Act: Section 2 gives definitions of the various terms and expressions used therein. If a particular definition is given in the Act itself, we have to be guided by that definition. For e.g. the term 'perquisite' has been defined under section 17(2) for the purpose of taxation of salaries.

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Terms not defined under the Act: If a particular definition is not given in the Act, reference can be made to the General Clauses Act or dictionaries.

Students should note this point carefully because certain terms like "dividend", "transfer", etc. have been given a wider meaning in the Income-tax Act, 1961 than they are commonly understood.

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

Assessee [Section 2(7)]

"Assessee" means a person by whom any tax or any other sum of money is payable under this Act. In addition, it includes –

- Every person in respect of whom any proceeding under this Act has been taken for the assessment of -
  - his income; or
  - the income of any other person in respect of which he is assessable; or
  - the loss sustained by him or by such other person; or
  - 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.
- Every assessee is a 'person', but every 'person' need not be an assessee.

Assessment [Section 2(8)]

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

Types of income-tax assessment:

1. Self-assessment under section 140A
2. Summary assessment under section 143(1)
3. Scrutiny assessment under section 143(3)
4. Best judgment assessment under section 144
5. Re-assessment or income escaping assessment under section 147

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Person [Section 2(31)]

The definition of 'assessee' leads us to the definition of 'person' as the former is closely connected with the latter. The term 'person' is important from another point of view also *viz.,* the charge of income-tax is on every 'person'. The definition of the term 'person' is inclusive and not exhaustive. The different types of persons recognized under the Act are provided in the diagram below:

We may briefly consider some of the above seven categories of assessees each of which constitute a separate unit of assessment or a separate tax entity.

(i) Individual

The term 'individual' means only a natural person, *i.e.,* a human being.

It also includes a minor or a person of unsound mind. But the assessment in such a case may be made under section 161(1) on the guardian or manager of the minor or lunatic who is entitled to receive his income. In the case of deceased person, assessment would be made on the legal representative.

(ii) HUF

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

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"Hindu undivided family" has not been defined under the Income-tax Act, 1961. The expression is, however, defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and daughters.

[Refer Chapter 9: Assessment of various entities in Module 2 for detail discussion of HUF]

(iii) Company [Section 2(17)]

For all purposes of the Act, the term 'Company', has a much wider connotation than that under the Companies Act, 2013. Under the Act, the expression 'Company' means:

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

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

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

(d) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company for such assessment years as may be specified in the CBDT's order.

Classes of Companies

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

Domestic company [Section 2(22A)] - It means an "Indian company" or any other company that has made the necessary arrangements to declare and pay dividends (including those on preference shares) within India from its income that is subject to income tax.

Indian company [Section 2(26)] - A company is considered an "Indian company" under section 2(26) of the Income-tax Act, 1961 if it meets two key conditions:

1. **Formation and Registration**: The company should have been formed and registered under the Companies Act, 1956[1].

2. **Office Location**: The company's registered or principal office should be in India.

Additionally, the term "Indian company" also includes the following provided their registered or principal office in India:

[1] Now Companies Act, 2013

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- Corporation established by or under a Central, State, or Provincial Act, such as Financial Corporation or State Road Transport Corporation.
- Institution, association, or body declared by the Board to be a company under section 2(17)(iv).
- Company formed and registered under any law in force in any part of India, excluding Jammu and Kashmir and specific Union territories.
- Company formed and registered under any law in force in Jammu and Kashmir.
- Company formed and registered under any law in force in Union territories like Dadra and Nagar Haveli, Daman and Diu, Pondicherry, or the State of Goa.

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

(2) A company is further classified into two primary categories based on public interest:

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

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

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

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

(d) **Mutual Benefit Finance Company (Nidhi or Mutual Benefit Society):** A company that primarily accept deposits from its members and is declared by the Central Government under Section 620A of the Companies Act, 1956[3], to be a *Nidhi* or Mutual Benefit Society.

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

(f) **Public Limited Company:** A company which is not a private company as defined in the Companies Act, 1956[4] and which fulfills any of the following conditions:

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

  (a) Government or

  (b) a Statutory Corporation or

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

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

[2] Section 8 of the Companies Act, 2013
[3] Section 406 of the Companies Act, 2013

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

[Refer Chapter 9: Assessment of various entities in Module 2 for detail discussion of companies]

(iv) Firm [Section 2(23)]

The terms 'firm', 'partner' and 'partnership' have the same meanings as assigned to them in the Indian Partnership Act, 1932. In addition, the definitions also include the terms limited liability partnership, a partner of limited liability partnership as they have been defined in the Limited Liability Partnership Act, 2008.

In an LLP, since liability of the partners is limited to their agreed contribution therein, it contains elements of both a corporate structure as well as a partnership firm structure.

However, for income-tax purposes a minor admitted to the benefits of an existing partnership would also be treated as partner.

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

(v) Association of Persons (AOP)

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

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For e.g., Mr. Yash, AB & Co. (Firm) and X (P) Ltd. Join together to carry on construction activity otherwise than as a partnership firm, such an association will be recognized as an association of persons.

(vi) Body of Individuals (BOI)

Body of individuals refers to a conglomeration of individuals who carry on some activity with or without the object of producing income. It denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus, co-executors or co-trustees are assessable as a BOI as their title and interest are indivisible. Income-tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI and on which the tax has already been paid by such BOI. For e.g., mutual trade associations, members club, etc.

Section 2(31) further explains that an association of persons/body of individuals or a local authority or an artificial juridical person shall be treated as a person, whether or not it is formed with the object of deriving income, profits or gains. Accordingly, even if such entities have been formed not for earning any income/ profit still they are "person" for the purpose of the Act and are covered by the provisions of the Act.

Difference between AOP and BOI: In case of a BOI, only individuals can be the members, whereas in case of AOP, any person can be its member i.e., entities like company, firm etc. can be the member of AOP but not of BOI.

In case of an AOP, members voluntarily come together with a common will for a common intention or purpose, whereas in case of BOI, such common will may or may not be present.

(vii) Local Authority

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

Note: A local authority is taxable in respect of that part of its income which arises from any business carried on by it in so far as that income does not arise from the supply of a commodity or service within its own jurisdictional area. However, income arising from the supply of water and electricity even outside the local authority's own jurisdictional areas is exempt from tax.

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(viii) Artificial Juridical Persons

Artificial Juridical Persons are the entities which are not natural persons but are separate entities in the eyes of law. This is a residual category could cover all artificial persons with a juristic personality not falling under any other category of persons. Deities, Bar Council, Universities are some important examples of Artificial Juridical Persons.

Income [Section 2(24)]

(i) Definition of Income

The definition of income as per the Income-tax Act, 1961 begins with the words "Income includes". Therefore, it is an inclusive definition and not an exhaustive one. Such a definition does not confine the scope of income but leaves room for more inclusions within the ambit of the term.

Section 2(24) of the Act gives a statutory definition of income. At present, the following items of receipts are specifically included in income:—

(1) Profits and gains;

(2) Dividends;

(3) Voluntary contributions received by a trust/ institution created wholly or partly for charitable or religious purposes or by an association or institution referred to in section 10(21) or by a fund or institution referred to in section 10(23C) (iiiad)/ (iiiae)/ (iv)/(v)/(vi)/(via) or an electoral trust;

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

(4) The value of any **perquisite or profit in lieu of salary** taxable under section 17(2) and (3), respectively;

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(5) Any **special allowance or benefit**, other than the perquisite included above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit;

(6) Any **allowance granted to the assessee** to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living;

(7) The value of **any benefit or perquisite**, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;

(8) The value of **any benefit or perquisite**, whether convertible into money or not, which is obtained by any representative assessee mentioned under section 160(1)(iii) and (iv), or by any beneficiary or any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay;

(9) **Deemed profits** chargeable to tax under **section 41 or section 59**;

(10) **Profits and gains** of business or profession chargeable to tax under section 28(ii)/(iii)/(iiia)/(iiib)/(iiic)/(v)/(va); or The value of any benefit or perquisite taxable under section 28(iv);

(11) Any **capital gains** chargeable under section 45;

(12) The **profits and gains of any insurance business carried on by Mutual Insurance Company or by a cooperative society**, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of the provisions contained in the first Schedule to the Act;

(13) The **profits and gains of any business of banking** (including providing credit facilities) carried on by a co-operative society with its members;

(14) Any **winnings from lotteries, 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. For this purpose,

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i. "Lottery" includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;

ii. "Card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game.

(15) Any sum received by the assessee from his employees as **contributions to any provident fund (PF) or superannuation fund or Employees State Insurance Fund (ESI) or any other fund for the welfare of such employees**;

(16) Any sum received under a **Keyman insurance policy** including the sum allocated by way of bonus on such policy will constitute income;

"Keyman insurance policy" means a life insurance policy taken by a person on the life of another person where the latter is or was an employee or is or was connected in any manner whatsoever with the former's business. It also includes such policy which has been assigned to a person with or without any consideration, at any time during the term of the policy.

(17) **Any sum referred to in section 28(va)**. Any sum, whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business or profession; or not sharing any know-how, patent, copy right, trade-mark, licence, franchise, or any other business or commercial right of a similar nature, or information or technique likely to assist in the manufacture or processing of goods or provision of services, shall be chargeable to income tax under the head "profits and gains of business or profession";

(18) **Fair market value of inventory** as on the date on which it is **converted into, or treated as, a capital asset**, determined in the prescribed manner [Section 28(via)];

(19) Any **sum of money received as advance**, if such sum is forfeited consequent to failure of negotiation for transfer of a capital asset [Section 56(2)(ix)];

(20) Any **sum of money or value of property received without consideration or for inadequate consideration** by any person [Section 56(2)(x)];

(21) Any **compensation or other payment**, due to or received by any person, by whatever named called, in **connection with termination of his employment** or the modification of the term and conditions relating thereto [Section 56(2)(xi)];

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(22) Any specified **sum received by a unit holder from a business trust** during the previous year, with respect to a unit held by him at any time during the previous year [Section 56(2)(xii)];

(23) **Sum received**, including the amount allocated by way of bonus, **under a LIP other than under a ULIP and keyman insurance policy, which is not exempt u/s 10(10D)**, to the extent the same exceeds the aggregate of the premium paid during the term of the policy, and not claimed as deduction under any other provision of the Act [Section 56(2)(xiii)];

[For details, refer to Chapter 5 "Income from Other Sources"].

(24) Assistance in the form of a **subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement**, by whatever name called, by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee is included in the definition of income.

Subsidy or Grant which are not included in the definition of income u/s 2(24)

- Subsidy or grant or reimbursement taken into account for determination of actual cost of depreciable asset in accordance with *Explanation 10* to section 43(1)
- Subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by a Central Govt. or State Govt., as the case may be.

(ii) Concept of Income under the Income-tax Act, 1961

- **Regular receipt *vis-à-vis* casual receipt:** Income, in general, means a periodic monetary return which accrues or is expected to accrue regularly from definite sources. However, under the Income-tax Act, 1961, even certain casual receipts which do not arise regularly are treated as income for tax purposes e.g., Winnings from lotteries, crossword puzzles.
- **Revenue receipt *vis-a-vis* Capital receipt:** Income normally refers to revenue receipts. Capital receipts are generally not included within the scope of income in general parlance. However, the Income-tax Act, 1961 has specifically included certain capital receipts within the definition of income e.g., Capital gains i.e., gains on sale of a capital assets like land, jewellery.

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- **Net receipt *vis-a-vis* Gross receipt:** Income means net receipts and not gross receipts. Net receipts are arrived at after deducting the expenditure incurred in connection with earning such receipts. The expenditure which can be deducted while computing income under each head is prescribed under the Income-tax Act, 1961. Income from certain eligible businesses/ professions is also determined on presumptive basis i.e., as a certain percentage of gross receipts.

- **Due basis *vis-a-vis* receipt basis:** Income is taxable either on due basis or receipt basis. For computing income under the heads "Profits and gains of business or profession" and "Income from other sources", the method of accounting regularly employed by the assessee should be considered, which can be either cash system or mercantile system. Some receipts are taxable only on receipt basis, like, income by way of interest received on compensation or enhanced compensation.

- **Application of Income vis-a-vis Diversion of Income:** Application of income means to discharge an obligation (which is gratuitous or self-imposed) after such income reaches the assessee. Where by virtue of an obligation by overriding title, income is diverted before it reaches the assessee, it is known as diversion of income. In case of the former, the income would be taxable in the hands of the person who applies it, whereas in the case of the latter, it is not taxable (i.e., even if the assessee were to collect the income he does so on behalf of the person to whom it is payable).

(iii) Concept of revenue and capital receipts

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

The Act contemplates a levy of tax on income and not on capital and hence it is very essential to distinguish between capital and revenue receipts. Capital receipts cannot be taxed, unless they fall within the scope of the definition of "income" and so the distinction between capital and revenue receipts is material for tax purposes.

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

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

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Criteria for determining whether a receipt is capital or revenue in nature

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

Fixed capital or Circulating capital: A receipt referable to fixed capital would be a capital receipt whereas a receipt referable to circulating capital would be a revenue receipt. The former is not taxable while the latter is taxable. Tangible and intangible assets which the owner keeps in his possession for making profits are in the nature of fixed capital. The circulating capital is one which is turned over and yields income or loss in the process.

Income from transfer of capital asset or trading asset: Profits arising from the sale of a capital asset are chargeable to tax as capital gains under section 45 whereas profits arising from the sale of a trading asset being of revenue nature are taxable as income from business under section 28 provided that the sale is in the regular course of assessee's business or the transaction constitutes an adventure in the nature of trade.

Capital Receipts *vis-a-vis* Revenue Receipts: Tests to be applied

(a) **Transaction entered into the course of business:** Profits arising from transactions which are entered into in the course of the business regularly carried on by the assessee, or are incidental to, or associated with the business of the assessee would be revenue receipts chargeable to tax.

Example: A banker's or financier's dealings in foreign exchange or sale of shares and securities, a shipbroker's purchases of ship in his own name, a share broker's purchase of shares on his own account would constitute transactions entered and yielding income in the ordinary course of their business. Whereas building and land would constitute capital assets in the hands of a trader in shares, the same would constitute stock-in-trade in the hands of a property dealer.

(b) **Profit arising from sale of shares and securities:** In the case of profit arising from the sale of shares and securities the nature of the profit has to be ascertained from the motive, intention or purpose with which they were bought. If the shares were acquired as an investor or with a view to acquiring a controlling interest or for obtaining a managing or selling agency or a directorship the profit or loss on their sale would be of a capital nature; but if the shares were acquired in the ordinary course of business as a dealer in shares, it would constitute his stock-in-trade. If the shares were acquired with speculative motive the profit or loss (although of a revenue nature) would have to be dealt with separately from other business.

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> ***Note:*** *However, securities held by Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the SEBI Act, 1992 would be treated as a capital asset. Even if the nature of such security in the hands of the Foreign Portfolio Investor is stock in trade, the same would be treated as a capital asset and the profit on transfer would be taxable as capital gains.*

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

(d) **Liquidated damages:** Receipt of liquidated damages directly and intimately linked with the procurement of a capital asset, which lead to delay in coming into existence of the profit-making apparatus, is a capital receipt. The amount received by the assessee towards compensation for sterilization of the profit earning source is not in the ordinary course of business. Hence, it is a capital receipt in the hands of the assessee.

(e) **Compensation on termination of agency/ service contract:** Where an assessee receives compensation on termination of the agency business being the only source of income, the receipt is a capital nature, but taxable under section 28(ii)(c). However, where the assessee has a number of agencies and one of them is terminated and compensation is received therefor, the receipt would be of a revenue nature since taking agencies and exploiting the same for earning income is the ordinary course of business. The loss of one agency would be made good profit from another agency. Compensation received from the employer or from any person for premature termination of the service contract is a capital receipt, but is taxable as profit in lieu of salary under section 17(3) or as income from other sources under section 56(2)(xi), respectively. Compensation received or receivable in connection with the termination

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or the modification of the terms and conditions of any contract relating to its business shall be taxable as business income.

(f) **Gifts:** Normally, gifts constitute capital receipts in the hands of the recipient. However, certain gifts are brought within the purview of income-tax, for example, receipt of property without consideration is brought to tax under section 56(2)(x).

For example, any sum of money or value of property received without consideration or for inadequate consideration by any person, other than a relative, is chargeable under the head "Income from Other Sources" *[For details, refer to Chapter 5 on "Income from Other Sources"].*

(iv) Diversion of income by overriding title and application of income

The concept of 'diversion of income by overriding title' signifies diversion of income at source by an overriding title before it reaches an assessee. Such a diversion can take place either under a legal compulsion or under a contractual obligation or otherwise. An obligation to apply the income in a particular way before it has accrued or arisen to the assessee results in the diversion of the income. On the other hand, an obligation to apply income which has accrued or arisen or has been received amounts merely to the apportionment or application of the income and not to its diversion. Sometimes the dividing line between diversion by overriding title and the application of income after it has accrued is somewhat thin.

When income or a portion of income is diverted at the source by an overriding title before it started flowing into the channel which was to reach the assessee concerned it could be excluded from his assessable income. Wherever there is such diversion of income, such diverted income, cannot be included in the total income of the assessee who claims that there has been a diversion. On the other hand, where income has accrued or arisen in the hands of the assessee, its subsequent application in any way will not affect the tax liability.

In order to decide whether a particular disbursement amounts to diversion or application of income, the true test is to probe into and decide whether the amount sought to be deducted, in truth, did not reach the assessee as his own income. It is the nature of the obligation that is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of his income. It is the nature of the obligation that is the decisive fact. Where, by obligation, income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. In order that there is

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diversion at source of the income, the obligation is to attach to the source which yields income and not to the income only. This was so held in *CIT vs. Sitaldas Tirathdas [1961] 41 ITR 367 (SC), M.K. Brothers Pvt. Ltd. vs. CIT [1972] 86 ITR 38 (SC)*. In many cases, it would really be a matter of proper drafting of the document creating the obligation, though, in substance, the result in both the situations may appear similar.

For the purpose of tax planning, the concept of 'diversion by overriding title' would have better scope for exploitation than the concept of 'application of income'. This is because, as pointed out above, where income is diverted by overriding title such diverted income is not taxed in the hands of the person who claims such diversion. On the other hand, the concept of application of income envisages first the accruing or arising of income and when once it has come within the grasp of the Income-tax Act, 1961 it is liable to income-tax whatever may be its destination or whomever it may be applied for. Therefore, if an overriding charge is created by the assessee either voluntarily or in pursuance of an obligation, whether pre-existing or not, the assessee may be able to invoke the principle of diversion of income by overriding charge. This is, of course, subject to the clubbing provisions contained in sections 60 to 64 (dealt with in Chapter 6: Income of other persons included in assessee's total income), which have the effect of getting over this principle in some situations.

Example on Application of Income

Mr. A is liable to pay ₹ 10,000 per month to Ms. B (his ex-wife) as alimony. Mr. A, being an employee of ABC Pvt. Ltd., instructs the HR department to pay ₹ 10,000 per month out of his salary to Ms. B directly and remit the remaining salary in his account.

In this case, the amount of ₹ 10,000 per month is an obligation of Mr. A to pay to Ms. B out of his income and not an income in which Ms. B had over riding entitlement.

In other words, this is the income of Mr. A, which is applied by him to fulfill an obligation and hence, includible in his total income and a mere arrangement to pay a sum directly to Ms. B would not make it a case of diversion of income.

Example on Diversion of Income

M/s ABC is a partnership firm in which Mr. A and his two sons, Mr. B & Mr. C are partners. The partnership deed provides that after the death of Mr. A, Mr. B & Mr. C shall continue the business of the firm subject to a condition that 20% of profit of the firm shall be given to Mrs. D (wife of Mr. A).

In the instant case, after the death of Mr. A, 20% of profits of the firm payable to Mrs. D gets diverted at source by the charge created in her favour as per the terms of the partnership deed. Such income does not reach the assessee-firm. Rather, such income

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stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said amount, but it so received for and on behalf of Mrs. D, who possesses the overriding title. Therefore, the amount payable to Mrs. D after the death of Mr. A would be excluded from the income of M/s ABC

(v) Classification of income under five heads of income

Under the Income-tax Act, 1961, for computation of total income, all income of a taxpayer are classified into five different heads of income. These are shown below –

The provisions relating to "Profits and gains of business or profession", "Capital Gains" and "Income from other sources" are discussed in Chapter 3: Profits and gains of business or profession, Chapter 4: Capital Gains and Chapter 5: Income from Other Sources, respectively, in this Module. The provisions relating to "Salaries" and "Income from house property" had been dealt with in detail at Intermediate level itself. The ensuing paragraphs contain an overview of Income under the head "Salaries" and "Income from house property".

Income under the head "Salaries"

Section 15 deals with the basis of charge. Salary is chargeable to tax either on 'due' basis or on 'receipt' basis, whichever is earlier. However, where any salary, paid in advance, is assessed in the year of payment, it cannot be subsequently brought to tax in the year in which it becomes due. If the salary paid in arrears has already been assessed on due basis, the same cannot be taxed again when it is paid.

The terms "Salary", "Perquisite" and "Profit in lieu of salary" are defined under section 17(1). Salary includes monetary as well as non-monetary items. The following deductions are allowable to an individual from the gross salary:

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Deductions allowable from Gross Salary	
(i)	**Standard deduction u/s 16(ia)** A standard deduction of ₹ 50,000 or the amount of salary, whichever is lower, is to be provided to the employee if the assesse exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). However, if the assessee is paying tax under default tax regime provided under section 115BAC(1A), standard deduction of ₹ 75,000 or the amount of salary, whichever is lower, is provided to the employee.
(ii)	**Entertainment allowance u/s 16(ii) (only for Govt. employees)** Least of the following is allowable as deduction: (a) ₹ 5,000 (b) 1/5th of basic salary (c) Actual entertainment allowance received [Deduction in respect of entertainment allowance would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). The deduction would not be available under the default tax regime i.e., under section 115BAC(1A)].
(iii)	**Professional Tax/Tax on employment (paid by employer/ employee) u/s 16(iii):** If professional tax is reimbursed or directly paid by the employer on behalf of the employee, the amount so paid is first included as salary income and then allowed as a deduction u/s 16. [Deduction in respect of professional tax would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). The deduction would not be available under the default tax regime i.e., under section 115BAC(1A)].

Income from house property

(I) **Annual Value -** The process of computation of income under the head "Income from house property" starts with the determination of annual value of the property. The concept of annual value and the method of determination is laid down in section 23.

The annual value of any property comprising of buildings or lands appurtenant thereto of which the assessee is the owner is chargeable to tax under the head "Income from house property".

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Exceptions: Annual value of the following properties are chargeable under the head "Profits and gains of business or profession" -

(i) Portions of property occupied by the assessee for the purpose of any business or profession carried on by him.

(ii) Commercial Properties of an assessee engaged in the business of letting out of properties.

It is pertinent to note that that any income from letting out of a residential house or part thereof by the assessee, being owner shall always be chargeable under the head "Income from house property.

Determination of Annual Value

GAV would be higher of expected rent and actual rent received or receivable during the previous year. The Expected Rent (ER) is the higher of fair rent (FR) and municipal value (MV) but restricted to standard rent (SR). In the absence of any information relating to Municipal value, fair rent and standard rent, actual rent would be considered as GAV.

(II) **Annual value of self-occupied property:** Where the property is self-occupied for **own residence** or **unoccupied** throughout the previous year ***due to any reason***, its Annual Value will be Nil, provided no other benefit is derived by the owner from such property.

The expression "Unoccupied property" refers to a property which cannot be occupied by the owner by reason of his employment, business or profession at a different place and he resides at such other place in a building not belonging to him.

The benefit of "Nil" Annual Value is available only for upto two self-occupied or unoccupied house properties i.e. for either one house property or two house properties owned by the assessee. The benefit of "Nil" Annual Value in respect of upto **two** self-occupied house properties is available only to an individual/ HUF.

No deduction for municipal taxes is allowed in respect of such property/properties as annual value means value determined after deduction of municipal taxes.

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(III) Annual value of property held as stock-in-trade: In some cases, property consisting of any building or land appurtenant thereto may be held as stock-in-trade, and the whole or any part of the property may not be let out during the whole or any part of the previous year. In such cases, the annual value of such property or part of the property shall be NIL.

This benefit would be available for the period upto **two** years from the end of the financial year in which certificate of completion of construction of the property is obtained from the competent authority.

(IV) Deductions from Net Annual Value under optional tax regime (normal provisions of the Act)

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(V) **Taxability of arrears of rent & unrealised rent:** As per section 25A(1), the amount of rent received in arrears from a tenant or the amount of unrealised rent realised subsequently from a tenant by an assessee shall be deemed to be income from house property in the financial year in which such rent is received or realised, and shall be included in the total income of the assessee under the head "Income from house property", whether the assessee is the owner of the property or not in that financial year. Section 25A(2) provides a deduction of 30% of arrears of rent or unrealised rent realised subsequently by the assessee.

(VI) **Annual value of co-owned property:** Where the house property owned by co-owners is self occupied by each of the co-owners, the annual value of the property of each co-owner will be Nil and each co-owner shall be entitled to a deduction of ₹ 30,000 / ₹ 2,00,000, as the case may be, under section 24(b) on account of interest on borrowed capital if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A).

However, the aggregate deduction of interest to each co-owner in respect of interest payable on loan taken for co-owned house property and interest, if any, payable on loan taken for another self-occupied property owned by him cannot exceed ₹ 30,000/ ₹ 2,00,000, as the case may be.

Where the house property owned by co-owners is let out, the income from such property shall be computed as if the property is owned by one owner and thereafter the income so computed shall be apportioned amongst each co-owner as per their specific share.

(VII) **Deemed ownership:** As per section 27, the following persons, though not legal owners of a property, are deemed to be the owners for the purposes of sections 22 to 26.

- In case of transfer of house property by an individual to his or her spouse otherwise than for adequate consideration or in connection with an agreement to live apart, the transferor is deemed to be the owner of the transferred property.
- In case of transfer of house property by an individual to his or her minor child (other than a minor married daughter) otherwise than for adequate consideration, the transferor would be deemed to be owner of the house property transferred.

  Exception – *In case of transfer to a minor married daughter, the transferor is not deemed to be the owner.*

  Note – *Where cash is transferred to spouse/minor child and the transferee acquires property out of such cash, then the transferor shall not be treated as deemed owner of the house property. However, clubbing provisions will be attracted.*

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- The holder of an impartible estate shall be deemed to be the individual owner of all properties comprised in the estate.
- A member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a House Building Scheme of a society/ company/ association, shall be deemed to be owner of that building or part thereof allotted to him although the co-operative society/company/ association is the legal owner of that building.
- A person who is allowed to take or retain the possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act shall be the deemed owner of that house property.
- A person who acquires any rights in or with respect to any building or part thereof, by virtue of any transaction as is referred to in section 269UA(f) i.e. transfer by way of lease for not less than 12 years, shall be deemed to be the owner of that building or part thereof.

  Exception *– In case the person acquiring any rights by way of lease from month to month or for a period not exceeding one year, such person will not be deemed to be the owner.*

India [Section 2(25A)]

The term 'India' means –

(i) the territory of India as per article 1 of the Constitution,

(ii) its territorial waters, seabed and subsoil underlying such waters,

(iii) continental shelf,

(iv) exclusive economic zone or

(v) any other specified maritime zone and the air space above its territory and territorial waters.

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

Maximum marginal rate and Average Rate of tax

As per section 2(10), **"Average Rate of tax"** means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

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Example: Total Income of Mr. A, who has exercised option of shifting out of default regime under section 115BAC, is ₹ 6,00,000 and tax payable on it including cess is ₹ 33,800, the average rate of tax works out to be **5.63%.**

Section 2(29C) defines "**Maximum marginal rate"** to mean the rate of income-tax (including surcharge on the income-tax, if any) applicable in relation to the highest slab of income in the case of an individual, AOP or BOI, as the case may be, as specified in Finance Act of the relevant year.

1.3 PREVIOUS YEAR AND ASSESSMENT YEAR

The concepts have been dealt with at the Intermediate level. Let us have a quick recap of these concepts -

Assessment year [Section 2(9)]

The term has been defined under section 2(9). This means a period of 12 months commencing on 1st April every year. The year in which income is earned is the previous year and such income is taxable in the immediately following year which is the assessment year. Income earned in the previous year 2025-26 is taxable in the assessment year 2026-27.

Assessment year always starts from 1st April and it is always a period of 12 months.

Previous year [Section 3]

It means the financial year immediately preceding the assessment year. As mentioned earlier, the income earned during the previous year is taxable in the assessment year.

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

If a source of income comes into existence in the said financial year, then the previous year will commence from the date on which the source of income newly comes into existence and will end with 31st March of the financial year.

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Examples: *A is running a business from 1993 onwards. Determine the previous year for the assessment year 2026-27.*

Ans. *The previous year will be 1.4.2025 to 31.3.2026.*

A chartered accountant sets up his profession on 1st July, 2025. Determine the previous year for the assessment year 2026-27.

Ans. *The previous year will be from 1.7.2025 to 31.3.2026.*

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

The income of an assessee for a previous year is charged to income-tax in the assessment year following the previous year. For instance, income of previous year 2025-26 is assessed during 2026-27. Therefore, 2026-27 is the assessment year for assessment of income of the previous year 2025-26.

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

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

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

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(b) Persons leaving India [Section 174]

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

Example: *Suppose Mr. X is leaving India for USA on 10.6.2025 and it appears to the Assessing Officer that he has no intention to return. Before leaving India, Mr. X may be asked to pay income-tax on the income earned during the P.Y. 2024-25 as well as the total income earned during the period 1.4.2025 to 10.06.2025.*

(c) AOP/ BOI/ Artificial Juridical Person formed for a particular event or purpose [Section 174A]

If an AOP/ BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/ BOI is likely to be dissolved in the same year or in the next year, he can make assessment of the income of such previous years up to the date of dissolution as income of the relevant assessment year.

Example: *Red Flakes is an AOP formed on 14.11.2025 by X and Y for a limited purpose of organizing a musical concert of a British band "Music Zone" on 14.06.2026. The AOP is likely to be dissolved after the concert. In such a case, the Assessing Officer can make the assessment for the income earned from 14.11.2025 to 31.03.2026 and 01.04.2026 to 14.06.2026 during the A.Y. 2026-27 itself.*

(d) Persons likely to transfer property to avoid tax [Section 175]

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

Example: *The Assessing Officer is informed that Mr. X, a defaulter of a leading bank, is likely to sell all his luxury cars on 02.10.2025 with a view to avoid payment of Income-tax. In such case, the Assessing Officer can commence proceedings to tax the income of the year commencing from 01.04.2025 to 02.10.2025 during A.Y. 2025-26 itself.*

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(e) Discontinued business [Section 176]

Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year up to the date of such discontinuance may, at the discretion of the Assessing Officer, be charged to tax in that assessment year.

> ***Example:*** *The Assessing Officer is informed during the course of assessment by X Pvt. Ltd. that they have discontinued their business from 31.05.2025. In such a case, the Assessing Officer may exercise his discretion and tax the income of the company from 01.04.2025 to 31.05.2025 during the A.Y. 2025-26. It may be noted that the income of the P.Y. 2025-26 will also be taxed in A.Y. 2025-26. However, as the Assessing Officer has discretion under section 176, he could alternatively wait till the completion of the assessment year and tax the income of the period commencing from 01.04.2025 to 31.05.2025 in the A.Y. 2026-27.*

Undisclosed sources of income

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

(a) Cash Credits [Section 68]

Where any sum is found credited in the books of the assessee and the assessee offers no explanation about the nature and source or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the sum so credited may be charged as income of the assessee of that previous year.

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Unexplained loan or borrowing - Where the sum so credited consists of loan or borrowing or any such amount, by whatever name called, any explanation offered by the assessee in whose books such sum is credited would not be deemed to be satisfactory, unless

- the person in whose name such credit is recorded in the books of such assessee also offers an explanation about the nature and source of such sum so credited and
- in the opinion of the Assessing Officer, such explanation has been found to be satisfactory.

Unexplained Share Capital/ Premium - Any explanation offered by a closely held company in respect of any sum credited as share application money, share capital, share premium or any such amount, by whatever name called, in the accounts of such company would not be deemed to be satisfactory, unless

- the person, being a resident, in whose name such credit is recorded in the books of such company also explains about the nature and the source of such sum so credited and
- in the opinion of the Assessing Officer, such explanation has been found to be satisfactory.

Non-applicability to Venture Capital Fund or Venture Capital Company[5] – The abovementioned additional conditions would not apply if the person, in whose name the sum is recorded, is a Venture Capital Fund or Venture Capital Company registered with SEBI.

(b) Unexplained Investments [Section 69]

Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account and the assessee offers no explanation about the nature and the source of investments or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the value of the investments are taxed as deemed income of the assessee of such financial year.

(c) Unexplained money etc. [Section 69A]

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and the same is not recorded in the books of account and the assessee offers no explanation about the nature and source of acquisition of such

[5] defined under section 10(23FB)

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money, bullion etc. or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the money and the value of bullion etc. may be deemed to be the income of the assessee for such financial year. Ownership is important and mere possession is not enough.

(d) Amount of investments etc., not fully disclosed in the books of account [Section 69B]

Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article and the Assessing Officer finds that the amount spent on making such investments or in acquiring such articles exceeds the amount recorded in the books of account maintained by the assessee and he offers no explanation for the difference or the explanation offered is unsatisfactory in the opinion of the Assessing Officer, such excess may be deemed to be the income of the assessee for such financial year.

Example: *If the assessee is found to be the owner of say 300 gms of gold (market value of which is ₹ 30,000) during the financial year ending 31.3.2026 but he has recorded having spent ₹ 20,000 in acquiring it, the Assessing Officer can add ₹ 10,000 (i.e., the difference of the market value of such gold and ₹ 20,000) as the income of the assessee, if the assessee offers no satisfactory explanation thereof.*

(e) Unexplained expenditure [Section 69C]

Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or the explanation is unsatisfactory in the opinion of the Assessing Officer, Assessing Officer can treat such unexplained expenditure as the income of the assessee for such financial year. Such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as deduction under any head of income.

(f) Amount borrowed or repaid on *hundi* [Section 69D]

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

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

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Section 115BBE provides the rate at which such cash credits, undisclosed income, undisclosed expenditure etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D would be subject to tax. See Special rates of tax on page 1.44 of this Chapter.

1.4 CHARGE OF INCOME TAX

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

(1) Tax shall be charged at the rates prescribed for the year by the annual Finance Act or the Income-tax Act, 1961 or both.

(2) The charge is on every person specified under section 2(31);

(3) Tax is chargeable on the total income earned during the previous year and not the assessment year. (There are certain exceptions provided by sections 172, 174, 174A, 175 and 176 discussed above);

(4) Tax shall be levied in accordance with and subject to the various provisions contained in the Act.

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

1.5 RATES OF TAX, SURCHARGE & CESS

Income-tax

Income-tax is to be charged on every person at the rates prescribed for the year by the Annual Finance Act or the Income-tax Act, 1961 or both.

Section 2 of the Finance Act, 2025 read with Part I of the First Schedule to the Finance Act, 2025, seeks to specify the rates at which income-tax is to be levied on income chargeable to tax for the assessment year 2025-26.

Part II lays down the rate at which tax is to be deducted at source during the financial year 2025-26 from income subject to such deduction under the Income-tax Act, 1961;

Part III lays down the rates for charging income-tax in certain cases, rates for deducting income-tax from income chargeable under the head "Salaries" and the rates for computing advance tax for the financial year 2025-26 where the assessee exercises the option to shift out of the default tax regime.

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Part III of the First Schedule to the Finance Act, 2025 will become Part I of the First Schedule to the Finance Act, 2026 and so on.

Surcharge

Surcharge is an additional tax payable over and above the income-tax. Surcharge is levied as a percentage of income-tax. Surcharge is presently being levied beyond a particular threshold of income for different persons. Also, higher rates of surcharge are prescribed for higher thresholds of income. However, under the special tax regimes for domestic companies and co-operative societies, a uniform surcharge is prescribed irrespective of the level of total income.

"Health and Education cess" on Income-tax

The amount of income-tax as increased by the union surcharge, if applicable, should be further increased by an additional surcharge called the "Health and Education cess on income-tax", calculated at the rate of 4% of such income-tax and surcharge, if applicable. Health and education cess is leviable in the case of all assessees i.e. individuals, HUF, AOPs/BOIs, Artificial Juridical Persons, firms, local authorities, co-operative societies and companies.

It is leviable to fulfill the commitment of the Government to provide and finance quality health services and universalised quality basic education and secondary and higher education.

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

(i) Income-tax:

Individual/HUF/AoP/BoI and Artificial Juridical Persons can pay tax at concessional rates under the default tax regime under section 115BAC. However, such person has to forego certain exemptions and deductions under this regime. Alternatively, he/it can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

Concessional tax rates under the default tax regime under section 115BAC(1A)

Individuals/ HUF/ AoPs/ BoIs or artificial judicial persons, other than those who exercise the option to opt out this regime under section 115BAC(6), have to pay tax in respect of their total income (other than income chargeable to tax at special rates under Chapter XII such as section 111A, 112, 112A, 115BB, 115BBJ etc.) at the following concessional rates, subject to certain conditions specified under section 115BAC(2) like non-availability of deduction in respect of Leave Travel Concession, interest on housing loan on self-occupied property, deductions under Chapter VI-A [other than section 80CCD(2), 80CCH(2) or section 80JJAA] etc. –

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

For detailed discussion on section 115BAC, refer to Chapter 9 in Module 2 of the Study Material.

Tax rates prescribed by the Annual Finance Act for optional tax regime

The slab rates for A.Y. 2026-27 applicable to an Individual/HUF/AOP/BOI/ Artificial Juridical Person, which has exercised the option of shifting out of the default tax regime, are as follows:

(i)	where the total income does not exceed ₹ 2,50,000	NIL
(ii)	where the total income exceeds ₹ 2,50,000 but does not exceed ₹ 5,00,000	5% of the amount by which the total income exceeds ₹ 2,50,000
(iii)	where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000;	₹ 12,500 *plus* 20% of the amount by which the total income exceeds ₹ 5,00,000
(iv)	where the total income exceeds ₹ 10,00,000	₹ 1,12,500 *plus* 30% of the amount by which the total income exceeds ₹ 10,00,000

For a senior citizen (being a resident individual who is of the age of 60 years but not more than 80 years at any time during the previous year), the basic exemption limit is ₹ 3,00,000. Further, resident individuals of the age of 80 years or more at any time during the previous year, being very senior citizens, would be eligible for a higher basic exemption limit of ₹ 5,00,000. Therefore, the tax slabs for these assessees would be as follows –

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

(i)	where the total income does not exceed ₹ 3,00,000	NIL
(ii)	where the total income exceeds ₹ 3,00,000 but does not exceed ₹ 5,00,000	5% of the amount by which the total income exceeds ₹ 3,00,000

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(iii)	where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000;	₹ 10,000 *plus* 20% of the amount by which the total income exceeds ₹ 5,00,000
(iv)	where the total income exceeds ₹ 10,00,000	₹ 1,10,000 *plus* 30% of the amount by which the total income exceeds ₹ 10,00,000

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

(i)	where the total income does not exceed ₹ 5,00,000	NIL
(ii)	where the total income exceeds ₹ 5,00,000 but does not exceed ₹ 10,00,000;	20% of the amount by which the total income exceeds ₹ 5,00,000
(iii)	where the total income exceeds ₹ 10,00,000	₹ 1,00,000 *plus* 30% of the amount by which the total income exceeds ₹ 10,00,000

Clarification regarding attaining prescribed age of 60 years/ 80 years on 31st March itself, in case of senior/very senior citizens whose date of birth falls on 1st April [Circular No. 28/2016, dated 27.07.2016]

An individual who is resident in India and of the age of 60 years or more (senior citizen) and 80 years or more (very senior citizen) is eligible for a higher basic exemption limit of ₹ 3,00,000 and ₹ 5,00,000, respectively.

The contentious issue is regarding the attainment of the aforesaid qualifying ages for availing higher basic exemption limit in cases of the persons whose date of birth falls on 1st April of calendar year. In other words, the broader question under consideration is whether a person born on 1st April of a particular year can be said to have completed a particular age on 31st March, on the preceding day of his/her birthday, or on 1st April itself of that year.

The Supreme Court had an occasion to consider a similar issue in the case of *Prabhu Dayal Sesma vs. State of Rajasthan &, another 1986, AIR, 1948* wherein it has dealt with on the general rules to be followed for calculating the age of the person. The Apex Court observed that while counting the age of the person, whole of the day should be reckoned and it starts from 12 o'clock in the midnight and he attains the specified age on the day preceding, the anniversary of his birthday. In the absence of any express provision, it is well settled that any specified age in law is to be computed as having been attained on the day preceding the anniversary of the birthday.

The CBDT has, vide this Circular, clarified that a person born on 1st April would be considered to have attained a particular age on 31st March, the day preceding the anniversary of his birthday. In particular, the question of attainment of age of eligibility for being considered a senior/very senior citizen would be decided on the basis of above criteria.

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Therefore, a resident individual whose 60th birthday falls on 1st April, 2026, would be treated as having attained the age of 60 years in the P.Y.2025-26, and would be eligible for higher basic exemption limit of ₹ 3 lakh in computing his tax liability for A.Y.2026-27 under the optional tax regime as per normal provisions of the Act. Likewise, a resident individual whose 80th birthday falls on 1st April, 2026, would be treated as having attained the age of 80 years in the P.Y.2025-26, and would be eligible for higher basic exemption limit of ₹ 5 lakh in computing his tax liability for A.Y.2026-27 under the optional tax regime as per normal provisions of the Act.

In respect of certain types of income, as mentioned below, the Income-tax Act, 1961 has prescribed specific rates. The special rates of tax have to be applied on the respective component of total income irrespective of the tax regime and the slab rates have to be applied on the balance of total income after adjusting the basic exemption limit.

<table>
<tr><th>S. No.</th><th>Section</th><th>Income</th><th>Rate of Tax</th></tr>
<tr><td rowspan="3">(a)</td><td rowspan="3">112</td><td>(I) Long term capital gains (other than LTCG taxable as per section 112A and mentioned in (II) below) arising from transfer of capital asset -
- from transfer of any land or building or both by an individual or a HUF, being a resident acquired before 23.7.2024</td><td>Lower of 20% with indexation or 12.5% without indexation</td></tr>
<tr><td>- from transfer of other capital asset</td><td>12.5% without indexation</td></tr>
<tr><td>(II) Long-term capital gains arising from transfer of unlisted securities or shares of company in which public are not substantially interested by non-resident assessee</td><td>12.5% without indexation and foreign currency fluctuations</td></tr>
<tr><td>(b)</td><td>112A</td><td>Long term capital gains on transfer of –
• Equity share in a company
• Unit of an equity oriented fund
• Unit of business trust
Condition for availing the benefit of this concessional rate is that securities transaction tax should have been paid –
<table>
<tr><th>In case of</th><th>Time of payment of STT</th></tr>
<tr><td>Equity shares</td><td>both at the time of acquisition and transfer</td></tr>
</table></td><td>12.5% on LTCG > ₹ 1.25 lakhs
Note: Total exemption in P.Y. cannot exceed ₹ 1.25 lakhs.</td></tr>
</table>

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		Unit of equity oriented fund or unit of business trust at the time of transfer	
(c)	111A	Short-term capital gains on transfer of – • Equity shares in a company • Unit of an equity oriented fund • Unit of business trust The conditions for availing the benefit of this concessional rate are – (i) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004; and (ii) such transaction should be chargeable to securities transaction tax.	20%
(d)	115BB	Winnings from • Lotteries; • Crossword puzzles; • Races including horse races; • Card games and other games of any sort; • Gambling or betting of any form or nature (other than winning from any online game)	30%
(e)	115BBJ	Net winnings from online games	30%
(f)	115BBE	Unexplained money, investment, expenditure, etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D [See discussion below]	60%

Unexplained money, investments etc. to attract tax@60% [Section 115BBE]

(i) In order to control laundering of unaccounted money by availing the benefit of basic exemption limit, the unexplained money, investment, expenditure, etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D would be taxed at the rate of 60% *plus* surcharge @25% of tax. Thus, the effective rate of tax (including surcharge@25% of tax and cess@4% of tax and surcharge) is 78%.

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

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(iii) Further, no set off of any loss shall be allowable against income brought to tax under sections 68 or section 69 or section 69A or section 69B or section 69C or section 69D.

ILLUSTRATION 1

Mr. Arjun has a total income of ₹ 16,00,000 for P.Y.2025-26, comprising of income from house property and interest on fixed deposits. Compute his tax liability for A.Y.2026-27 assuming his age is –

(a) 52 years

(b) 64 years

(c) 83 years

Assume that Mr. Arjun has exercised the option to shift out/ opt out of the default tax regime.

SOLUTION

(a) Computation of Tax liability of Mr. Arjun (aged 52 years)

Tax liability:

First ₹ 2,50,000 - Nil	-
Next ₹ 2,50,001 - ₹ 5,00,000 - @5% of ₹ 2,50,000	₹ 12,500
Next ₹ 5,00,001 - ₹ 10,00,000 - @20% of ₹ 5,00,000	₹ 1,00,000
Balance i.e., ₹ 16,00,000 minus ₹ 10,00,000 - @30% of ₹ 6,00,000	₹ 1,80,000
	₹ 2,92,500
Add: Health and Education cess@4%	₹ 11,700
	₹ 3,04,200

(b) Computation of Tax liability of Mr. Arjun (aged 64 years)

Tax liability:

First ₹ 3,00,000 - Nil	
Next ₹ 3,00,001 - ₹ 5,00,000 - @5% of ₹ 2,00,000	₹ 10,000
Next ₹ 5,00,001 - ₹ 10,00,000 - @20% of ₹ 5,00,000	₹ 1,00,000
Balance i.e., ₹ 16,00,000 minus ₹ 10,00,000 - @30% of ₹ 6,00,000	₹ 1,80,000
	₹ 2,90,000
Add: Health and Education cess@4%	₹ 11,600
	₹ 3,01,600

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(c) Computation of Tax liability of Mr. Arjun (aged 83 years)

Tax liability:

First ₹ 5,00,000 - Nil	
Next ₹ 5,00,001 - ₹ 10,00,000 - @ 20% of ₹ 5,00,000	₹ 1,00,000
Balance i.e., ₹ 16,00,000 minus ₹ 10,00,000 - @ 30% of ₹ 6,00,000	₹ 1,80,000
	₹ 2,80,000
Add: Health and Education cess@4%	₹ 11,200
	₹ 2,91,200

Surcharge

In case the Individual/HUF/AoP[6]/BoI and Artificial Juridical Person pays tax under default tax regime under section 115BAC

Income-tax computed in accordance with the provisions of section 115BAC and/ or section 111A or section 112 or section 112A or 115BBE or section 115BBJ would be increased by surcharge given under the following table:

	Particulars	Rate of surcharge on income-tax	Examples	
			Components of total income	Applicable rate of surcharge
(i)	Where the total income (including dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 50 lakhs but ≤ ₹ 1 crore	10%	**Example**	
			• Dividend ₹ 15 lakhs; • STCG u/s 111A ₹ 15 lakhs; • LTCG u/s 112 ₹ 25 lakhs; • LTCG u/s 112A ₹ 20 lakhs; and • Other income ₹ 25 lakhs	Surcharge would be levied @10% on income-tax computed on total income of ₹ 1 crore.
(ii)	Where total income (including dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 1 crore but ≤ ₹ 2 crore	15%	**Example**	
			• Dividend income ₹ 10 lakhs; • STCG u/s 111A ₹ 35 lakhs; • LTCG u/s 112 ₹ 50 lakhs;	Surcharge would be levied @15% on income-tax computed on total income of ₹ 1.85 crores.

[6] (other than an AOP consisting of only companies as members)

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			• LTCG u/s 112A ₹ 35 lakhs; and • Other income ₹ 55 lakhs	
(iii)	Where total income (excluding dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 2 crore	25%	**Example**	
			• Dividend income ₹ 51 lakhs; • STCG u/s 111A ₹ 44 lakh; • LTCG u/s 112 ₹ 42 lakhs; • LTCG u/s 112A ₹ 55 lakh; and • Other income ₹ 6 crores	Surcharge@15% would be levied on income-tax on: • Dividend income of ₹ 51 lakhs; • STCG of ₹ 44 lakhs chargeable to tax u/s 111A; • LTCG of ₹ 42 lakhs chargeable to tax u/s 112; and • LTCG of ₹ 55 lakhs chargeable to tax u/s 112A. Surcharge@25% would be leviable on income-tax computed on other income of ₹ 6 crores included in total income
	The rate of surcharge on the income-tax payable on the portion of dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A	Not exceeding 15%		
(iv)	Where total income (including dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 2 crore in cases not covered under (iii) above	15%	**Example**	
			• Dividend income ₹ 40 lakhs; • STCG u/s 111A ₹ 35 lakhs; • LTCG u/s 112 ₹ 42 lakhs; • LTCG u/s 112A ₹ 50 lakhs; and Other income ₹ 1.10 crore	Surcharge would be levied@15% on income-tax computed on total income of ₹ 2.77 crore.

Marginal relief

The purpose of marginal relief is to ensure that the increase in amount of tax payable (including surcharge) due to increase in total income of an assessee beyond the prescribed limit should not exceed the amount of increase in total income.

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Marginal relief is available in case of such persons paying tax under default tax regime u/s 115BAC referred to in above i.e., -

	Particulars	Marginal relief
(i)	Where the total income > ₹ 50 lakhs but ≤ ₹ 1 crore	**Step 1 -** Compute income-tax on total income; and add surcharge@10% on such income-tax **(A)** **Step 2 -** Compute income-tax on ₹ 50 lakhs **Step 3 -** Total income (-) ₹ 50 lakhs **Step 4 -** Add the amount computed in Step 2 and Step 3 **(B)** **Step 5 –** Income-tax liability on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., **A**) or Step 4 (i.e., **B**). Consequently, if **A**>**B**, the marginal relief would be **A** – **B**.
(ii)	Where the total income > ₹ 1 crore but ≤ ₹ 2 crores	**Step 1 -** Compute income-tax on total income; and add surcharge@15% on income-tax **(C)** **Step 2 -** Compute income-tax on total income of ₹ 1 crore + surcharge on such income-tax@10% **Step 3 -** Total income (-) ₹ 1 crore **Step 4 -** Add the amount computed in Step 2 and Step 3 **(D)** **Step 5 –** Income-tax liability on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., **C**) or Step 4 (i.e., **D**). Consequently, if **C**>**D**, the marginal relief would be **C** – **D**.
(iii)	Where the total income > ₹ 2 crores	**Step 1 -** Compute income-tax on total income; and add surcharge@25% on income-tax **(E)** **Step 2 -** Compute income-tax on total income of ₹ 2 crore + surcharge on such income-tax@15% **Step 3 -** Total income (-) ₹ 2 crore **Step 4 -** Add the amount computed in Step 2 and Step 3 **(F)** **Step 5 –** Income-tax liability on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., **E**) or Step 4 (i.e., **F**). Consequently, if **E**>**F**, the marginal relief would be **E** – **F**.

Note – It is presumed that the total income referred to above does not include dividend income, long term capital gains taxable under section 112/ 112A and short-term capital gains taxable under section 111A.

In case the total income includes dividend income, long term capital gains taxable under section 112/112A or short-term capital gains taxable under section 111A, surcharge on income-tax

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computed on such dividend income and capital gains cannot exceed 15%. This must be kept in mind while computing marginal relief in cases referred to in (iii) above.

In case the Individual/HUF/AoP[7]/BoI and Artificial Juridical Person exercises the option to shift out of the default tax regime

Income-tax computed in accordance with normal provisions of the Act or section 111A or section 112 or section 112A or 115BBE or section 115BBJ would be increased by surcharge given under the following table:

	Particulars	Rate of surcharge on income-tax	Example	
			Components of total income	Applicable rate of surcharge
(i)	Where the total income (including dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 50 lakhs but ≤ ₹ 1 crore	10%	**Example**	
			• Dividend ₹ 10 lakhs; • STCG u/s 111A ₹ 20 lakhs; • LTCG u/s 112 ₹ 15 lakhs; • LTCG u/s 112A ₹ 20 lakhs; and • Other income ₹ 25 lakhs	Surcharge would be levied@10% on income-tax computed on total income of ₹ 90 lakhs.
(ii)	Where total income (including dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 1 crore but ≤ ₹ 2 crore	15%	**Example**	
			• Dividend income ₹ 10 lakhs; • STCG u/s 111A ₹ 40 lakhs; • LTCG u/s 112 ₹ 55 lakhs; • LTCG u/s 112A ₹ 35 lakhs; and • Other income ₹ 50 lakhs	Surcharge would be levied@15% on income-tax computed on total income of ₹ 1.90 crores.
(iii)	Where total income (excluding dividend income and capital gains chargeable to tax u/s 111A, 112 and	25%	**Example**	
			• Dividend income ₹ 51 lakhs;	Surcharge@15% would be levied on income-tax on:

[7] (other than an AOP consisting of only companies as members)

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	112A) > ₹ 2 crore but ≤ ₹ 5 crore		• STCG u/s 111A ₹ 44 lakh; • LTCG u/s 112 ₹ 42 lakhs; • LTCG u/s 112A ₹ 55 lakh; and • Other income ₹ 3 crores	• Dividend income of ₹ 51 lakhs; • STCG of ₹ 44 lakhs chargeable to tax u/s 111A; • LTCG of ₹ 42 lakhs chargeable to tax u/s 112; and • LTCG of ₹ 55 lakhs chargeable to tax u/s 112A. Surcharge@25% would be leviable on income-tax computed on other income of ₹ 3 crores included in total income
	The rate of surcharge on the income-tax payable on the portion of dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A	Not exceeding 15%		
(iv)	Where total income (excluding dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 5 crore	37%	**Example**	
			• Dividend income ₹ 60 lakhs; • STCG u/s 111A ₹ 50 lakhs; • LTCG u/s 112 ₹ 42 lakhs; • LTCG u/s 112A ₹ 25 lakhs; and • Other income ₹ 6 crore	Surcharge@15% would be levied on income-tax on: • Dividend income of ₹ 60 lakhs; • STCG of ₹ 50 lakhs chargeable to tax u/s 111A; • LTCG of ₹ 42 lakhs chargeable to tax u/s 112; and • LTCG of ₹ 25 lakhs chargeable to tax u/s 112A. Surcharge@37% would be leviable on the income-tax computed on other income of ₹ 6 crores included in total income.
	Rate of surcharge on the income-tax payable on the portion of dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A	Not exceeding 15%		

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(v)	Where total income (including dividend income and capital gains chargeable to tax u/s 111A, 112 and 112A) > ₹ 2 crore in cases not covered under (iii) and (iv) above	15%	**Example**	
			• Dividend income ₹ 55 lakhs; • STCG u/s 111A ₹ 60 lakhs; • LTCG u/s 112 ₹ 42 lakhs; • LTCG u/s 112A ₹ 35 lakhs; and • Other income ₹ 1.10 crore	Surcharge would be levied@15% on income-tax computed on total income of ₹ 3.02 crore.

Marginal relief

Marginal relief in case of such persons referred to in above under the optional tax regime (as per the normal provisions of the Act).

	Particulars	Marginal relief
(i)	Where the total income > ₹ 50 lakhs but ≤ ₹ 1 crore	**Step 1 -** Compute income-tax on total income; and add surcharge@10% on such income-tax **(A)** **Step 2 -** Compute income-tax on ₹ 50 lakhs **Step 3 -** Total income (-) ₹ 50 lakhs **Step 4 -** Add the amount computed in Step 2 and Step 3 **(B)** **Step 5 –** Income-tax liability on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., **A**) or Step 4 (i.e., **B**). Consequently, if **A>B**, the marginal relief would be **A – B**.
(ii)	Where the total income > ₹ 1 crore but ≤ ₹ 2 crores	**Step 1 -** Compute income-tax on total income; and add surcharge@15% on income-tax **(C)** **Step 2 -** Compute income-tax on total income of ₹ 1 crore + surcharge on such income-tax@10% **Step 3 -** Total income (-) ₹ 1 crore **Step 4 -** Add the amount computed in Step 2 and Step 3 **(D)** **Step 5 –** Income-tax liability on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., **C**) or Step 4 (i.e., **D**). Consequently, if **C>D**, the marginal relief would be **C – D**.

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(iii)	Where the total income > ₹ 2 crores but ≤ ₹ 5 crores	**Step 1 -** Compute income-tax on total income; and add surcharge@25% on income-tax **(E)** **Step 2 -** Compute income-tax on total income of ₹ 2 crore + surcharge on such income-tax@15% **Step 3 -** Total income (-) ₹ 2 crore **Step 4 -** Add the amount computed in Step 2 and Step 3 **(F)** **Step 5 –** Income-tax liability on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., **E**) or Step 4 (i.e., **F**). Consequently, if **E>F**, the marginal relief would be **E – F**.
(iv)	Where the total income > ₹ 5 crores	**Step 1 -** Compute income-tax on total income; and add surcharge@37% on income-tax **(G)** **Step 2 -** Compute income-tax on total income of ₹ 5 crore + surcharge on such income-tax@25% **Step 3 -** Total income (-) ₹ 5 crore **Step 4 -** Add the amount computed in Step 2 and Step 3 **(H)** **Step 5 –** Income-tax liability on total income (along with surcharge) would be the lower of the amount arrived at in Step 1 (i.e., **G**) or Step 4 (i.e., **H**). Consequently, if **G>H**, the marginal relief would be **G – H**.

Note – It is presumed that the total income referred to above does not include dividend income, long term capital gains taxable under section 112/ 112A and short-term capital gains taxable under section 111A.

In case the total income includes dividend income, long term capital gains taxable under section 112/ 112A or short-term capital gains taxable under section 111A, surcharge on income-tax computed on such dividend income and capital gains cannot exceed 15%. This must be kept in mind while computing marginal relief in cases referred to in (iii) and (iv) above.

ILLUSTRATION 2

Compute the tax liability of Mr. Arpit (aged 42), having total income of ₹ 51 lakhs for the Assessment Year 2026-27. Assume that his total income comprises of salary income, Income from house property and interest on fixed deposit. Assume that Mr. Arpit has exercised the option to shift out of section 115BAC.

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SOLUTION

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

(A)	Income-tax (including surcharge) computed on total income of ₹ 51,00,000		
	₹ 2,50,000 – ₹ 5,00,000 @5%	₹ 12,500	
	₹ 5,00,001 – ₹ 10,00,000 @20%	₹ 1,00,000	
	₹ 10,00,001 – ₹ 51,00,000 @30%	₹ 12,30,000	
	Total	₹ 13,42,500	
	Add: Surcharge @ 10%	₹ 1,34,250	₹ 14,76,750
(B)	Income-tax computed on total income of ₹ 50 lakhs		
	(₹ 12,500 *plus* ₹ 1,00,000 *plus* ₹ 12,00,000)		₹ 13,12,500
(C)	Total Income *Less* ₹ 50 lakhs		₹ 1,00,000
(D)	Income-tax computed on total income of ₹ 50 lakhs *plus* the		
	excess of total income over ₹ 50 lakhs **(B +C)**		₹ 14,12,500
(E)	**Tax liability: lower of (A) and (D)**		₹ 14,12,500
	Add: Health and education cess @4%		₹ 56,500
	Tax liability		**₹ 14,69,000**
(F)	**Marginal Relief (A – D)**		**₹ 64,250**

Alternative method -

(A)	Income-tax (including surcharge) computed on total income of ₹ 51,00,000		
	₹ 2,50,000 – ₹ 5,00,000@5%	₹ 12,500	
	₹ 5,00,001 – ₹ 10,00,000@20%	₹ 1,00,000	
	₹ 10,00,001 – ₹ 51,00,000@30%	₹ 12,30,000	
	Total	₹ 13,42,500	
	Add: Surcharge@10%	₹ 1,34,250	₹ 14,76,750
(B)	Income-tax computed on total income of ₹ 50 lakhs		
	(₹ 12,500 plus ₹ 1,00,000 plus ₹ 12,00,000)		₹ 13,12,500
(C)	Excess tax payable (A)-(B)		₹ 1,64,250

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(D)	**Marginal Relief** (₹ 1,64,250 – ₹ 1,00,000, being the amount of income in excess of ₹ 50,00,000)	**₹ 64,250**
(E)	Tax liability (A)-(D)	₹ 14,12,500
	Add: Health and education cess @4%	₹ 56,500
	Tax liability	**₹ 14,69,000**

ILLUSTRATION 3

Compute the tax liability of Mr. Veer (aged 51) under the default tax regime, having total income of ₹ 1,01,00,000 for the Assessment Year 2026-27. Assume that his total income comprises of salary income, Income from house property and interest on fixed deposit.

SOLUTION

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

(A)	Income-tax (including surcharge) computed on total income of ₹ 1,01,00,000	
	₹ 4,00,000 – ₹ 8,00,000@5%	₹ 20,000
	₹ 8,00,001 – ₹ 12,00,000@10%	₹ 40,000
	₹ 12,00,001 – ₹ 16,00,000@15%	₹ 60,000
	₹ 16,00,001 – ₹ 20,00,000@20%	₹ 80,000
	₹ 20,00,001 – ₹ 24,00,000@25%	₹ 1,00,000
	₹ 24,00,001 – ₹ 1,01,00,000@30%	₹ 23,10,000
	Total	₹ 26,10,000
	Add: Surcharge@15%	₹ 3,91,500
	Tax liability without marginal relief	**₹ 30,01,500**
(B)	Income-tax computed on total income of ₹ 1 crore	
	(₹ 3,00,000 plus ₹ 22,80,000)	₹ 25,80,000
	Add: Surcharge@10%	₹ 2,58,000
		₹ 28,38,000
(C)	Total Income *Less* ₹ 1 crore	₹ 1,00,000

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(D)	Income-tax computed on total income of ₹ 1 crore *plus* the excess of total income over ₹ 1 crore **(B +C)**	₹ 29,38,000
(E)	**Tax liability: lower of (A) & (D)**	₹ 29,38,000
	Add: Health and education cess @4%	₹ 1,17,520
	Tax liability	**₹ 30,55,520**
(F)	**Marginal relief (A-D)**	**₹ 63,500**

Alternative method:

(A)	Income-tax (including surcharge) computed on total income of ₹ 1,01,00,000		
	₹ 4,00,000 – ₹ 8,00,000@5%	₹ 20,000	
	₹ 8,00,001 – ₹ 12,00,000@10%	₹ 40,000	
	₹ 12,00,001 – ₹ 16,00,000@15%	₹ 60,000	
	₹ 16,00,001 – ₹ 20,00,000@20%	₹ 80,000	
	₹ 20,00,001 – ₹ 24,00,000@25%	₹ 1,00,000	
	₹ 24,00,001 – ₹ 1,01,00,000@30%	₹ 23,10,000	
	Total	₹ 26,10,000	
	Add: Surcharge @ 15%	₹ 3,91,500	₹ 30,01,500
(B)	Income-tax computed on total income of ₹ 1 crore [(₹ 3,00,000 plus ₹ 22,80,000) plus surcharge@10%]		₹ 28,38,000
(C)	Excess tax payable (A)-(B)		₹ 1,63,500
(D)	**Marginal Relief** (₹ 1,63,500 – ₹ 1,00,000, being the amount of income in excess of ₹ 1,00,00,000)		₹ **63,500**
(E)	Tax liability (A) - (D)		₹ 29,38,000
	Add: Health and education cess @4%		₹ 1,17,520
	Tax liability		**₹ 30,55,520**

ILLUSTRATION 4

Compute the tax liability of Mr. Varun (aged 58), having total income of ₹ 2,01,00,000 for the Assessment Year 2026-27. Assume that his total income comprises of salary income, Income from

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house property and interest on fixed deposit. Assume that Mr. Varun has exercised the option to shift out of section 115BAC.

SOLUTION

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

(A)	Income-tax (including surcharge) computed on total income of ₹ 2,01,00,000		
	₹ 2,50,000 – ₹ 5,00,000 @ 5%	₹ 12,500	
	₹ 5,00,001 – ₹ 10,00,000 @ 20%	₹ 1,00,000	
	₹ 10,00,001 – ₹ 2,01,00,000@30%	₹ 57,30,000	
	Total	₹ 58,42,500	
	Add: Surcharge @ 25%	₹ 14,60,625	₹ 73,03,125
(B)	Income-tax computed on total income of ₹ 2 crore		
	(₹ 12,500 plus ₹ 1,00,000 plus ₹ 57,00,000)		₹ 58,12,500
	Add: Surcharge@15%		₹ 8,71,875
			₹ 66,84,375
(C)	Total Income *Less* ₹ 2 crore		₹ 1,00,000
(D)	Income-tax computed on total income of ₹ 2 crore *plus* the		
	excess of total income over ₹ 2 crore **(B +C)**		₹ 67,84,375
(E)	**Tax liability (A) or (D), whichever is lower**		₹ 67,84,375
	Add: Health and education cess @4%		₹ 2,71,375
	Tax liability		**₹ 70,55,750**
(F)	**Marginal relief (A-D)**		**₹ 5,18,750**

Alternative method

(A)	Income-tax (including surcharge) computed on total income of ₹ 2,01,00,000		
	₹ 2,50,000 – ₹ 5,00,000 @ 5%	₹ 12,500	
	₹ 5,00,001 – ₹ 10,00,000 @ 20%	₹ 1,00,000	
	₹ 10,00,001 – ₹ 2,01,00,000@30%	₹ 57,30,000	
	Total	₹ 58,42,500	
	Add: Surcharge@25%	₹ 14,60,625	₹ 73,03,125

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(B)	Income-tax computed on total income of ₹ 2 crore	
	[(₹ 12,500 plus ₹ 1,00,000 plus ₹ 57,00,000) *plus* surcharge@15%]	₹ 66,84,375
(C)	Excess tax payable (A)-(B)	₹ 6,18,750
(D)	**Marginal Relief** (₹ 6,18,750 – ₹ 1,00,000, being the amount	
	of income in excess of ₹ 2,00,00,000)	₹ **5,18,750**
(E)	Tax liability (A) - (D)	₹ 67,84,375
	Add: Health and education cess@4%	₹ 2,71,375
	Tax liability	**₹ 70,55,750**

ILLUSTRATION 5

Compute the tax liability of Mr. Akhil (aged 65) in a most beneficial manner. He is having total income of ₹ 5,01,00,000 for the Assessment Year 2026-27. Assume that his total income comprises of salary income, Income from house property and interest on fixed deposit and is the same under both tax regimes.

SOLUTION

Computation of tax liability of Mr. Akhil under default tax regime for the A.Y. 2026-27

Income-tax (including surcharge) computed on total income of ₹ 5,01,00,000	
₹ 4,00,000 – ₹ 8,00,000@5%	₹ 20,000
₹ 8,00,001 – ₹ 12,00,000@10%	₹ 40,000
₹ 12,00,001 – ₹ 16,00,000@15%	₹ 60,000
₹ 16,00,001 – ₹ 20,00,000@20%	₹ 80,000
₹ 20,00,001 – ₹ 24,00,000@25%	₹ 1,00,000
₹ 24,00,001 – ₹ 5,01,00,000@30%	₹ 1,43,10,000
Total	₹ 1,46,10,000
Add: Surcharge@25%	₹ 36,52,500
	₹ 1,82,62,500
Add: Health and education cess @4%	₹ 7,30,500
Tax liability	**₹ 1,89,93,000**

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Computation of tax liability of Mr. Akhil under optional tax regime for the A.Y. 2026-27

(A)	Income-tax (including surcharge) computed on total income of ₹ 5,01,00,000		
	₹ 3,00,000 – ₹ 5,00,000 @ 5%	₹ 10,000	
	₹ 5,00,001 – ₹ 10,00,000 @ 20%	₹ 1,00,000	
	₹ 10,00,001 – ₹ 5,01,00,000@30%	₹ 1,47,30,000	
	Total	₹ 1,48,40,000	
	Add: Surcharge @ 37%	₹ 54,90,800	₹ 2,03,30,800
(B)	Income-tax computed on total income of ₹ 5 crore		
	(₹ 10,000 plus ₹ 1,00,000 plus ₹ 1,47,00,000)		₹ 1,48,10,000
	Add: Surcharge@25%		₹ 37,02,500
			₹ 1,85,12,500
(C)	Total Income *Less* ₹ 5 crore		₹ 1,00,000
(D)	Income-tax computed on total income of ₹ 5 crore *plus* the		
	excess of total income over ₹ 5 crore **(B +C)**		₹ 1,86,12,500
(E)	**Tax liability (A) or (D), whichever is lower**		₹ 1,86,12,500
	Add: Health and education cess@4%		₹ 7,44,500
	Tax liability		**₹ 1,93,57,000**
(F)	**Marginal Relief (A – D)**		**₹ 17,18,300**

Alternative method

(A)	Income-tax (including surcharge) computed on total income of ₹ 5,01,00,000		
	₹ 3,00,000 – ₹ 5,00,000@5%	₹ 10,000	
	₹ 5,00,001 – ₹ 10,00,000@20%	₹ 1,00,000	
	₹ 10,00,001 – ₹ 5,01,00,000@30%	₹ 1,47,30,000	
	Total	₹ 1,48,40,000	
	Add: Surcharge @ 37%	₹ 54,90,800	₹ 2,03,30,800
(B)	Income-tax computed on total income of ₹ 5 crore		
	[(₹ 10,000 plus ₹ 1,00,000 plus ₹ 1,47,00,000) *plus* surcharge@25%]		₹ 1,85,12,500

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(C)	Excess tax payable (A)-(B)	₹ 18,18,300
(D)	**Marginal Relief** (₹ 18,18,300 – ₹ 1,00,000, being the amount of income in excess of ₹ 5,00,00,000)	**₹ 17,18,300**
(E)	Tax liability (A) - (D)	₹ 1,86,12,500
	Add: Health and education cess @4%	₹ 7,44,500
	Tax liability	**₹ 1,93,57,000**

It is beneficial for Mr. Akhil to pay tax under default tax regime under section 115BAC, since his tax liability would be lower by ₹ 3,64,000 (₹ 1,93,57,000 - ₹ 1,89,93,000).

Firm/ LLP/ Local Authority

Income-tax

On the whole of the total income 30%

Special rates for capital gains under sections 112, 112A and 111A would be applicable to Firm/ LLP/ local authority also.

Surcharge

Where the total income exceeds ₹ 1 crore, surcharge is payable at the rate of 12% of income-tax computed as above.

Marginal Relief

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

Co-operative Society

Income-tax rates as per the normal provisions of the Act

(i)	Where the total income does not exceed ₹ 10,000	10% of the total income
(ii)	Where the total income exceeds ₹ 10,000 but does not exceed ₹ 20,000	₹ 1,000 plus 20% of the amount by which the total income exceeds ₹ 10,000
(iii)	Where the total income exceeds ₹ 20,000	3,000 plus 30% of the amount by which the total income exceeds ₹ 20,000

Note – *A co-operative society, resident in India, can opt for concessional rate of tax under section 115BAD.*

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Tax rate in case of a manufacturing co-operative society, resident in India (set up and registered on or after 1.4.2023 and commences manufacture of article or thing before 31.3.2024) which has opted for concessional tax regime u/s 115BAE: 15% of income derived from or incidental to manufacturing or production of an article or thing

Tax rate in case of other resident co-operative society opting for concessional tax regime u/s 115BAD: 22% of total income

Note - Co-operative society, resident in India, can opt for concessional rate of tax u/s 115BAD, subject to certain conditions. The total income of such co-operative societies would be computed without giving effect to deduction under section 10AA, 33AB, 33ABA, 35(1)(ii)/(iia)/(iii), 35(2AA), 35AD, 35CCC, additional depreciation under section 32(1)(iia), deductions under Chapter VI-A (other than section 80JJAA) etc. and set off of loss and depreciation brought forward from earlier years relating to the above deductions. The provisions of alternate minimum tax under section 115JC would not be applicable to a co-operative society opting for section 115BAD or 115BAE.

For detailed discussion on sections 115BAD and 115BAE, please refer Chapter 9 in Module 2 of the Study Material.

Special rates for capital gains under sections 112, 112A and 111A would be applicable to Co-operative society also.

Surcharge

(a) In case of a co-operative society (other than a co-operative society opted for section 115BAD or section 115BAE), whose total income > ₹ 1 crore but is ≤ ₹ 10 crore

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of **7%** of income-tax computed in accordance with the slab rates given above and/ or section 111A or section 112 or section 112A.

Marginal Relief

Marginal relief is available in case of such co-operative societies i.e., the total amount of income-tax (together with surcharge) computed on such income should not exceed the amount of income-tax computed on total income of ₹ 1 crore by more than the amount of income that exceeds ₹ 1 crore.

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(b) In case of a co-operative society (other than a co-operative society opted for section 115BAD or section 115BAE), whose total income is > ₹ 10 crore

Where the total income exceeds ₹ 10 crore, surcharge is payable at the rate of **12%** of income-tax computed in accordance with the slab rates given above and/ or section 111A or section 112 or section 112A.

Marginal Relief

Marginal relief is available in case of such co-operative societies i. e., the total amount of income-tax (together with surcharge) computed on such income should not exceed the amount of income-tax and surcharge computed on total income of ₹ 10 crore by more than the amount of income that exceeds ₹ 10 crore.

(c) In case of a co-operative society opted for section 115BAD or section 115BAE

Surcharge @10% of income-tax computed under section 115BAD or section 115BAE would be leviable. Since there is no threshold limit for applicability of surcharge, consequently, there would be no marginal relief.

Domestic Company

Income-tax

If the total turnover or gross receipt in the P.Y.2023-24 ≤ ₹400 crore	***25% of the total income***
In any other case	30% of the total income

Notes –

- **In case of a domestic manufacturing company (set up and registered on or after 1.10.2019 and commences manufacture of article or thing[8] before 31.3.2024) which has exercised option u/s 115BAB:** 15% of income derived from or incidental to manufacturing or production of an article or thing
- **In case of a domestic company exercising option u/s 115BAA:** 22% of total income

Domestic company can opt for section 115BAA, subject to certain conditions. The total income of such companies would be computed without giving effect to deductions under section 10AA, 33AB, 33ABA, 35(1)(ii)/(iia)/(iii), 35(2AA), 35(2AB), 35AD, 35CCC, 35CCD, Chapter VI-A (except section 80JJAA or section 80M), additional depreciation under section 32(1)(iia) etc. and without set-off of brought forward loss and unabsorbed depreciation attributable to such deductions.

For detailed discussion on sections 115BAA and 115BAB, please refer Chapter 9 in Module 2 of the Study Material.

[8]Including business of generation of electricity

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Special rates for capital gains under sections 112, 112A and 111A would be applicable to domestic company also.

Surcharge

(a) In case of a domestic company (other than a domestic company opted for section 115BAA or section 115BAB), whose total income > ₹ 1 crore but is ≤ ₹ 10 crore

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of 7% of income-tax computed in accordance with the rates given above.

Marginal Relief

Marginal relief is available in case of such companies i.e., the total amount of income-tax (together with surcharge) computed on such income should not exceed the amount of income-tax computed on total income of ₹ 1 crore by more than the amount of income that exceeds ₹ 1 crore.

ILLUSTRATION 6

Compute the marginal relief available to X Ltd., a domestic company, assuming that the total income of X Ltd. is ₹ 1,01,00,000 for A.Y.2026-27 and the total income does not include any income in the nature of capital gains. Assume that the company has not exercised option under section 115BAA or 115BAB.

*[**Note** - The gross receipts of X Ltd. for the P.Y.2023-24 is ₹ 402 crore]*

SOLUTION

The tax payable on total income of ₹ 1,01,00,000 of X Ltd. computed @32.1% (including surcharge @7%) is ₹ 32,42,100. However, the tax cannot exceed ₹ 31,00,000 (i.e., the tax of ₹ 30,00,000 payable on total income of ₹ 1 crore plus ₹ 1,00,000, being the amount of total income exceeding ₹ 1 crore). The marginal relief is ₹ 1,42,100 (i.e., ₹ 32,42,100 - ₹ 31,00,000). Therefore, the tax payable on ₹ 1,01,00,000 would be ₹ 32,24,000 (₹ 31,00,000 *plus* health and education cess @4% of ₹ 1,24,000).

(b) In case of a domestic company (other than a domestic company opted for section 115BAA or section 115BAB), whose total income is > ₹ 10 crore

Where the total income exceeds ₹ 10 crore, surcharge is payable at the rate of **12%** of income-tax computed in accordance with the rates given above.

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Marginal Relief

Marginal relief is available in case of such companies i.e., the total amount of income-tax (together with surcharge) computed on such income should not exceed the amount of income-tax and surcharge computed on total income of ₹ 10 crore by more than the amount of income that exceeds ₹ 10 crore.

ILLUSTRATION 7

Compute the marginal relief available to Y Ltd., a domestic company, assuming that the total income of Y Ltd. for A.Y.2026-27 is ₹ 10,01,00,000 and the total income does not include any income in the nature of capital gains. Assume that the company has not exercised option under section 115BAA or 115BAB.

*[**Note -** The gross receipts of Y Ltd. for the P.Y.2023-24 is ₹ 410 crore]*

SOLUTION

The tax payable on total income of ₹ 10,01,00,000 of Y Ltd. computed@ 33.6% (including surcharge@12%) is ₹ 3,36,33,600. However, the tax cannot exceed ₹ 3,22,00,000 [i.e., the tax of ₹ 3,21,00,000 (32.1% of ₹ 10 crore) payable on total income of ₹ 10 crore plus ₹ 1,00,000, being the amount of total income exceeding ₹ 10 crore]. The marginal relief is ₹ 14,33,600 (i.e., ₹ 3,36,33,600 - ₹ 3,22,00,000). Therefore, the tax payable on ₹ 10,01,00,000 would be ₹ 3,34,88,000 (i.e., ₹ 3,22,00,000 *plus* health and education cess @4% of ₹ 12,88,000).

(c) In case of a domestic company opted for section 115BAA or section 115BAB

Surcharge @10% of income-tax computed under section 115BAA or section 115BAB would be leviable. Since there is no threshold limit for applicability of surcharge, consequently, there would be no marginal relief.

Foreign Company

Income-tax

Royalties and fees for rendering technical services (FTS) received from Government or an Indian concern in pursuance of an agreement, approved by the Central Government, made by the company with the Government or Indian concern between 1.4.1961 and 31.3.1976 (in case of royalties) and between 1.3.1964 and 31.3.1976 (in case of FTS)	50%
Other income	35%

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Special rates for capital gains under sections 112, 112A and 111A would be applicable to foreign company also.

Surcharge

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

Where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, surcharge is payable at the rate of 2% of income-tax computed in accordance with the rates given above.

Marginal Relief

Marginal relief is available in case of such companies i.e., the total amount of income-tax (together with surcharge) computed on such income should not exceed the amount of income-tax computed on total income of ₹ 1 crore by more than the amount of income that exceeds ₹ 1 crore.

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

Where the total income exceeds ₹ 10 crore, surcharge is payable at the rate of **5%** of income-tax computed in accordance with the rates given above.

Marginal Relief

Marginal relief is available in case of such companies i.e., the total amount of income-tax (together with surcharge) computed on such income should not exceed the amount of income-tax and surcharge computed on total income of ₹ 10 crore by more than the amount of income that exceeds ₹ 10 crore.

1.6 REBATE FOR RESIDENT INDIVIDUALS [SECTION 87A]

In order to provide tax relief to the individual taxpayers, section 87A provides a rebate from the tax payable by an assessee, being an **individual resident in India**.

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

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

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

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

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ILLUSTRATION 8

Mr. Mahesh aged 32 years and a resident in India, has a total income of ₹ 10,50,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2026-27 under default tax regime under section 115BAC.

SOLUTION

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

Particulars	₹
Tax on total income of ₹ 10,50,000	
Tax @10% of ₹ 2,50,000 plus ₹ 20,000	45,000
Less: Rebate u/s 87A (Lower of tax payable or ₹ 60,000)	45,000
Tax Liability	Nil

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

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

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

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

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

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

ILLUSTRATION 9

Mr. Nitin aged 42 years and a resident in India, has a total income of ₹ 12,15,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2026-27 under default tax regime under section 115BAC.

SOLUTION

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

Particulars	₹	
Step 1: Total Income of ₹ 12,15,000 - ₹ 12,00,000	15,000	**(A)**

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Step 2: Tax on total income of ₹ 12,15,000		
Tax @10%of ₹ 15,000 + ₹ 60,000	62,250	**(B)**
Step 3: Since B > A, rebate u/s 87A would be B-A [₹ 62,250 - ₹ 15,000]	47,250	
	15,000	
Add: HEC@4%	600	
Tax Liability	15,600	

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

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

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

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

ILLUSTRATION 10

Mr. Manish, aged 47 years and a resident in India, has a total income of ₹ 4,15,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2026-27 if he exercises the option to shift out of the default tax regime.

SOLUTION

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

Particulars	₹
Tax on total income of ₹ 4,15,000	
Tax@5%of ₹ 1,65,000	8,250
Less: Rebate u/s 87A (Lower of tax payable or ₹ 12,500)	8,250
Tax Liability	Nil

- *Rebate under section 87A is allowed from income-tax computed before adding Health and education cess on income-tax.*

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SIGNIFICANT SELECT CASES

Sl. No.	Case Law	
1.	***Bank of Rajasthan Ltd. vs CIT [2024] 469 ITR 280 (SC)***	
	Issue	**Facts, Analysis and Decision**
	Whether the interest paid by the banks for broken period on purchase of securities can be claimed as revenue expenditure?	**Facts of the case:** In the present case, the assessee (a Scheduled Bank) involves in purchase and sale of government securities. It classified these securities as stock-in-trade in its books of account. The assessee consistently followed the method of setting off and netting the amount of interest paid by it on the purchase of securities [i.e., interest for the broken period ***(refer note below for the meaning of broken period)]*** against the interest recovered by it on the sale of securities and offering the net interest income to tax. This method was accepted in earlier assessments. However, the Commissioner of Income Tax (CIT) exercised revisional jurisdiction under section 263, holding that the broken period interest forms part of cost of acquisition and is not allowed as deduction. **Analysis and Decision:** The Apex Court noted that the banks are required to purchase Government securities to maintain the Statutory Liquidity Ratio. As per RBI's guidelines, there are three categories of securities: HTM (Held to Maturity), AFS (Available for Sale) and HFT (Held for Trading). As far as AFS and HFT are concerned, banks held such securities as stock-in-trade. Therefore, in these two categories of securities, the benefit of deduction of interest for the broken period will be available. The securities of the HTM category are usually held for a long term till their maturity. If it is found that HTM security is held as an investment, the benefit of broken period interest will not be available. Accordingly, the Apex Court held that as the securities were treated as stock-in-trade, the interest on the broken period cannot be considered as capital expenditure and will have to be treated as revenue expenditure, and thus, allowed as deduction.

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		Note - *When a Bank purchases a security on a date which falls between the dates on which the interest is payable on the security, the purchaser Bank, in addition to the price of the security, has to pay an amount equivalent to the interest accrued for the period from the last interest payment till the date of purchase. This interest is termed as the interest for the broken period.*
2.	***PCIT vs. Adadyn Technologies (P.) Ltd. [2024] 465 ITR 409 (SC)***	
	Issue	**Facts and Decision**
	Whether the expenses incurred by the Assessee towards development of software for advertisement, which, due to technological development, had to be abandoned, can be claimed as revenue expenditure allowable?	**Facts of the case:** The assessee is a company engaged in the business of rendering customized internet advertising services to advertisers which could be used on the Desktop. In order to develop its software, assessee had incurred certain expenditure. Due to rapid change in the technology, the application sought to be developed by the assessee had become obsolete and the assessee abandoned further development. **Decision:** The High Court held that since the product having been abandoned, the assessee shall not get any enduring benefit. In substance, assessee has incurred expenditure in these two years to develop a software but due to change in technology, it had to abandon the product. In effect, it had lost money spent on this product. Accordingly, the High Court held that the assessee shall not get any enduring benefit and therefore, the expenditure was to be treated as revenue in nature. SLP filed by the revenue against impugned order of the High Court was dismissed by the Supreme Court.
3.	***Mahle Anand Filter Systems Pvt. Ltd. v. ACIT [2023] 456 ITR 29 (SC)***	
	Issue	**Analysis & Decision**
	Can foregoing a security deposit to settle a dispute be considered a revenue expenditure?	When the assessee sought to vacate certain leased premises, disputes arose, and to end the dispute with the lessor, the assessee agreed not to claim the security deposit of ₹ 5.8 crores. The Apex Court affirmed the decision of the High Court which held that the amount of ₹ 5.8 crores could not be treated

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		as revenue expenditure merely because it was paid in the course of a dispute. It is evident that the character of the amount was of a capital nature and remained so although assessee decided to forgo ₹ 5.8 crores (the security deposit).
4.	***CIT v. Saurashtra Cement Ltd. (2010) 325 ITR 422 (SC)***	
	Issue	**Analysis & Decision**
	What is the nature of liquidated damages received by a company from the supplier of plant for failure to supply machinery to the company within the stipulated time – a capital receipt or a revenue receipt?	The damages are directly and intimately linked with the procurement of a capital asset i.e., the cement plant, which lead to delay in coming into existence of the profit-making apparatus. It was not a receipt in the course of profit earning process. Therefore, **the amount received by the assessee towards compensation for sterilization of the profit earning source, is not in the ordinary course of business, hence it is a capital receipt in the hands of the assessee.**
5.	***Honda Siel Cars India Ltd. v. CIT(2017) 395 ITR 713(SC)***	
	Issue	**Analysis & Decision**
	Whether technical fee paid under a technical collaboration agreement for setting up a joint venture company in India is to be treated as revenue or capital expenditure, where, upon termination of the agreement, the joint venture would come to an end?	If a limited right to use technical know-how is obtained for a limited period for improvising existing business, the expenditure is revenue in nature. However, if technical know-how is obtained for setting up a new business, the position may be different. The very purpose of the technical collaboration agreement, in this case, was to set up the Joint Venture. The collaboration included not only transfer of technical information, but, complete assistance, actual, factual and on the spot, for establishment of plant, machinery, etc. so as to set up a manufacturing unit. Upon termination of technical collaboration agreement, the joint venture itself would come to an end. Therefore, in this case, **technical fee is capital in nature since upon termination of technical collaboration agreement, the joint venture itself would come to an end**.

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TEST YOUR KNOWLEDGE

Questions

1. *Mr. Bhargava, a leading advocate on corporate law, decided to reduce his practice and to accept briefs only for paying his taxes and making charities with the fees received on such briefs. In a particular case, he agreed to appear to defend one company in the Supreme Court on the condition that he would be provided with ₹ 5 lakhs for a public charitable trust that he would create. He defended the company and was paid the sum by the company. He created a trust of that sum by executing a trust deed. Decide whether the amount received by Mr. Bhargava is assessable in his hands as income from profession.*

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

3. *MKG Agency is a partnership firm consisting of Mr. Mohan and his three major sons. The partnership deed provided that after the death of Mr. Mohan, the business shall be continued by the sons, subject to the condition that the firm shall pay 20% of the profits to their mother, Lakshmi. Mr. Mohan died in March, 2025. In the previous year 2025-26, the reconstituted firm paid ₹ 1 lakh (equivalent to 20% of the profits) to Lakshmi and claimed the amount as deduction from its income. Examine the correctness of the claim of the firm.*

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

5. *Mr. C borrowed on Hundi, a sum of ₹ 25,000 by way of bearer cheque on 11.09.2025 and repaid the same with interest amounting to ₹ 30,000 by account payee cheque on 12.10.2025.*

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

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6. *The Assessing Officer found, during the course of assessment of a firm, that it had paid rent in respect of its business premises amounting to ₹ 60,000, which was not debited in the books of account for the year ending 31.3.2026. The firm did not explain the source for payment of rent. The Assessing Officer proposes to make an addition of ₹ 60,000 in the hands of the firm for the assessment year 2026-27. The firm claims that even if the addition is made, the sum of ₹ 60,000 should be allowed as deduction while computing its business income since it has been expended for purposes of its business. Examine the claim of the firm.*

Answers

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

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

3. The issue raised in the problem is based on the concept of diversion of income by overriding title, which is well recognised in the income-tax law. In the instant case, the amount of ₹ 1 lakh, being 20% of profits of the firm, paid to Lakshmi gets diverted at source by the charge created in her favour as per the terms of the partnership deed. Such income does not reach the assessee-firm.

Rather, such income stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said

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amount but it so received for and on behalf of Lakshmi, who possesses the overriding title. Therefore, the amount paid to Lakshmi should be excluded from the income of the firm. This view has been confirmed in *CIT vs. Nariman B. Bharucha & Sons (1981) 130 ITR 863 (Bom)*.

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

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

Therefore, the HUF would retain its status as such.

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

In this case, Mr. C has borrowed ₹ 25,000 on Hundi by way of bearer cheque. Therefore, it shall be deemed to be income of Mr. C for the previous year 2025-26. Since the repayment of the same along with interest was made by way of account payee cheque, the same would not be hit by the provisions of section 69D. Therefore, the action of the Assessing Officer treating the amount borrowed as income during the previous year is valid in law.

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

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CHAPTER 2

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** whether a particular income would constitute agricultural income or non-agricultural income;
- **compute** the tax on non-agricultural income by applying the concept of partial integration of agricultural income with non-agricultural income;
- **examine** the provisions of different clauses of section 10;
- **analyse and apply** such provisions to determine whether a particular income would form/ would not form part of total income;
- **analyse and apply** the provisions of section 14A to determine the expenditure incurred in relation to income not includible in total income.

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2.1 INTRODUCTION

(1) Exemption under section 10 *vis-a-vis* Deduction under Chapter VI-A

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

Moreover, there are certain other incomes which are included in gross total income but are wholly or partly allowed as deductions under Chapter VI-A in computation of total income. Students should note a very important difference between exemption under section 10 and the deduction under Chapter VI-A.

(2) Exemptions which are discussed under the relevant chapters:

In this chapter, we are going to study the provisions of section 10 which enumerate the various categories of income that are exempt from tax.

Students may note that, in this chapter, only some of the exemptions are discussed. The remaining exemptions are being discussed in the respective chapters as shown hereunder[1]:

[1] The exemptions under section 10 in relation to Salaries have been dealt with in detail at the Intermediate level itself. The remaining exemptions are discussed in other chapters of this Study Material.

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LIST OF EXEMPTIONS BEING DISCUSSED IN RESPECTIVE CHAPTERS

Capital Gains

- Receipts from ULIP [Section 10(10D)]
- Capital gain on transfer of a unit of Unit Scheme [Section 10(33)]
- Capital gain on compulsory acquisition of agricultural land within specified urban limits [Section 10(37)]
- Transfer of specified capital asset under Land Pooling Scheme [Section 10(37A)]
- Income received in transaction of reverse mortgage [Section 10(43)]

Income from Other Sources

- Receipts from LIC [Section 10(10D)]
- Interest income arising to certain persons [Section 10(15)]
- Family pension received by widow/ children/ nominated heirs of armed forces members [Section 10(19)]

Income of other Persons Included in Assessee's Total Income

- Exemption in respect of minor's income included in the hands of parent [Section 10(32)]

Deductions from Gross Total Income

- Payment from Sukanya Samriddhi Account [Section 10(11A)]
- Payment from NPS Trust to an assessee on closure of his account or on his opting out of the pension scheme [Section 10(12A)]
- ***Payment from NPS Trust to an assessee, being a subscriber to the UPS, at the time of his superannuation or voluntary retirement or retirement [Section 10(12AA)]***
- ***Lumpsum amount received by an assessee, being a subscriber to the UPS [Section 10(12AB)]***
- Payment from NPS Trust to an employee on partial withdrawal [Section 10(12B)]
- ***Payment from NPS Trust to an assessee, being the parent or guardian of a minor, on partial withdrawal [Section 10(12BA)]***
- Payment from Agnipath Corpus Fund to a person enrolled under the Agnipath Scheme or to his nominee [Section 10(12C)]

Assessment of Trusts and Institutions, Political Parties and other special entities

- Income of certain funds or institutions [Section 10(23C)]
- Income of Securitisation trusts [Section 10(23DA)]
- Income of Investment Fund [Section 10(23FBA)]
- Income of Unit holders of Investment Fund [Section 10(23FBB)]
- Income of business trusts [Sections 10(23FC), 10(23FCA) and 10(23FD)]

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Non-resident Taxation

- Interest on moneys standing to the credit of individual in his NRE account [Section 10(4)(ii)]
- Interest income of a non-corporate non-resident or foreign company on specified off-shore Rupee Denominated Bonds issued by an Indian company or business trust [Section 10(4C)]
- Income of a specified fund on transfer of certain specified asset [Section 10(4D)]
- Income of a non-resident as a result of transfer of non-deliverable forward contracts/ offshore derivative instruments/ over the counter derivatives entered into with an offshore banking unit of an IFSC [Section 10(4E)]
- Income of a non-resident by way of royalty or interest, on account of lease of an aircraft or a ship in a previous year, paid by a unit of an IFSC [Section 10(4F)]
- Income of a non-resident from portfolio of securities etc. in an account maintained with an offshore banking unit in any IFSC [Section 10(4G)]
- Income received by a non-resident or a Unit of an IFSC [Section 10(4H)]
- Remuneration received by individuals, who are not citizens of India [Section 10(6)]
- Tax paid on behalf of foreign state or foreign enterprise on amount paid as consideration of acquiring aircraft, etc. on lease [Section 10(6BB)]
- Income arising to foreign companies from projects connected with the security of India [Section 10(6C)]
- Royalty income or fees for technical services arising to non-resident fom National Technical Research Organisation (NTRO) [Section 10(6D)]
- Interest income arising to certain persons [Section 10(15)]
- Income arising to foreign state or foreign enterprise by way of consideration of acquiring aircraft, etc. on lease [Section 10(15A)]
- Income of a foreign company from lease rentals of cruise ships [Section 10(15B)]
- Income of European Economic Community (EEC) [Section 10(23BBB)]
- Income derived by the SAARC Fund for Regional Projects [Section 10(23BBC)]
- Income accruing or arisiing to or received by a unit holder from a specified fund or on transfer of units in a specified fund [Section 10(23FBC)]
- Certain incomes of wholly owned subsidiary of Abu Dhabi Investment Authority, Sovereign Wealth Fund and specified pension fund [Section 10(23FE)]
- Capital Gains arising or received by a non-resident or a specified fund on account of transfer of share of a company resident in india [Section10(23FF)]
- Any income of a unit of IFSC primarily engaged in the business of leasing of an aircraft ***or a ship***, by way of dividends from a company being a unit of any IFSC primarily engaged in the business of leasing of an aircraft ***or a ship*** [Section 10(34B)]
- Income received by certain foreign companies in India in Indian currency from sale of crude oil to any person in India [Section 10(48)]
- Income accruing or arising to a foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India [Section 10(48A)]
- Income accruing or arising to a foreign company on account of sale of leftover stock of crude oil, if any, from the facility in India after the expiry of the agreement or the arrangement [Section 10(48B)]

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2.2 INCOMES NOT INCLUDED IN TOTAL INCOME [SECTION 10]

Let us now have a look at the various incomes which are exempt from tax and the conditions to be satisfied in order to be eligible for exemption.

(1) Agricultural income [Section 10(1)]

Section 10(1) provides that agricultural income is not to be included in the total income of the assessee. The reason for total exemption of agricultural income from the scope of central income-tax is that under the Constitution, the Central Government has no power to levy a tax on agricultural income.

Definition of agricultural income [Section 2(1A)]

This definition is very wide and covers the income of not only the cultivators but also the land holders who might have rented out the lands. Agricultural income may be received in cash or in kind.

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

(i) It may be rent or revenue derived from **land situated in India** and **used for agricultural purposes**.

(ii) It may be income derived from such land by

- (a) **agriculture** or
- (b) the performance of a **process ordinarily employed** by a cultivator or receiver of rent in kind **to render the produce fit to be taken to the market** or
- (c) the **sale,** by a cultivator or receiver of rent in kind, **of such agricultural produce raised or received by him,** in respect of which no process has been performed other than a process of the nature mentioned in point (b) above.

(iii) Lastly, agricultural income may be derived from any **farm building** required for agricultural operations.

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

(i) Rent or revenue derived from land situated in India and used for agricultural purposes: The following three conditions have to be satisfied for income to be treated as agricultural income:

- (a) Rent or revenue should be derived from land;

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(b) Land has to be situated in India (If agricultural land is situated in a foreign country, the entire income would be taxable); and

(c) land should be used for agricultural purposes.

The amount received in money or in kind, by one person from another for right to use land is termed as **Rent.** The rent can either be received by the owner of the land or by the original tenant from the sub-tenant. It implies that ownership of land is not necessary. Thus, the rent received by the original tenant from sub-tenant would also be agricultural income subject to the other conditions mentioned above.

The scope of the term "**Revenue"** is much broader than rent. It includes income other than rent. For example, fees received for renewal for grant of land on lease would be revenue derived from land.

(ii) Income derived from such land by

(a) Agriculture: The term "Agriculture" has not been defined in the Act. However, cultivation of a field involving human skill and labour on the land can be broadly termed as **agriculture**.

"Agriculture" means tilling of the land, sowing of the seeds and similar operations. It involves basic operations and subsequent operations.

"Agriculture" comprises within its scope the basic as well as the subsidiary operations regardless of the nature of the produce raised on the land. These produce may be grain, fruits or vegetables necessary for *sustenance* of human beings including

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

Note: The term 'agriculture' cannot be extended to all activities which have some distant relation to land like dairy farming, breeding and rearing of live stock, butter and cheese making and poultry farming. This aspect is discussed in detail later on in this chapter.

Whether income from nursery constitutes agricultural income?

In the past, there have been court rulings that only if a nursery is maintained by carrying out the basic operations on land and subsequent operations in continuation thereof, income from such nursery would be treated as agricultural income and would qualify for exemption under section 10(1).

The Supreme Court has, in *CIT v. Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466*, held that the basic operations must be performed before any income can be called as agricultural income. The basic operations involve cultivation of the ground, in the sense of tilling of the land, sowing of the seeds, planting and other similar operations on the land. Such basic operations demand the expenditure of human labour and skill upon the land itself and further, they are directed to make the crop sprout from the land. Therefore, income derived from sale of plants grown directly in pots would not be treated as agricultural income.

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

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

(b) Process ordinarily employed to render the produce fit to be taken to the market: Sometimes, to make the agricultural produce a saleable commodity, it becomes necessary to perform some kind of process on the produce. The income from the

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process employed to render the produce fit to be taken to the market would be agricultural income. However, it must be a process ordinarily employed by the cultivator or receiver of rent in kind and the process must be applied to make the produce fit to be taken to the market.

The ordinary process employed to render the produce fit to be taken to the market includes thrashing, winnowing, cleaning, drying, crushing etc. For example, the process ordinarily employed by the cultivator to obtain the rice from paddy is to first remove the hay from the basic grain, and thereafter to remove the chaff from the grain. The grain has to be properly filtered to remove stones etc. and finally the rice has to be packed in gunny bags for sale in the market.

After such process, the rice can be taken to the market for sale. This process of making the rice ready for the market may involve manual operations or mechanical operations. All these operations constitute the process ordinarily employed to make the product fit for the market. The produce must retain its original character in spite of the processing unless there is no market for selling it in that condition.

However, if marketing process is performed on a produce which can be sold in its raw form, income derived therefrom is partly agricultural income and partly business income.

(c) **Sale of such agricultural produce in the market:** Any income from the sale of any produce to the cultivator or receiver of rent-in kind is agricultural income provided it is from the land situated in India and used for agricultural purposes. However, if the produce is subjected to any process other than process ordinarily employed to make the produce fit for market, the income arising on sale of such produce would be partly agricultural income and partly non-agricultural income.

Similarly, if other agricultural produce like tea, cotton, tobacco, sugarcane etc. are subjected to manufacturing process and the manufactured product is sold, the profit on such sale will consist of agricultural income as well as business income. That portion of the profit representing agricultural income will be exempted.

Apportionment of Income between business income and agriculture income: Rules 7, 7A, 7B & 8 of Income-tax Rules, 1962 provides the basis of apportionment of income between agricultural income and business income.

I. Rule 7 - Income from growing and manufacturing of any product

Where income is partially agricultural income and partially income chargeable to income-tax as business income, the market value of any agricultural produce which has been raised by the assessee or received by him as rent in kind and which has been utilised as raw material

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in such business or the sale receipts of which are included in the accounts of the business shall be deducted. No further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent in kind.

Determination of market value - There are two possibilities here:

(i) The agricultural produce is capable of being sold in the market either in its raw stage or after application of any ordinary process to make it fit to be taken to the market. In such a case, the value calculated at the average price at which it has been so sold during the relevant previous year will be the market value.

(ii) It is possible that the agricultural produce is not capable of being ordinarily sold in the market in its raw form or after application of any ordinary process. In such case the market value will be the total of the following:—

- The expenses of cultivation;
- The land revenue or rent paid for the area in which it was grown; and
- Such amount as the Assessing Officer finds having regard to the circumstances in each case to represent at reasonable profit.

ILLUSTRATION 1

Mr. Amar grows sugarcane and uses the same for the purpose of manufacturing sugar in his factory. 40% of sugarcane produce is sold for ₹ 12 lakhs, and the cost of cultivation of such sugarcane is ₹ 6 lakhs. The cost of cultivation of the balance sugarcane (60%) is ₹ 15 lakhs and the market value of the same is ₹ 25 lakhs. After incurring ₹ 1.5 lakhs in the manufacturing process on the balance sugarcane, the sugar was sold for ₹ 30 lakhs. Compute Amar's business income and agricultural income.

SOLUTION

Computation of Business Income and Agriculture Income of Mr. Amar

Particulars	Business Income	Agricultural Income	
	(₹)	(₹)	(₹)
Sale of Sugar			
Business income			
Sale Proceeds of sugar	30,00,000		
Less: Market value of sugar (60%)	25,00,000		

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Less: Manufacturing exp.	1,50,000		
	3,50,000		
Agricultural income			
Market value of sugar (60%)		25,00,000	
Less: Cost of cultivation		15,00,000	
			10,00,000
Sale of sugarcane			
Agricultural Income			
Sale proceeds of sugarcane (40%)		12,00,000	
Less: Cost of cultivation		6,00,000	
			6,00,000
			16,00,000

II. Rule 7A – Income from growing and manufacturing of rubber

This rule is applicable when income derived from the sale of centrifuged latex or cenex or latex based crepes or brown crepes or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India. In such cases 35% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 65% is agricultural income and is exempt.

ILLUSTRATION 2

Mr. Nilesh manufactures latex from the rubber plants grown by him in India. These are then sold in the market for ₹ 36 lakhs. The cost of growing rubber plants is ₹ 16 lakhs and that of manufacturing latex is ₹ 12 lakhs. Compute his total income.

SOLUTION

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

Total profits from the sale of latex = ₹ 36 lakhs – ₹ 16 lakhs – ₹ 12 lakhs = ₹ 8 lakhs.

Agricultural income = 65% of ₹ 8 lakhs = ₹ 5.2 lakhs

Business income = 35% of ₹ 8 lakhs = ₹ 2.8 lakhs

III. Rule 7B – Income from growing and manufacturing of coffee

(i) In case of income derived from the sale of coffee grown and cured by the seller in India, 25% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 75% is agricultural income and is exempt.

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(ii) In case of income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, with or without mixing chicory or other flavoring ingredients, 40% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 60% is agricultural income and is exempt.

IV. Rule 8 - Income from growing and manufacturing of tea

This rule applies only in cases where the assessee himself grows tea leaves and manufactures tea in India. In such cases 40% profits on sale is taxable as business income under the head "Profits and gains from business or profession", and the balance 60% is agricultural income and is exempt.

Rule	Apportionment of income in certain cases	Agricultural Income	Business Income
7A	Income from sale of rubber products derived from rubber plant grown by the seller in India	65%	35%
7B	Income from sale of coffee		
	- grown and cured by the seller in India	75%	25%
	- grown, cured, roasted and grounded by the seller in India	60%	40%
8	Income from sale of tea grown and manufactured by the seller in India	60%	40%

(iii) Income from farm building – Income from the farm building which is owned and occupied by the receiver of the rent or revenue of any such land or occupied by the cultivator or the receiver of the rent in kind, of any land with respect to which, or the produce of which, any process discussed above is carried on, would be treated as agricultural income.

However, the income arising from the use of such farm building for any purpose (including letting for residential purpose or for the purpose of business or profession) other than agriculture referred in (b) & (c) of (ii) of para (1) in page 2.5 would not be agricultural income.

Further, the income from such farm building would be agricultural income only if the following conditions are satisfied:

(a) The building should be on or in the immediate vicinity of the land; and

(b) The receiver of the rent or revenue or the cultivator or the receiver of rent in kind should, by reason of his connection with such land require it as a dwelling house or as a store house.

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

(i) The land should either be assessed to land revenue in India or be subject to a local rate assessed and collected by the officers of the Government as such or;

(ii) Where the land is not so assessed to land revenue in India or is not subject to local rate:-

a. It should not be situated in any area as comprised within the jurisdiction of a municipality or a cantonment board and which has a population not less than 10,000.

b. It should not be situated in any area within such distance, measured aerially, in relation to the range of population as shown hereunder –

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

Example:

	Area	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item a.	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year	Would income derived from farm building situated in this area be treated as agricultural income?
(i)	A	1 km	9,000	Yes
(ii)	B	1.5 kms	12,000	No
(iii)	C	2 kms	11,00,000	No
(iv)	D	3 kms	80,000	Yes
(v)	E	4 kms	3,00,000	No
(v)	F	5 kms	12,00,000	No
(vi)	G	6 kms	8,000	Yes
(vii)	H	7 kms	4,00,000	Yes
(viii)	I	8 kms	10,50,000	No
(ix)	J	9 kms	15,00,000	Yes

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Would income arising from transfer of agricultural land situated in urban area be agricultural income?

No, as per *Explanation 1* to section 2(1A), the capital gains arising from the transfer of such urban agricultural land would not be treated as agricultural income under section 10 but will be taxable under section 45.

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

Indirect connection with land

We have seen above that agricultural income is exempt, whether it is received by the tiller or the landlord. However, non-agricultural income does not become agricultural merely on account of its indirect connection with the land. The following examples will illustrate the above point.

Example: A rural society has as its principal business the selling on behalf of its member societies, butter made by these societies from cream sold to them by farmers. The making of butter was a factory process separated from the farm.

The butter resulting from the factory operations separated from the farm was not an agricultural product and the society was, therefore, not entitled to exemption under section 10(1) in respect of such income.

Example: X was the managing agent of a company. He was entitled for a commission at the rate of 10% p.a. on the annual net profits of the company. A part of the company's income was agricultural income. X claimed that since his remuneration was calculated with reference to the income of the company, part of which was agricultural income, such part of the commission as was proportionate to the agricultural income was exempt from income tax.

Since, X received remuneration under a contract for personal service calculated on the amount of profits earned by the company, such remuneration does not constitute agricultural income.

Example: Y owned 100 acres of agricultural land, a part of which was used as pasture for cows. The lands were purely maintained for manuring and other purposes connected with agriculture and only the surplus milk after satisfying the assessee's needs was sold. The question arose whether income from such sale of milk was agricultural income.

The regularity with which the sales of milk were effected and quantity of milk sold showed that the assessee carried on regular business of producing milk and selling it as a commercial proposition. Hence, it was not agricultural income.

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Example: In regard to forest trees of spontaneous growth which grow on the soil unaided by any human skill and labour there is no cultivation of the soil at all. Even though operations in the nature of forestry operations performed by the assessee may have the effect of nursing and fostering the growth of such forest trees, it cannot constitute agricultural operations.

Income from the sale of such forest trees of spontaneous growth does not, therefore, constitute agricultural income.

Examples of Agricultural income and non-agricultural income:

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

Example: Agricultural income

- Income derived from sampling or seedlings grown in a nursery.
- Income from growing of flowers and creepers.
- Rent received from land used for grazing of cattle required for agricultural activities.
- Income from growing of bamboo.

Example: Non-agricultural income

- Income from breeding of livestock.
- Income from poultry farming.
- Income from fisheries.
- Income from dairy farming.

ILLUSTRATION 3

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

SOLUTION

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

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

Partial integration of agricultural income with non-agricultural income

As in the above discussion, we have seen that agricultural income is exempt subject to conditions mentioned in the definition clause of section 2(1A). However, a method has been laid down to levy tax on agricultural income in an indirect way. This concept is known as **partial integration of agricultural income with non-agricultural income.** It is applicable to individuals, HUF, AOPs, BOIs and artificial juridical persons. Two conditions which need to be satisfied for partial integration are:

1. The net agricultural income should exceed ₹ 5,000 p.a., and
2. Non-agricultural income should exceed the maximum amount not chargeable to tax. (i.e., If such person is paying tax under default tax regime u/s 115BAC, then *₹4,00,000 is the basic exemption limit irrespective of the age of the person*. If such person has exercised the option to shift out of the default tax regime, then, the basic exemption limit would be ₹ 5,00,000 for resident individuals of the age of 80 years or more at any time during the previous year, ₹ 3,00,000 for resident individuals of the age of 60 years or more (but less than 80 years) at any time during the previous year and ₹ 2,50,000 for all others). Only if non-agricultural income exceeds this limit, partial integration would be required.

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

Tax calculation in such cases is as follows:

Step 1: Add non-agricultural income with net agricultural income. Compute tax on the aggregate amount.

Step 2: Add net agricultural income and the basic exemption limit available to the assessee. Compute tax on the aggregate amount.

Step 3: Deduct the amount of income tax calculated in step 2 from the income tax calculated in step 1 i.e., Step 1 – Step 2.

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Step 4: The sum so arrived at shall be increased by surcharge, if applicable. It would be reduced by the rebate, if any, available u/s 87A.

Step 5: Thereafter, it would be increase by health and education cess @4%.

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

ILLUSTRATION 4

Mr. X, a resident, has provided the following particulars of his income for the P.Y.2025-26.

i. Income from salary (computed) - ₹ 11,50,000

ii. Income from house property (computed) - ₹ 3,80,000

iii. Agricultural income from a land in Assam - ₹ 4,50,000

iv. Expenses incurred for earning agricultural income - ₹ 1,60,000

Compute his tax liability for A.Y. 2026-27 assuming his age is -

(a) 40 years

(b) 75 years

SOLUTION

(a) Computation of tax liability (age 40 years)

Computation of total income of Mr. X for the A.Y. 2026-27 under default tax regime under section 115BAC

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

1. Net agricultural income exceeds ₹ 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit of ₹ 4,00,000.

His tax liability is computed in the following manner:

Particulars	₹	₹
Income from salary		11,50,000
Income from house property		3,80,000
Net agricultural income [₹ 4,50,000 (-) ₹ 1,60,000]	2,90,000	
Less: Exempt under section 10(1)	(2,90,000)	-
Gross Total Income		**15,30,000**
Less: Deductions under Chapter VI-A		-
Total Income		**15,30,000**

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Step 1 : ₹ 15,30,000 + ₹ 2,90,000 = ₹ 18,20,000

Tax on ₹ 18,20,000 = ₹ 1,64,000

(i.e., 5% of ₹ 4,00,000 *plus* 10% of ₹ 4,00,000 *plus* 15% of ₹ 4,00,000 plus 20% of ₹ 2,20,000)

Step 2 : ₹ 2,90,000 + ₹ 4,00,000 = ₹ 6,90,000

Tax on ₹ 6,90,000 = ₹ 14,500 (i.e. 5% of ₹ 2,90,000)

Step 3 : ₹ 1,64,000 – ₹ 14,500 = ₹ 1,49,500

Step 4 & 5 : Total tax payable = ₹ 1,49,500 + 4% of ₹ 1,49,500 = ₹ 1,55,480

Computation of total income of Mr. X for the A.Y. 2026-27 under normal provisions of the Act

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

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

His tax liability is computed in the following manner:

Particulars	₹	₹
Income from salary		11,50,000
Income from house property		3,80,000
Net agricultural income [₹ 4,50,000 (-) ₹ 1,60,000]	2,90,000	
Less: Exempt under section 10(1)	(2,90,000)	-
Gross Total Income		**15,30,000**
Less: Deductions under Chapter VI-A		-
Total Income		**15,30,000**

Step 1 : ₹ 15,30,000 + ₹ 2,90,000 = ₹ 18,20,000

Tax on ₹ 18,20,000 = ₹ 3,58,500

(i.e., 5% of ₹ 2,50,000 *plus* 20% of ₹ 5,00,000 plus 30% of ₹ 8,20,000)

Step 2 : ₹ 2,90,000 + ₹ 2,50,000 = ₹ 5,40,000

Tax on ₹ 5,40,000 = ₹ 20,500

(i.e. 5% of ₹ 2,50,000 *plus* 20% of ₹ 40,000)

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Step 3 : ₹ 3,58,500 – ₹ 20,500 = ₹ 3,38,000

Step 4 & 5 : Total tax payable = ₹ 3,38,000 + 4% of ₹ 3,38,000 = ₹ 3,51,520

(b) Computation of tax liability (age 75 years)

Computation of total income of Mr. X for the A.Y. 2026-27 under default tax regime under section 115BAC

Tax liability of Mr. X would be same under default tax regime whether he is of age of 40 years of 75 years i.e., ₹ 1,55,480.

Computation of total income of Mr. X for the A.Y. 2026-27 under normal provisions of the Act

His tax liability is computed in the following manner:

Step 1 : ₹ 15,30,000 + ₹ 2,90,000 = ₹ 18,20,000

Tax on ₹ 18,20,000 = ₹ 3,56,000

(i.e. 5% of ₹ 2,00,000 plus 20% of 5,00,000 plus 30% of 8,20,000)

Step 2 : ₹ 2,90,000 + ₹ 3,00,000 = ₹ 5,90,000.

Tax on ₹ 5,90,000 = ₹ 28,000

(i.e. 5% of ₹ 2,00,000 plus 20% of ₹ 90,000)

Step 3 : ₹ 3,56,000 – ₹ 28,000 = ₹ 3,28,000

Step 4 & 5: Total tax payable = ₹ 3,28,000 + 4% of ₹ 3,28,000 = ₹ 3,41,120.

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

(i) As explained in Chapter 1, a HUF is a 'person' and hence, a unit of assessment under the Act. Income earned by the HUF is assessable in its own hands.

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

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

(a) out of the income of the family or

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

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(3) Share income of a partner [Section 10(2A)]

This clause exempts from tax a partner's share in the total income of the firm. In other words, the partner's share in the total income of the firm determined in accordance with the profit-sharing ratio will be exempt from tax.

Taxability of partner's share, where the income of the firm is exempt under Chapter III/ deductible under Chapter VI-A [Circular No. 8/2014 dated 31.03.2014]

Section 10(2A) provides that a partner's share in the total income of a firm which is separately assessed as such shall not be included in computing the total income of the partner. In effect, a partner's share of profits in such firm is exempt from tax in his hands.

Sub-section (2A) was inserted in section 10 by the Finance Act, 1992 with effect from 1.4.1993 consequent to change in the scheme of taxation of partnership firms. Since A.Y.1993-94, a firm is assessed as such and is liable to pay tax on its total income. A partner is, therefore, not liable to tax once again on his share in the said total income.

An issue has arisen as to the amount which would be exempt in the hands of the partners of a partnership firm, in cases where the firm has claimed exemption/deduction under Chapter III or Chapter VI-A.

The CBDT has clarified that the income of a firm is to be taxed in the hands of the firm only and the same can under no circumstances be taxed in the hands of its partners. Therefore, the entire profit credited to the partners' accounts in the firm would be exempt from tax in the hands of such partners, even if the income chargeable to tax becomes Nil in the hands of the firm on account of any exemption or deduction available under the provisions of the Act.

(4) Payments to Bhopal Gas Victims [Section 10(10BB)]

Any payment made to a person under Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985 and any scheme framed thereunder will be fully exempt.

However, payments made to any assessee in connection with Bhopal Gas Leak Disaster to the extent he has been allowed a deduction under the Act on account of any loss or damage caused to him by such disaster will not be exempted.

(5) Compensation received on account of disaster [Section 10(10BC)]

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

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

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

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

(a) substantial loss of life or human suffering; or

(b) damage to, and destruction of, property; or

(c) damage to, or degradation of, environment.

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

ILLUSTRATION 5

An amount of ₹ 5 lakhs was paid on 17.3.2026 to the parents of Amit by the Government of Chattisgarh as compensation to the aggrieved family, whose only son Amit lost his life in Maoist local bus bomb blast in Dantewada.

Examine with reasons, whether the amount of compensation received is chargeable to tax in A.Y. 2026-27.

SOLUTION

As per section 10(10BC), the meaning of "disaster" shall be derived from Disaster Management Act, 2005 which defines disaster to mean a catastrophe, mishap, calamity or grave occurrence in any area, arising from natural or manmade causes, or by accident or negligence. It should have the effect of causing substantial loss of life or human suffering or damage to, and destruction of property, or damage to, or degradation of environment. It should be of such a nature or magnitude to be beyond the coping capacity of the community of the affected area.

If, for this reason, any compensation is paid by the Central Government or by a State Government or by a local authority, then, the same will be exempt from tax. Accordingly, the amount of ₹ 5 lakhs received by the parents of deceased Amit from the Government of Chattisgarh for the disaster because of Dantewada bus bomb blast is exempt under section 10(10BC).

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(6) Educational scholarships [Section 10(16)]

The value of scholarship granted to meet the cost of education would be exempt from tax in the hands of the recipient irrespective of the amount or source of scholarship.

(7) Payments to MPs & MLAs [Section 10(17)]

The following incomes of Members of Parliament or State Legislatures will be exempt:

(i) ***Daily Allowance -*** Daily allowance received by any Member of Parliament or of State Legislatures or any Committee thereof.

(ii) ***Constituency Allowance of MPs -*** In the case of a Member of Parliament, any allowance received under Members of Parliament (Constituency Allowance) Rules, 1986; and

(iii) ***Constituency allowance of MLAs -*** Any constituency allowance received by any person by reason of his membership of any State Legislature under any Act or rules made by that State Legislature.

(8) Awards for literary, scientific and artistic works and other awards by the Government [Section 10(17A)]

Any payment, whether in cash or in kind -

- in pursuance of any award instituted in the public interest by the Central/ State Government or any body approved by the Central Government or
- as a reward by Central/ State Government for such purposes as may be approved by the Central Government in public interest,

will enjoy exemption under this clause.

(9) Pension received by recipient of gallantry awards [Section 10(18)]

(i) ***Exemption of Pension -*** Any income by way of pension received by an individual is exempt from income-tax if -

(a) such individual was an employee of Central or State Government and

(b) has been awarded "Param Vir Chakra" or "Maha Vir Chakra" or "Vir Chakra" or such other gallantry award notified by the Central Government in this behalf.

(ii) ***Exemption of Family Pension -*** In case of the death of such individual, any income by way of family pension received by any member of the family of the individual shall also be exempt under this clause.

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(iii) ***Meaning of Family -*** Family, in relation to an individual, means –

- the spouse and children of the individual; and
- the parents, brothers and sisters of the individuals or any of them wholly or mainly dependent on the individual.

Exemption of disability pension granted to disabled personnel of armed forces who have been invalided on account of disability attributable to or aggravated by such service [Circular No. 13/2019, dated 24.6.2019]

The entire disability pension, i.e. "disability element" and "service element" of pension granted to members of naval, military or air forces who have been invalided out of naval, military or air force service on account of bodily disability attributable to or aggravated by such service would be exempt from tax.

The CBDT has, vide this circular, clarified that exemption in respect of disability pension would be available to all armed forces personnel (irrespective of rank) who have been invalided out of such service on account of bodily disability attributable to or aggravated by such service. However, such tax exemption will be available only to armed forces personnel who have been invalided out of service on account of bodily disability attributable to or aggravated by such service and not to personnel who have been retired on superannuation or otherwise.

(10) Annual value of palaces of former rulers [Section 10(19A)]

The annual value of any one palace in the occupation of former Ruler during the relevant previous year would be excluded from the total income, provided the annual value was exempt before 28.12.1971 by virtue of the provisions of the prevailing orders, i.e., the Merged States (Tax Concessions) Order, 1949 or the Part B States (Tax Concessions) Order, 1950.

The Supreme Court has, in *Maharao Bhim Singh of Kota v. CIT (2017) 390 ITR 532*, observed that, in order to claim exemption from payment of income-tax on the residential palace of the Ruler under section 10(19A), it is necessary for the Ruler to satisfy the following conditions:

(i) He should own the palace as his ancestral property;

(ii) Such palace should be in his occupation as his residence; and

(iii) The palace should be declared by the Central Government to be exempt from payment of Income-tax under paragraph 15(iii) of the 1950 Order.

The Supreme Court, accordingly, held that where part of the residential palace is found to be in occupation of the tenant and the remaining is in occupation of the Ruler for his residence, the Ruler

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is entitled to claim exemption for the whole of his residential palace under section 10(19A). Such exemption cannot be confined to that portion of the palace which is in his actual occupation thereby subjecting the income derived from the portion let out to payment of income-tax in the hands of the Ruler.

(11) Income of local authorities [Section 10(20)]

(i) ***Exempt income -*** Following income arising to a local authority would be exempt

- Income under the head house property; or
- Income from Capital gains; or
- Income from Other Sources; or
- Income from trade or business carried on by it which accrues or arises
  - ✓ from the supply of commodity or service under its jurisdictional area
  - ✓ from the supply of water or electricity within or outside its own jurisdictional area.

(ii) ***Meaning of Local Authority -*** For the purposes of this clause, "local authority" means the following:

(a) Panchayat

(b) Municipality

(c) Municipal Committee and District Board legally entitled to, or entrusted by the Government with the control or management of a Municipal or local Fund

(d) Cantonment Board

(12) Income of research associations approved under section 35(1)(ii)/(iii) [Section 10(21)]

This clause provides for exemption in respect of any income of research associations which are approved under section 35(1)(ii)/(iii)[2]. This exemption has, however, been made subject to the following conditions:

(i) ***Application and accumulation for the objects -*** It should apply its income or accumulate for application wholly and exclusively to its objects and provisions of section 11(2) and (3)[3] would also apply in relation to such accumulation.

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[2]Section 35(1)(ii)/(iii) will be discussed in Chapter 3
[3]Section 11(2) and (3) will be discussed in Chapter 10

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(ii) ***Approved modes of investment/ deposit -*** The association should invest or deposit its funds in the forms or modes specified in section 11(5)[4]. This condition would however not apply to -

(a) any assets held by the research association where such assets form part of the corpus of the fund of the association as on 1-6-1973;

(b) any bonus shares allotted to the research institution, in respect of the shares mentioned above forming part of the corpus of such fund, etc.;

(c) any voluntary contributions received and maintained in the form of jewellery, furniture or other article as the Board may specify for any period during the previous year.

(iii) ***Exemption in relation voluntary contribution –*** Exemption would not be denied in relation to voluntary contribution, other than voluntary contribution in cash or voluntary contribution of the nature referred in (a) to (c) above, subject to the condition that such voluntary contribution is not held by the association 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.

(iv) ***Non-applicability of exemption in respect of business income -*** The exemption will not apply to income of such association which are in the nature of profits and gains of business unless the business is incidental to the attainment of its objectives and separate books of account are maintained in respect of such business.

(v) ***Withdrawal of Approval -*** The approval once granted may be withdrawn if at any time the Government is satisfied that –

(a) the research association has not applied its income in accordance with sections 11(2) and (3);

(b) the research association has not invested or deposited its funds in accordance with point (ii) above.

(c) the activities of the research association are not genuine;

(d) the activities of the research association are not being carried out in accordance with the conditions imposed on the basis of which the approval was granted.

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

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[4]Section 11(5) will be discussed in Chapter 10

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(13) Income of professional associations [Section 10(23A)]

(i) ***Exempt and Non-exempt income -*** All income arising to an association is exempt from inclusion in income, except the following categories of income, provided it satisfies the specified conditions:

(a) income under the head 'income from house property';

(b) income received for rendering any specific service; and

(c) income by way of interest or dividends derived from its investments.

(ii) ***Conditions to be satisfied -*** Associations or institutions must.

- established in India
- have as its object the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture, or any other profession specified by the Central Government
- apply their income or accumulate it solely to their objects of establishment
- be approved by the Central Government by general or special order

(iii) ***Withdrawal of Approval -*** However, approval once granted may be withdrawn if, at any time, the Government is satisfied that –

(a) the association or institution has not applied or accumulated its income in accordance with the provisions of the section;

(b) the activities of the association or institution are not being carried out in accordance with the conditions imposed on the basis of which the approval was granted.

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

(14) Income of institutions established by armed forces [Section 10(23AA)]

Any income received by any person on behalf of any regimental fund or non-public fund established by the armed forces of the Union for the welfare of the past and present members of such forces or their dependents is exempt from tax.

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

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(15) Income of Funds established for welfare of employees of which such employees are members [Section 10(23AAA)]

A number of funds have been established for the welfare of employees or their dependents in which such employees themselves are members. These funds are utilised to provide benefits to a member on his superannuation, or in the event of his illness or illness of any member of his family, or to the dependents of a member on his death.

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

- the fund should have been established for the welfare of employees or their dependents and for such purposes as may be notified by the Board
- such employees should be the members of the fund
- the fund should apply its income, or accumulate it for application, wholly and exclusively to the objects for which it is established
- the fund shall invest its fund and contributions made by the employees and other sums received by it in any one mode specified u/s11(5)
- the fund should be approved by the Principal Commissioner or Commissioner in accordance with the prescribed rules

The approval shall have effect for such assessment year or years not exceeding three assessment years as may be specified in the order of approval.

(16) Income of Fund set up by Life Insurance Corporation or other insurer under pension scheme [Section 10(23AAB)]

Any income of a fund set up by the LIC of India or any other insurer under a pension scheme to which contribution is made by any person for receiving pensions from such fund. Such scheme should be approved by the Controller of Insurance or the IRDA.

(17) Income of institution established for development of Khadi and Village industries [Section 10(23B)]

(i) ***Institutions eligible for exemption -*** The exemption will be available to institutions constituted as public charitable trusts or registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India existing solely for development of khadi and village industries or both and not for purpose of profit.

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

(iii) ***Conditions for availing exemption -***

(a) The institution has to apply its income or accumulate it for application, solely for the development of khadi or village industries or both.

(b) They should be approved by the Khadi and Village Industries Commission.

The approval shall have effect for such assessment year or years not exceeding three assessment years as may be specified in the order of approval.

(iv) ***Withdrawal of Approval -*** The approval once granted may be withdrawn if at any time the Government is satisfied that –

(a) the institution has not applied or accumulated its income in accordance with the provisions of the section;

(b) the activities of the institution are not being carried out in accordance with the conditions imposed on the basis of which the approval was granted.

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

(18) Income of authorities set up under State or Provincial Act for promotion of Khadi and Village Industries [Section 10(23BB)]

Income derived by authorities similar to Khadi and Village Industries Board, set up under any State or Provincial Act, for the development of Khadi or Village industries in the state is exempt from tax.

(19) Income of authorities set up to administer religious or charitable trusts [Section 10(23BBA)

Income of bodies or authorities established, constituted or appointed under any enactment for the administration of 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 purpose is exempt from tax.

However, it is clarified that this section does not provide exemption in respect of income of any trust, endowment or society.

(20) Income of the IRDA [Section 10(23BBE)]

Any income of the IRDA established under section 3(1) of the IRDA Act, 1999 will be exempt.

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(21) Income of Central Electricity Regulatory Commission [Section 10(23BBG)]

This clause provides exemption to any income of Central Electricity Regulatory Commission constituted under section 76(1) of the Electricity Act, 2003.

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

Any income of the Prasar Bharati (Broadcasting Corporation of India) established under section 3(1) of the Prasar Bharati (Broadcasting Corporation of India) Act, 1990 is exempt.

(23) Income of certain funds or institutions [Section 10(23C)]

An exemption is available in respect of any income received by any person on behalf of the following entities:

(i) the Prime Minister's National Relief Fund or the Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES FUND) [Sub-clause (i)];

(ii) the Prime Minister's Fund (Promotion of Folk Art) [Sub-clause (ii)];

(iii) the Prime Minister's Aid to Students Fund [Sub-clause (iii)];

(iv) the National Foundation for Communal Harmony [Sub-clause (iiia)];

(v) the Swachh Bharat Kosh, set up by the Central Government [Sub-clause (iiiaa)];

(vi) the Clean Ganga Fund, set up by the Central Government [Sub-clause (iiiaaa)];

(vii) the Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund in respect of any State or Union Territory [Sub-clause (iiiaaaa)];

(viii) any university or other educational institution exists solely for educational purposes and not for profit which is **wholly or substantially financed by the Government** [Sub-clause (iiiab)];

(ix) any hospital or other institution **wholly or substantially financed by the Government**, which exists solely for philanthropic purposes and not for profit and which exists for the reception and treatment of persons suffering from illness or mental defectiveness or reception and treatment of convalescing persons or persons requiring medical attention or rehabilitation [Sub-clause (iiiac)];

> If the government grant to a university or other educational institution, hospital or other institution during the relevant previous year exceeds **50%** of the total receipts (including any voluntary contributions), of such university or other educational institution, hospital or other institution, as the case may be, then, such university or other educational institution, hospital or other institution shall be considered as being **substantially financed by the Government** for that previous year.

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(x) any university or other educational institution existing solely for educational purposes and not for profit and aggregate annual receipts of the person from such university(ies) or educational institution(s) do not exceed ₹ 5 crore [Sub-clause (iiiad)];

(xi) any hospital or other institution which exists solely for philanthropic purposes and not for profit and which exists for the reception and treatment of persons suffering from illness or mental defectiveness or reception and treatment of convalescing persons or persons requiring medical attention or rehabilitation if aggregate annual receipts of the person from such hospital(s) or institution(s) do not exceed ₹ 5 crore [Sub-clause (iiiae)];

If the person has receipts from university or universities or educational institution or institutions as referred to in (x) as well as from hospital or hospitals or institution or institutions as referred to in (xi), the exemptions would not apply, if the aggregate of annual receipts of the person from such university or universities or educational institution or institutions or hospital or hospitals or institution or institutions, exceed ₹ 5 crore;

(xii) any other fund or institution for charitable purposes approved by the Principal Commissioner or Commissioner of Income-tax, having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States [Sub-clause (iv)];

(xiii) any trust (including any other legal obligation) or institution wholly for public religious or wholly for public religious and charitable purposes approved by the Principal Commissioner or Commissioner of Income-tax [Sub-clause (v)];

(xiv) any university or other educational institutions which exists solely for educational purposes and not for profit approved by Principal Commissioner or Commissioner of Income-tax [Sub-clause (vi)];

(xv) any hospital or other institution which exists solely for philanthropic purposes and not for profit and which exists for the reception and treatment of persons suffering from illness or mental defectiveness or reception and treatment of convalescing persons or persons requiring medical attention or rehabilitation approved by the Principal Commissioner or Commissioner of Income-tax [Sub-clause (via)].

Refer to "Chapter 10: Assessment of Trusts or institutions, Political Parties and Other special entities, wherein the provisions of section 10(23C) are discussed in detail.

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

(i) The income of a Mutual Fund registered under the SEBI Act and regulations made thereunder or other Mutual Fund set up by a public sector bank/public financial institution/RBI subject to certain conditions is exempt.

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

Note: *The income of a mutual fund registered under the SEBI will be exempt without any conditions laid down by the Central Government. In the case of other mutual funds, the conditions will be applicable*.

(25) Income of Investor Protection Funds set up by recognised stock exchanges in India [Section 10(23EA)]

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

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

(26) Specified income of Investor Protection Fund set up by commodity exchanges [Section 10(23EC)]

(i) This clause exempts 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, by notification in the Official Gazette, specify in this behalf.

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

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

(27) Income of Investor Protection Fund set up by depositories [Section 10(23ED)]

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

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(ii) In line with section 10(23EA), section 10(23ED) provides that any income, by way of contribution from a depository, of such Investor Protection Fund set up by a depository in accordance with the regulations made under the SEBI Act, 1992 and the Depositories Act, 1996, will not be included while computing the total income of such investor protection fund.

(iii) The Central Government, would, by way of notification in the Official Gazette, specify such investor protection funds set up by depositories in accordance with the SEBI and depositories regulations.

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

(v) "Depository" means a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under section 12(1A) of the SEBI Act, 1992.

(28) Specified income of Core Settlement Guarantee Fund (SGF) set up by a recognized Clearing Corporation [Section 10(23EE)]

(i) The Clearing Corporations are required, under the provisions of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 notified by SEBI, to establish a fund, called Core Settlement Guarantee Fund (Core SGF) for each segment of each recognized stock exchange to guarantee the settlement of trades executed in respective segments of the exchange.

(ii) Under sections 10(23EA), 10(23EC) and 10(23ED), any income by way of contributions received from recognized stock exchanges or commodity exchanges and the members thereof or depositories of Investor Protection Fund set up by such recognised stock exchanges in India, or by commodity exchanges in India or by such depository, respectively, as the Central Government may notify in this behalf, are exempt from taxation.

(iii) On parallel lines, section 10(23EE) exempts any specified income of such Core SGF set up by a recognized clearing corporation in accordance with the regulations, notified by the Central Government.

(iv) 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 the specified person, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is shared, and shall accordingly be chargeable to income-tax.

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(v) **Meaning of certain terms:**

Terms	Meaning
Regulations	Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 made under the SEBI Act, 1992 and Securities Contracts (Regulation) Act, 1956 or International Financial Services Centres Authority (Market Infrastructure Institutions) Regulations, 2021 made under the IFSC Act, 2019.
Recognised clearing corporation	Meaning assigned as per Regulation 2(1)(o) of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 made under the SEBI Act, 1992 and Securities Contracts (Regulation) Act, 1956 i.e., "Recognised clearing corporation" means a clearing corporation which is recognised by the SEBI under section 4 read with section 8A of the SEBI Act, 1992 or under regulation 2(1)(n) of the International Financial Services Centres Authority (Market Infrastructure Institutions) Regulations, 2021 made under the IFSC Act, 2019 i.e., a clearing corporation in an IFSC recognised by the Authority;
Specified Income	(a) the income by way of contribution received from specified persons; (b) the income by way of penalties imposed by the recognised clearing corporation and credited to the Core Settlement Guarantee Fund; or (c) the income from investment made by the Fund.
Specified person	(a) any recognised clearing corporation which establishes and maintains the Core Settlement Guarantee Fund; (b) any recognised stock exchange being shareholder in such recognised clearing corporation or a contributor to Core Settlement Guarantee Fund; and (c) any clearing member contributing to the Core Settlement Guarantee Fund.

(29) Income of trade unions [Section 10(24)]

Any income under the heads “Income from house property” and “Income from other sources” of a registered trade union, within the meaning of the Trade Unions Act, 1926, formed primarily for the purpose of regulating the relations between workmen and the employers or between workmen and workmen will be exempt.

Further, this exemption is also available in respect of an association of such registered unions.

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(30) Income of provident funds, superannuation funds, gratuity funds [Section 10(25)]

Any income of a recognized provident fund (RPF) and of an approved superannuation fund or gratuity fund is exempt from tax and the trustees of these funds would not be liable to pay tax thereon.

The exemption also applies to -

(i) the interest on securities which are held by or are the property of statutory provident fund (SPF) governed by the Provident Funds Act, 1925;

(ii) the capital gains of the fund, if any, arising to it from the sale, exchange or transfer of such securities;

(iii) any income received by the Board of Trustees constituted

- under Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 and
- under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952,

on behalf of the Deposit Linked Insurance Funds established under these respective Acts.

(31) Income of Employees' State Insurance (ESI) Fund [Section 10(25A)]

The contributions paid under ESI Act, 1948 and all other moneys received on behalf of the ESI Corporation are paid into a Fund called the ESI Fund. This Fund is held and administered by the ESI Corporation. The amounts lying in the Fund are to be expended for payment of cash benefits and provision of medical treatment and attendance to insured persons and their families, establishment and maintenance of hospitals and dispensaries, etc. Any income of the ESI Fund is exempted from income-tax.

(32) Income of member of a scheduled tribe [Section 10(26)]

A member of a Scheduled Tribe residing in -

(i) any area specified in the Constitution i.e., The North Cachar Hills District, The Karbi Anglong District, The Bodoland Territorial Areas District, Khasi Hills District, Jaintia Hills District or The Garo Hills District or

(ii) in the States of Manipur, Tripura, Arunachal Pradesh, Mizoram and Nagaland, or

(iii) in Ladakh

is exempt from tax on his income arising or accruing -

(a) from any source in the areas or States aforesaid.

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

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(33) Specified income of a Sikkimese Individual [Section 10(26AAA)]

The following income, which accrues or arises to a Sikkimese individual, would be exempt from income-tax –

(a) income from any source in the State of Sikkim; or

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

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

Any income of an Agricultural Produce Market Committee or Board constituted under any law for the time being in force for the purpose of regulating the marketing of agricultural produce would be exempt.

(35) Income of a corporation etc. for the promotion of interests of members of Scheduled Casts or Tribes or backward classes or any two or all of them [Section 10(26B)]

Any income of a corporation (established by a Central, State or Provincial Act) or other body, institution or association (wholly financed by Government) formed for promotion of the interests of the members of Scheduled Castes or Tribes or backward classes or of any two or all of them is exempt from tax.

(36) Income of corporations established to protect interests of minority community [Section 10(26BB)]

Any income of a corporation established by the Central Government or any State Government for promoting the interests of the members of a minority community will be exempt from income tax.

Section 80G also provides tax relief in respect of donations made to these corporations.

(37) Income of corporation established for welfare and economic upliftment of ex-servicemen [Section 10(26BBB)]

Any income of a corporation established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen, being citizens of India, would be exempt from income-tax.

(38) Income of a co-operative society for promoting interest of members of Scheduled castes or Tribes or both [Section 10(27)]

Any income of a co-operative society formed for promoting the interests of the members of either the scheduled castes or scheduled tribes or both will be exempted from being included in the total income of the society.

Conditions:

(i) The membership of the co-operative society should consist of only other co-operative societies formed for similar purposes, and

(ii) The finances of the society shall be provided by the Government and such other societies.

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(39) Incomes of certain bodies like Coffee/Tea/Rubber Board, etc. [Section 10(29A)]

Under this clause, any income accruing or arising to the following bodies is exempt from tax:

(i) the Coffee Board constituted under section 4 of the Coffee Act, 1942,

(ii) the Rubber Board constituted under section 4(1) of the Rubber Board Act, 1947,

(iii) the Tea Board established under section 4 of the Tea Act, 1953,

(iv) the Tobacco Board constituted under the Tobacco Board Act, 1975,

(v) the Marine Products Export Development Authority established under section 4 of the Marine Products Export Development Authority Act, 1972,

(vi) the Agricultural and Processed Food Products Export Development Authority established under section 4 of the Agricultural and Processed Food Products Export Development Act, 1985,

(vii) the Spices Board constituted under section 3(1) of the Spices Board Act, 1986,

(viii) the Coir Board established under the Coir Industry Act, 1953.

(40) Tea board subsidy [Section 10(30)]

The amount of any subsidy received by any assessee engaged in the business of growing and manufacturing tea in India through or from the Tea Board will be wholly exempt from tax.

Conditions:

(i) The subsidy should have been received under any scheme for replantation or replacement of the bushes or for rejuvenation or consolidation of areas used for cultivation of tea, as notified by the Central Government.

(ii) The assessee should furnish a certificate from the Tea Board, as to the amount of subsidy received by him during the previous year, to the Assessing Officer.

(41) Other subsidies [Section 10(31)]

Amount of any subsidy received by an assessee engaged in the business of growing and manufacturing rubber, coffee, cardamom or other specified commodity in India, as notified by the Central Government, will be wholly exempt from tax.

Conditions:

(i) The subsidies should have been received from or through the Rubber Board, Coffee Board, Spices Board or any other Board in respect of any other commodity under any scheme for replantation or replacement of rubber, coffee, cardamom or other plants or for rejuvenation or consolidation of areas used for cultivation of all such commodities.

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(ii) The assessee should furnish a certificate from the Board, as to the amount of subsidy received by him during the previous year, to the Assessing Officer.

(42) Specified income arising from any international sporting event in India [Section 10(39)]

(i) This clause exempts income of the nature and to the extent, arising from any international sporting event in India, to the person or persons notified by the Central Government in the Official Gazette.

(ii) Such international sporting event should -

(a) be approved by the international body regulating the international sport relating to such event;

(b) have participation by more than two countries;

(c) be notified by the Central Government in the Official Gazette for the purposes of this clause.

(43) Certain grants etc. received by a subsidiary from its Indian holding company engaged in the business of generation or transmission or distribution of power [Section 10(40)]

(i) This clause exempts income of any subsidiary company by way of grant or otherwise received from an Indian company, being its holding company engaged in the business of generation or transmission or distribution of power.

(ii) The receipt of such income should be for settlement of dues in connection with reconstruction or revival of an existing business of power generation.

(iii) The exemption under this clause is available if the reconstruction or revival of any existing business of power generation is by way of transfer of such business to the Indian company notified under section 80-IA(4)(v)(a).

(44) Specified income of certain bodies or authorities [Section 10(42)]

(i) This clause exempts income, of the nature and to the extent, arising to a body or authority, notified by the Central Government.

(ii) Such body or authority should have been established or constituted or appointed -

(a) under a treaty or an agreement entered into by the Central Government with two or more countries or a convention signed by the Central Government;

(b) not for the purposes of profit.

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(45) Income received by any person on behalf of NPS Trust [Section 10(44)]

The NPS Trust would exempt from the applicability of –

(i) income-tax on any income received by any person for, or on behalf of, the NPS Trust [Section 10(44)]; and

(ii) securities transaction tax on all purchases and sales of equity and derivatives by the NPS Trust.

Further, the NPS Trust shall receive all income without any deduction of tax at source. [Section 197A(1E)].

Thus, the NPS Trust, which was set up to manage the assets and funds under the New Pension System in the interest of the beneficiaries, would enjoy a "pass-through status".

(46) Specified income of notified entities not engaged in commercial activity [Section 10(46)]

(i) Section 10(46) provides for exemption of income arising to a body or authority or Board or Trust or Commission, other than those covered under section 10(46A), or a class thereof, the nature and extent of which is to be specified by the Central Government.

(ii) For availing the benefit of exemption under this clause, the body or authority or Board or Trust or Commission or a class thereof should be established or constituted by or under a Central, State or Provincial Act or constituted by the Central or State Government with the object of regulating or administering an activity for the benefit of the general public.

(iii) Further, the body or authority or Board or Trust or Commission should –

(a) not be engaged in any commercial activity; and

(b) be notified by the Central Government in this behalf.

(47) Any income of notified entities established or constituted under a Central Act or State Act [Section 10(46A)]

(i) Section 10(46A) provides for exemption of any income arising to a body or authority or Board or Trust or Commission, not being a company.

(ii) For availing the benefit of exemption under this clause, the body or authority or Board or Trust or Commission, not being a company, should be established or constituted by or under a Central Act or State Act with one or more of the following purposes -

- dealing with and satisfying the need for housing accommodation;
- planning, development or improvement of cities, towns and villages;

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- regulating, or regulating and developing, any activity for the benefit of the general public; or
- regulating any matter, for the benefit of the general public, arising out of the objects for which it has been created.

(iii) Further, the body or authority or Board or Trust or Commission, not being a company should be notified by the Central Government in this behalf.

(48) Any income of National Credit Guarantee Trustee Company Ltd, credit guarantee fund or credit guarantee Fund Trust [Section 10(46B)]

Section 10(46B) provides exemption of any income accruing or arising to

- National Credit Guarantee Trustee Company Ltd., being a company established and wholly financed by the Central Government for the purpose of operating credit guarantee funds established and wholly financed by the Central Government;
- Credit guarantee funds established and wholly financed by the Central Government and managed by the National Credit Guarantee Trustee Company Ltd.;
- Credit Guarantee Fund Trust for Micro and Small Enterprises, being a trust created by the Government of India and the Small Industries Development Bank of India established under Small Industries Development Bank of India Act, 1989.

(49) Income of notified infrastructure debt funds [Section 10(47)]

In order to give a fillip to infrastructure and encourage inflow of long-term foreign funds to this sector, the Central Government to notify infrastructure debt funds to be set up in accordance with the prescribed guidelines, the income of which would be exempt from tax.

(50) Certain income of Indian Strategic Petroleum Reserves Limited [Section 10(48C)]

Any income accruing or arising to the Indian Strategic Petroleum Reserves Limited, being a wholly owned subsidiary of the Oil Industry Development Board under the Ministry of Petroleum and Natural Gas, as a result of arrangement for replenishment of crude oil stored in its storage facility in pursuance of directions of the Central Government would be exempt.

However, exemption would not available in respect of an arrangement, if the crude oil is not replenished in the storage facility within three years from the end of the financial year in which the crude oil was removed from the storage facility for the first time.

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(51) Income of an institution established for financing infrastructure and development [Section 10(48D)]

Any income accruing or arising to an institution established for financing the infrastructure and development, set up under an Act of Parliament and notified by the Central Government, for 10 consecutive assessment years beginning from the assessment year relevant to the previous year in which such institution is set up would be exempt.

(52) Income of a developmental financing institution licensed by RBI [Section 10(48E)]

Any income accruing or arising to a developmental financing institution, licensed by the RBI under an Act of Parliament referred to in section 10(48D) and notified by the Central Government, for 5 consecutive assessment years beginning from the assessment year relevant to the previous year in which the developmental financing institution is set up would be exempt.

Further, the Central Government may, by issuing notification, extend the exemption for a further period, not exceeding 5 more consecutive assessment year, subject to fulfillment of such conditions as may be specified in the said notification.

Students should carefully note that all the items under section 10 listed above are either wholly or partially exempt from taxation and the exempt portion is not even includible in the total income of the person concerned.

2.3 RESTRICTIONS ON ALLOWABILITY OF EXPENDITURE [SECTION 14A]

As per section 14A, notwithstanding anything to the contrary, expenditure incurred in relation to any exempt income is not allowed as a deduction while computing income under any of the five heads of income [Sub-section (1)].

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

The method for determining expenditure in relation to exempt income is to be prescribed by the CBDT for the purpose of disallowance of such expenditure under section 14A. Such method should be adopted by the Assessing Officer in the following cases –

(i) if he is not satisfied with the correctness of the claim of the assessee, having regard to the accounts of the assessee. [Sub-section (2)]; or

(ii) where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of total income [Sub-section (3)].

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

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

(a) the correctness of the claim of expenditure by the assessee; or

(b) the claim made by the assessee that no expenditure has been incurred

in relation to exempt income for such previous year, he shall determine the amount of expenditure in relation to such income in the manner provided hereunder –

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

(i) the amount of expenditure directly relating to income which does not form part of total income;

(ii) an amount equal to 1% of the annual average of the monthly averages of the opening and closing balances of the value of investment, income from which does not form part of total income.

However, the amount referred to in clause (i) and clause (ii) shall not exceed the total expenditure claimed by the assessee.

Expenditure incurred during a previous year (say, P.Y. 2025-26) in relation to exempt income would be disallowed while computing total income of that previous year by applying the provisions of section 14A even though such exempt income has not accrued or arisen or has not been received during the said previous year.

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

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

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

The above position is clarified by the usage of the term "includible" in the heading to section 14A [Expenditure incurred in relation to income not includible in total income] and Rule 8D [Method for determining amount of expenditure in relation to income not includible in total income], which

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indicates that it is not necessary that exempt income should necessarily be included in a particular year's income, for triggering disallowance. Also, the terminology used in section 14A is "income under the Act" and not "income of the year", which again indicates that it is not material that the assessee should have earned such income during the financial year under consideration.

In effect, section 14A read along with Rule 8D provides for disallowance of expenditure even where the taxpayer has not earned any exempt income in a particular year.

SIGNIFICANT SELECT CASES

CASE LAW	
CIT v. Kribhco (2012) 349 ITR 0618 (Delhi)	
Issue	**Analysis & Decision**
Is section 14A applicable in respect of deductions, which are permissible and allowed under Chapter VI-A?	Deductions under Chapter VIA are different from the exclusions/exemptions provided under Chapter III. Section 14A is applicable only if an income is not included in the total income as per the provisions of Chapter III of the Income-tax Act, 1961. Therefore, **no disallowance can be made u/s 14A in respect of income included in total income in respect of which deduction is allowable u/s 80C to 80U.**

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TEST YOUR KNOWLEDGE

Questions

1. *Examine with reasons, based on the provisions of the Act, as to chargeability of the following receipts to tax in the assessment year 2026-27:*

   (i) Rent of ₹ 60,000 charged from tenants occupying houses constructed on the land situated in India and used for agricultural purposes. The tenants, working in the nearby industrial area, occupy these houses for their own residential purposes.

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

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

2. *Mr. Akash, a resident Indian, earns income of ₹ 22 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in India and ₹ 30 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in Malaysia during the A.Y.2026-27. What would be his business income, assuming he has no other business?*

3. *Mr. Ram, a resident Indian, earns income of ₹ 15 lakhs from sale of coffee grown and cured in India during the A.Y.2026-27. His friend, Mr. Shyam, a resident Indian, earns income of ₹ 25 lakhs from sale of coffee grown, cured, roasted and grounded by him in India during the A.Y.2026-27. What would be the business income chargeable to tax in India of Mr. Ram and Mr. Shyam?*

Answers

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

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

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

2. Since Mr. Akash is a resident, his global income would be taxable in India. Income of ₹ 30 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in Malaysia would be his business income since it is from rubber plants grown **outside India**. 35% income from sale of rubber manufactured from latex obtained from rubber plants grown by him in India would be taxable as business income and balance 65% would be exempt as agricultural income.

Business income = 35% of ₹ 22 lakhs + ₹ 30 lakhs = ₹ 37.70 lakhs

3. In case of income derived from the sale of coffee grown and cured by the seller in India, 25% income on such sale is taxable as business income. In case of income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, 40% income on such sale is taxable as business income.

Business income of Mr. Ram = 25% of ₹ 15 lakhs = ₹ 3.75 lakhs

Business income of Mr. Shyam = 40% of ₹ 25 lakhs = ₹ 10 lakhs

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CHAPTER 3

PROFITS AND GAINS OF BUSINESS OR PROFESSION

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **examine** whether a particular income would be chargeable to tax under the head "Profits and gains of business or profession" by analysing the provisions of section 28;
- **comprehend** the "Income Computation and Disclosure Standards" (ICDSs) and analyse and apply these standards to determine the income chargeable to tax under this head;
- **analyse and apply** the provisions of sections 30 to 37 to determine whether any particular expenditure /payment would be admissible as deduction while computing income under this head;
- **analyse and apply** the conditions contained under sections 40 & 40A to determine whether a particular expenditure/ payment would be admissible/ inadmissible as deduction while computing income under this head;
- **analyse and apply** the provisions of section 43B to allow/ disallow expenditures specified therein, in respect of which deduction is admissible only on actual payment;
- **examine** when certain receipts are deemed as income chargeable to tax under this head;

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- **appreciate** the provisions of section 44AA relating to maintenance of books of account and identify the assessees, who are compulsorily required to maintain books of account;
- **appreciate** the provisions of section 44AB, listing the circumstances when an assessee is compulsorily required to get the books of account audited under Income-tax Act, 1961;
- **examine** the presumptive tax provisions contained in sections 44AD, 44ADA & 44AE to determine whether an assessee engaged in a business, profession or plying, hiring or leasing goods carriages can opt for such presumptive taxation schemes;
- **compute** income under this head applying the charging and deeming provisions, allowing the permissible deductions and disallowing the impermissible deductions.

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CHAPTER OVERVIEW

3.1 MEANING OF 'BUSINESS' AND 'PROFESSION'

The income chargeable to tax under this head is in respect of the profits and gains of **any business or profession**, carried on by an assessee at any time during the previous year.

Business	Profession
The term **"business"** has been defined in section 2(13) to "include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture".	The term **"profession"** has not been defined in the Act. It means an occupation requiring some degree of learning. The term 'profession' includes vocation as well [Section 2(36)]
• Thus, a painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect and even an astrologer are persons who can be said to be carrying on a profession but not business.	

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- It is, however, not material whether a person is carrying on a 'business' or 'profession' or 'vocation' since for purposes of assessment, profits from all these sources are treated and taxed alike (except in case of tax audit and presumptive income provisions, where the rates and threshold limits are different for business and profession).
- Business necessarily means a continuous exercise of an activity with a profit motive; nevertheless, profit from a single venture in the nature of trade may also be treated as business.

Meaning of 'Profits'

(1) **Profits in cash or in kind:** Profits may be realised in money or in money's worth, i.e., in cash or in kind. Where profit is realised in any form other than cash, the cash equivalent of the receipt on the date of receipt must be taken as the value of the income received in kind.

(2) **Capital receipts:** Capital receipts are not generally to be taken into account while computing profits under this head.

(3) **Voluntary Receipts:** Payment voluntarily made by persons who were under no obligation to pay anything at all would be income in the hands of the recipient, if they were received in the course of a business or by the exercise of a profession or vocation. Thus, any amount paid to a lawyer by a person who was not a client, but who has been benefited by the lawyer's professional service to another would be assessable as the lawyer's income.

(4) **Application of the gains of trade is immaterial:** Gains made even for the benefit of the community by a public body would be liable to tax. To attract the provisions of section 28, it is necessary that the business, profession or vocation should be carried on at least for some time during the accounting year but not necessarily throughout that year and not necessarily by the assessee-owner personally, but it should be under his direction and control.

(5) **Income from distinct businesses:** The profits of each distinct business must be computed separately but the tax chargeable under this section is not on the separate income of every distinct business but on the aggregate profits of all the business carried on by the assessee.

(6) **Computation of profits:** Profits should be computed after deducting the losses and expenses incurred for earning the income in the regular course of the business, profession, or vocation unless the loss or expenses is expressly or by necessary implication, disallowed by the Act. The charge is not on the gross receipts but on the profits and gains.

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(7) **Legality of income:** The illegality of a business, profession or vocation does not exempt its profits from tax. The revenue is not concerned with the taint of illegality in the income or its source. Thus, income tax is not restricted in its application to lawful business only.

However, expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law would not be allowable as deduction while computing profits of such business.

3.2 INCOME CHARGEABLE UNDER THIS HEAD [SECTION 28]

The various items of income chargeable to tax as income under the head 'profits and gains of business or profession' are as under:

(1) **Income from business, profession or vocation:** Income arising to any person by way of profits and gains from the business or profession carried on by him at any time during the previous year.

However, income from letting out of a residential house or a part of the house by the owner is chargeable to tax under the head "Income from house property" and not under the head "Profits and gains of business or profession".

(2) **Any compensation or other payment due to or received by:**

(i) Any person, by whatever name called, managing the whole or substantially the whole of -

(a) the affairs of an Indian company or

(b) the affairs in India of any other company

at or in connection with the termination of his management or office or the modification of any of the terms and conditions relating thereto;

(ii) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto;

(iii) any person, for or in connection with the vesting in the Government or in any corporation owned or controlled by the Government under any law for the time being in force, of the management of any property or business;

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(iv) any person, by whatever name called, at or in connection with the termination or modification of the terms and conditions, of any contract relating to his business.

(3) Income from specific services performed for its members by a trade, professional or business: Income derived by any trade, professional or similar associations from specific services rendered by them to their members. It may be noted that this forms an exception to the general principle of mutuality governing the assessment of income of mutual associations such as chambers of commerce, stock brokers' associations etc.

As a result, a trade, professional or similar association performing specific services for its members is to be deemed as carrying on business in respect of these services and on that assumption the income arising therefrom is to be subjected to tax. For this purpose, it is not necessary that the income received by the association should definitely or directly be related to these services.

(4) Incentives received or receivable by assessee carrying on export business:

(i) Profit on sale of import entitlements: Profits on sale of a licence granted under the Imports (Control) Order, 1955[1] made under the Imports and Exports (Control) Act, 1947[2].

(ii) Cash assistance against exports under any scheme of GoI: Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India.

(iii) Customs duty or excise duty re-paid or repayable as drawback: Any Customs duty or Excise duty drawback repaid or repayable to any person against export under the Customs and Central Excise Duties Drawback Rules, 1971[3].

(iv) Profit on transfer of Duty Entitlement Pass Book Scheme or Duty Free Replenishment Certificate: Any profit on the transfer of the Duty Entitlement Pass Book Scheme[4] or Duty Free Replenishment Certificate, being Duty Remission Scheme, under the export and import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992.

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[1] Now Foreign Trade (Exemption from application of Rules in certain cases) Order, 1993
[2] Now Foreign Trade (Development and Regulation) Act, 1992
[3] Now Customs and Central Excise Duties Drawback Rules, 2017
[4] The pre-export DEPB scheme was abolished with effect from 1 April 2000. After several extensions through the years, the post-export scheme was phased out on 30 September 2011 and thereafter DEPB items were incorporated into the Duty Drawback Schedule with effect from 1 October 2011

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(5) Value of any benefit or perquisite: The value of any benefit or perquisite arising from business or the exercise of any profession, whether –

- convertible into money or not or
- in cash or in kind or partly in cash and partly in kind

Example:

If a company provides rent free residential accommodation to a lawyer in consideration of professional services rendered by him to the company, the value of such accommodation would be assessable in the hands of the said lawyer as his income under the head "Profits and gains or business or profession".

(6) Sum due to, or received by, a partner of a firm: Any interest, salary, bonus, commission or remuneration, by whatever name called, due to or received by a partner of a firm from such firm will be deemed to be income from business. However, where any interest, salary, bonus, commission or remuneration by whatever name called, or any part thereof has not been allowed to be deducted under section 40(b), in the computation of the income of the firm the income to be taxed shall be adjusted to the extent of the amount disallowed.

Example:

Suppose a firm pays interest at 20% p.a. simple interest to a partner. The allowable rate of interest is 12% p.a. Hence, the excess 8% paid will be disallowed in the hands of the firm. Since the excess interest has suffered tax in the hands of the firm due to disallowance, the same will not be taxed in the hands of the partner. However, the interest allowed to the extent of 12% p.a. in the hands of firm will be taxed in the hands of partner.

Exemption of share income of a partner [Section 10(2A)]

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

(7) Any sum whether received or receivable, in cash or kind, under an agreement

(i) **for not carrying out any activity** in relation to any business or profession; or

However, the following sums received or receivable would not be chargeable to tax under the head "profits and gains from business or profession":

(a) 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

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right to carry on any business or profession, which is chargeable under the head "Capital gains".

(b) 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.

(ii) **for 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 for services.

Meaning of certain terms

Term	Meaning
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;
Service	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.

(8) Any sum received under a Keyman insurance policy: Any sum received by the assessee, as an employer, under a Keyman insurance policy including the sum allocated by way of bonus on such policy will be taxable as income from business.

(9) Fair market value of inventory on its conversion as capital asset: Fair market value of inventory on the date of its conversion or treatment as capital asset, determined in the prescribed manner, would be chargeable to tax as business income[5].

[5] Rule 11UAB inserted to prescribe the manner of determination of fair market value (FMV) of the inventory on the date of conversion. For detailed reading of 11UAB of the Income-tax Rules, 1962, refer to Annexure 2 at the end of this module.

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(10) Sum received on account of capital asset referred under section 35AD: Any sum received or receivable, in cash or kind, on account of any capital asset (in respect of which whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD) being demolished, destroyed, discarded or transferred.

Note - *Where a specified person, being a partner of a firm or member of other AOP/BoI, receives during the P.Y. any stock in trade from a specified entity, being a firm or other AOP/BoI in connection with the dissolution or reconstitution of such specified entity, then, the specified entity would be deemed to have transferred such stock in trade to the specified person in the year in which it is received by the specified person. Profit and gains arising from such deemed transfer would be deemed to be the income of such specified entity in the same year of receipt by specified person and chargeable to income-tax under the "Profit and gains of business or profession"* ***[Section 9B]. For detailed discussion on section 9B, refer Chapter 4 – "Capital Gains".***

3.3 SPECULATION BUSINESS

Explanation 2 to section 28 specifically provides that where an assessee carries on speculative business, that business of the assessee must be deemed as distinct and separate from any other business. This becomes necessary because section 73 provides that losses in speculation business unlike other business, cannot be set-off against the profits of any business other than a speculation business.

Likewise, a loss in speculation business carried forward to a subsequent year can be set-off only against the profit and gains of any speculative business in the subsequent year. Profits and losses resulting from speculative transaction must, therefore, be treated as separate and distinct from profits and gains of business and profession from any other business.

(1) Meaning of Speculative Transaction

"Speculative transaction" means a transaction in which a contract for the purchase or sales of any commodity including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips [Section 43(5)].

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

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However, this deeming provision does not apply to the following companies –

(i) A company whose gross total income consists of mainly income chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources";

(ii) A company, the principal business of which is –

(a) the business of trading in shares; or

(b) the business of banking; or

(c) the granting of loans and advances.

Accordingly, if these companies as mentioned above carry on the business of purchase and sale of shares of other companies, they would not be deemed to be carrying on speculation business [*Explanation* to section 73].

(2) Transaction not deemed to be speculative transaction

The following forms of transactions shall not be deemed to be speculative transaction:

(i) **Hedging contract in respect of raw materials or merchandise:** A contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for the actual delivery of goods manufactured by him or merchandise sold by him; or

(ii) **Hedging contract in respect of stocks and shares:** A contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuation; or

(iii) **Forward contract:** A contract entered into by a member of a forward market or stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as a member; or

(iv) **Trading in derivatives:** An eligible transaction carried out in respect of trading in derivatives in a recognized stock exchange.

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Meaning of certain terms

Term	Meaning
Eligible transaction	Any transaction,– (A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange; and (B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note, the unique client identity number allotted under any Act referred to in (A) above and permanent account number;

(v) **Trading in commodity derivatives:** An eligible transaction in respect of trading in commodity derivatives carried out in a recognised stock exchange, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013.

However, the requirement of chargeability of commodities transaction tax is not applicable in respect of trading in agricultural commodity derivatives.

Meaning of certain terms

Term	Meaning
Eligible transaction	Any transaction,– (A) carried out electronically on screen-based systems through a member or an intermediary registered under the bye-laws, rules and regulations of the recognised stock exchange for trading in commodity derivative in accordance with the provisions of the Forward Contracts (Regulation) Act, 1952 and the rules, regulations or bye-laws made or directions issued under that Act on a recognised stock exchange; and (B) which is supported by a time stamped contract note issued by such member or an intermediary to every client indicating in the contract note, the unique client identity number allotted under the Act, rules, regulations or bye-laws referred to in (A) above, unique trade number and permanent account number

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3.4 METHOD OF ACCOUNTING

(1) Method of Accounting (Section 145)

Section 145 of the Income-tax Act, 1961 provides for the method of accounting. Section 145(1) requires income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" to be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee, subject to the provisions of section 145(2).

However, as per section 145B, certain income would be taxable in the following manner:

(i) interest received by an assessee on compensation or on enhanced compensation, shall be deemed to be the income of the year in which it is received. [Such income is taxable under the head "Income from other sources"]

(ii) the claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.

(iii) income referred to in section 2(24)(xviii) i.e., assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement, by whatever name called, by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee shall be deemed to be the income of the previous year in which it is received, if not charged to income tax for any earlier previous year.

Under section 145(2), the Central Government is empowered to notify in the Official Gazette from time to time, **income computation and disclosure standards (ICDSs)** to be followed by any class of assessees or in respect of any class of income.

Accordingly, the Central Government has, vide *Notification No. S.O.3079(E) dated 29.9.2016*, notified ten ICDSs to be applicable from A.Y.2017-18.

The notified ICDSs have to be followed by all assessees (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB) following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profits and gains of business or profession" or "Income from other sources", from A.Y.2017-18.

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The ten notified ICDSs are:

ICDS I	:	Accounting Policies
ICDS II	:	Valuation of Inventories
ICDS III	:	Construction Contracts
ICDS IV	:	Revenue Recognition
ICDS V	:	Tangible Fixed Assets
ICDS VI	:	The Effects of Changes in Foreign Exchange Rates
ICDS VII	:	Government Grants
ICDS VIII	:	Securities
ICDS IX	:	Borrowing Costs
ICDS X	:	Provisions, Contingent Liabilities and Contingent Assets

Cardinal features of Notified ICDSs

(1) **Applicability:** All the notified ICDSs are applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and **not** for the purpose of maintenance of books of accounts. This is stated in the Preamble at the beginning of each ICDS.

(2) **Position in case of conflict with the Income-tax Act, 1961:** In the case of conflict between the provisions of the Income-tax Act, 1961 and the notified ICDSs, the provisions of the Act shall prevail to that extent. This is also stated in the Preamble at the beginning of each ICDS.

(3) **Scope Paragraph:** Each of the ten notified ICDSs has a scope paragraph explaining what exactly the ICDS deals with. In some standards, the scope paragraph also specifies what the ICDS does not deal with.

(4) **Transitional Provisions:** All ICDSs (except ICDS VIII on Securities) contain transitional provisions to facilitate first time adoption and prevent any tax leakage or any double taxation.

(5) **Disclosure Requirements:** All ICDSs (except ICDS VI on Effects of changes in foreign exchange rates and ICDS VIII on Securities) contain specific disclosure requirements. The last paragraph(s) of these ICDSs is on disclosure.

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Salient Features of the notified ICDSs

ICDS I: Accounting Policies

- This ICDS deals with significant accounting policies.
- While it recognizes the fundamental accounting assumptions of going concern, consistency and accrual, it does not recognize the concepts of "materiality" and "prudence" in selection of accounting policies.
- Treatment and presentation of transactions have to be governed by their substance and not merely by the legal form.
- Marked to market loss or an expected loss is not to be recognized unless recognition of such loss is in accordance with the provisions of any other ICDS.

ICDS II: Valuation of Inventories

- "Inventories" has been defined to mean assets held for –
  - sale in the ordinary course of business;
  - in the process of production for such sale;
  - in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- This ICDS requires inventory to be valued at cost or net realizable value, whichever is lower.
- This ICDS requires disclosure of the accounting policies adopted in measuring inventories including the cost formulae used and the total carrying amount of inventories and its classification appropriate to a person.

ICDS III: Construction Contracts

- This ICDS is required to be applied in determination of income for a construction contract of a contractor.
- It recognizes percentage of completion method (POCM) for recognizing contract revenue and contract costs associated with a construction contract.
- However, contract revenue and contract costs associated with the construction contract, which commenced on or before 31.3.2016 but not completed by the said date, can be recognised based on the method regularly followed by the person prior to the previous year 2016-17.

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- This ICDS also contains certain disclosure requirements, like the amount of contract revenue recognized as revenue in the period, the methods used to determine the stage of completion of contracts in progress etc.

ICDS IV: Revenue Recognition

- This ICDS deals with the bases for recognition of revenue arising in the course of the ordinary activities of a person from –
  - the sale of goods;
  - the rendering of services;
  - the use by others of the person's resources yielding interest, royalties or dividends.
- It does not, however, deal with the aspects of revenue recognition which are dealt with by other ICDSs.
- "Revenue" is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of a person from the sale of goods, from the rendering of services, or from the use by others of the person's resources yielding interest, royalties or dividends. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.
- This ICDS also contains a provision wherein the revenue from sale of goods could be recognized when there is reasonable certainty of its ultimate collection.
- Revenue from service transactions is required to be recognized on the basis of percentage completion method. However, revenue can be recognised on a straight line basis over a specific period of time, when services are provided by an indeterminate number of acts over such period.
- Revenue from service contracts with duration of not more than 90 days to be recognised when the rendering of services under that contract is completed or substantially completed.
- This ICDS contains certain disclosure requirements, like the amount of revenue from service transactions recognized as revenue during the previous year, the method used to determine the stage of completion of service transactions in progress, information relating to service transactions in progress at the end of the previous year etc.

ICDS V: Tangible Fixed Assets

- This ICDS deals with the treatment of tangible fixed assets.

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- "Tangible fixed asset" is an asset being land, building, machinery, plant or furniture held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.
- This ICDS provides the components of actual cost of such assets and valuation of such assets in special cases.
- The fair value of a tangible fixed asset acquired in exchange for shares or other securities or another asset shall be its actual cost.
- The ICDS also provides that depreciation on such assets and income arising on transfer of such assets shall be computed in accordance with the provisions of the Income-tax Act, 1961.
- The ICDS also contains disclosure requirements in respect of such assets, like the description of asset or block of assets, rate of depreciation, actual cost or written down value, as the case may be, additions or deductions during the year with dates, depreciation allowable and written down value at the end of the year.

ICDS VI: The Effects of changes in foreign exchange rates

- This ICDS deals with treatment of transactions in foreign currencies, translating the financial statements of foreign operations and treatment of foreign currency transactions in the nature of forward exchange contracts.
- This ICDS requires exchange differences arising on settlement of monetary items or conversion thereof at last day of the previous year to be recognized as income or as expense in that previous year.
- In respect of non-monetary items, exchange differences arising on conversion thereof as at the last day of the previous year shall not be recognized as income or as expense in that previous year.
- At the last day of each previous year, foreign currency monetary items shall be converted into reporting currency by applying the closing rate.
- Non-monetary items in a foreign currency shall be converted into reporting currency by using the exchange rate at the date of the transaction.
- Non-monetary item being inventory which is carried at net realisable value denominated in a foreign currency shall be reported using the exchange rate that existed when such value was determined.

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- The ICDS contains provisions for initial recognition, conversion at the last date of the previous year and recognition of exchange differences. These provisions shall be subject to the provisions of section 43A of the Income-tax Act, 1961 and Rule 115 of the Income-tax Rules, 1962.

ICDS VII: Government Grants

- This ICDS deals with the treatment of government grants. It recognizes that government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks etc.
- This ICDS does not deal with Government assistance other than in the form of Government grants and Government participation in the ownership of the enterprise.
- It requires recognition of Government Grants when there is a reasonable assurance that the person shall comply with the conditions attached to them and the grants shall be received. However, it also states that recognition of Government grant shall not be postponed beyond the date of actual receipt.
- This ICDS requires Government grants relatable to depreciable fixed assets to be reduced from actual cost/WDV. It further provides that where the Government grant is not directly relatable to the asset acquired, then a pro-rata reduction of the amount of grant should be made in the same proportion as such asset bears to all assets with reference to which the Government grant is so received.
- The standard requires grants relating to non-depreciable fixed assets to be recognized as income over the same period over which the cost of meeting such obligations is charged to income.
- The standard also requires Government grants receivable as compensation for expenses or losses incurred in a previous financial year or for the purpose of giving immediate financial support to the person with no further related costs to be recognized as income of the period in which it is receivable.
- All other Government Grants have to be recognized as income over the periods necessary to match them with the related costs which they are intended to compensate.
- The standard contains certain disclosure requirements, like nature and extent of Government grants recognized during the previous year as income, nature and extent of Government grants not recognized during the previous year as income and reasons thereof etc.

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ICDS VIII: Securities

- This ICDS deals with securities.
- There are two parts. Part A deals with securities held as stock-in-trade. Part B deals with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 or the Companies Act, 2013.
- It requires securities (referred to in Part A) to be recognized at actual cost on acquisition, which shall comprise of its purchase price and include acquisition charges like brokerage, fees, tax, duty or cess.
- The actual cost of a security (referred to in Part A) acquired in exchange for other securities or another asset shall be the fair value of the security so acquired.
- Subsequently, at the end of any previous year, securities held as stock-in-trade have to be valued at actual cost initially recognized or net realizable value at the end of that previous year, whichever is lower.
- It goes on to provide that such comparison of actual cost initially recognized and net realizable value has to be done category-wise and not for each individual security.
- Where actual cost initially recognized cannot be ascertained by reference to specific identification, use of "First in First Out" method or "Weighted Average Cost" formula is permitted for subsequent measurement of securities held as stock-in-trade (other than unlisted or unquoted securities) referred to in Part A.
- Securities referred to in Part B to be classified, recognised and measured in accordance with the extant guidelines issued by the RBI in this regard. Any claim for deduction in excess of the said guidelines will not be taken into account. To this extent, the provisions of ICDS VI on the effect of changes in foreign exchange rates relating to forward exchange contracts would not apply.

ICDS IX: Borrowing Costs

- This ICDS deals with the treatment of borrowing costs. It does not deal with the actual or imputed cost of owners' equity and preference share capital.
- It requires borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalized as part of the cost of that asset. Other borrowing costs have to be recognized in accordance with the provisions of the Act.
- Qualifying asset has been defined to mean –
  - land, building, machinery, plant or furniture, being tangible assets;

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- know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
- inventories that require a period of twelve months or more to bring them to a saleable condition.

► This ICDS requires capitalization of specific borrowing costs and general borrowing costs.

► This ICDS provides the formula for capitalization of borrowing costs when funds are borrowed generally and used for the purpose of acquisition, construction or production of a qualifying asset.

► For the purpose of computing the amount of borrowing costs to be capitalized, in a case where the funds are not borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, a qualifying asset would be such asset that necessarily require a period of 12 months or more for its acquisition, construction or production.

► It also provides as to when capitalization of borrowing costs would commence and cease.

► It requires disclosure of the accounting policy adopted for borrowing costs and the amount of borrowing costs capitalized during the year.

ICDS X: Provisions, Contingent Liabilities and Contingent Assets

► This ICDS deals with Provisions, Contingent Liabilities and Contingent Assets. However, it does not deal with provisions, contingent liabilities and contingent assets –

- resulting from financial instruments,
- resulting from executory contracts,
- arising in insurance business from contracts with policyholders and
- covered by another ICDS.

It also does not deal with recognition of revenue dealt with by ICDS on Revenue Recognition.

► The ICDS specifies the conditions for recognition of a provision, namely, existence of a present obligation as a result of a past event, reasonable certainty that outflow of resources embodying economic benefits will be required to settle the obligation and making a reliable estimate of the amount of the obligation.

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- It provides that a person shall not recognize a contingent liability or a contingent asset. However, it requires contingent assets to be assessed continually. When it becomes reasonably certain that inflow of economic benefit will arise, the asset and related income have to be recognized in the previous year in which the change occurs.
- It contains provisions for measurement and review of a provision and asset and related income.
- It also provides that a provision shall be used only for expenditures for which the provision was originally recognized.
- The ICDS also contains specific disclosure requirements in respect of each class of provision, asset and related income recognized.

Clarification on Income Computation and Disclosure Standards (ICDS) notified under section 145(2) of the Income-tax Act, 1961 – [Circular No. 10/2017, dated 23-03-2017]

After notification of ICDS, it was brought to the notice of the CBDT by the stakeholders that certain provisions of ICDS may require amendment/ clarification for proper implementation. The matter was referred to an expert committee. The Committee after duly consulting the stakeholders in this regard has recommended a two-fold approach for the smooth implementation of ICDS i.e., amendment to the provisions of ICDS in respect of certain issues and issuance of clarifications by way of FAQs for the rest of issues.

The CBDT has, vide this circular, issued the following clarification on other issues:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Question 10: *Which ICDS would govern derivative instruments?*

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

Question 12: *Since there is no specific scope exclusion for real estate developers and Build - Operate-Transfer (BOT) projects from ICDS IV on Revenue Recognition, please clarify whether*

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ICDS-III and ICDS-IV should be applied by real estate developers and BOT operators. Also, whether ICDS is applicable for leases.

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

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

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

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

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

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

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

Question 18: *If the taxpayer sells a security on 30th April 2025. The interest payment dates are December and June. The actual date of receipt of interest is on 30th June 2025 but the interest on accrual basis has been accounted as income on 31st March 2025. Whether the taxpayer shall be permitted to claim deduction of such interest i.e. offered to tax but not received while computing the capital gain?*

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

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

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

Security	Category	Cost	NRV	Lower of cost or NRV	ICDS Value
A	Share	100	75	75	
B	Share	120	150	120	
C	Share	140	120	120	
D	Share	200	190	190	
	Total	**560**	**535**	**505**	**535**
E	Debt Security	150	160	150	
F	Debt Security	105	90	90	
G	Debt Security	125	135	125	
H	Debt Security	220	230	220	
	Total	**600**	**615**	**585**	**600**
Securities Total		**1160**	**1150**	**1090**	**1135**

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

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

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

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

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

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

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

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

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

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

Notified ICDS and Corresponding AS and IND AS

ICDS	Corresponding AS	Corresponding IND AS
ICDS I - Accounting Policies	AS – 1 Disclosure of Accounting Policies	Ind AS 1 - Presentation of Financial Statements
ICDS II - Valuation of Inventories	AS - 2 Valuation of Inventories (Revised)	Ind AS – 2 Inventories
ICDS III - Construction Contracts	AS 7 – Construction Contracts	Ind AS 115 – Revenue from Contracts with Customers
ICDS IV - Revenue Recognition	AS 9 – Revenue Recognition	Ind AS 115 - Revenue from Contracts with Customers
ICDS V - Tangible Fixed Assets	AS 10 – Property, Plant and Equipment (Revised)	Ind AS 16 Property, Plant and Equipment
ICDS VI - The Effects of changes in foreign exchange rates	AS 11 – The Effects of Changes in Foreign Exchange Rates (Revised)	Ind AS 21 – The Effects of Changes in Foreign Exchange Rates

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ICDS VII - Government Grants	AS 12 - Accounting for Government Grants	Ind AS 20 – Accounting for Government Grants and Disclosure of Government Assistance
ICDS VIII - Securities	AS 13 - Accounting for Investments (Revised)	Ind AS 40 – Investment Property, Ind AS109 – Financial Instruments, Ind AS 105 – Non-current Assets held for Sale and Discontinued Operations
ICDS IX - Borrowing Costs	AS 16 - Borrowing Costs	Ind AS 23 - Borrowing Costs
ICDS X - Provisions, Contingent Liabilities and Contingent Assets	AS 29 - Provisions, Contingent Liabilities and Contingent Assets (Revised)	Ind AS 37 - Provisions, Contingent Liabilities and Contingent Assets

Student may note that the text of the notified ICDSs has been given as Annexure 1 at the end of this Module.

(2) Method of Accounting in certain cases [Section 145A]

The Delhi High Court had, in the case of *Chamber of Tax Consultants & Anr vs. Union of India & Ors,* held that certain provisions of ICDSs are *ultra vires* the Act, since they seek to overcome binding judicial precedents and are, thus, contrary to the law settled by the Supreme Court and various High Courts.

In order to bring certainty in the wake of such judicial pronouncements section 36(1)(xviii), section 40A(13), section 43AA, section 43CB, section 145A and section 145B have been inserted in the Income-tax Act, 1961 with effect from A.Y.2017-18.

Section 145A provides that for the purpose of determining the income chargeable under the head "Profits and gains of business or profession":

(a) the valuation of inventory shall be made at lower of actual cost or net realizable value computed in accordance with notified ICDS i.e., ICDS II "Valuation of inventories".

(b) the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation.

(c) inventory being securities not listed or listed but not quoted on a recognised stock exchange with regularity from time to time shall be valued at actual cost initially recognised in accordance with the notified ICDS i.e., ICDS VIII: Securities.

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(d) inventory being listed and quoted securities, shall be valued at lower of actual cost or net realisable value in accordance with notified ICDS i.e., ICDS VIII: Securities. Such comparison of actual cost and net realisable value shall be done category-wise.

However, inventories being securities held by a scheduled bank or public financial institution shall be valued in accordance with notified ICDS after taking into account the extant guidelines issued by the RBI.

Note: Student may note that section 36(1)(xviii), section 40A(13), section 43AA, section 43CB, and section 145B are discussed at respective places in this chapter.

3.5 COMPUTATION OF PROFITS AND GAINS FROM BUSINESS OR PROFESSION [SECTION 29]

According to section 29, the profits and gains of any business or profession are to be computed in accordance with the provisions contained in sections 30 to 43D. It must, however, be remembered that in addition to the specific allowances and deductions stated in sections 30 to 36, the Act further permits allowance of items of expenses under the residuary section 37(1), which extends the allowance to items of business expenditure not covered by sections 30 to 36, where these are allowable according to accepted commercial practices.

3.6 ADMISSIBLE DEDUCTIONS

(1) Rent, rates, taxes, repairs and insurance for buildings [Section 30]

Section 30 allows deduction in respect of the rent, rates, taxes, repairs and insurance of buildings used by the assessee for the purpose of his business or profession.

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- **Where the premises are occupied by the assessee as a tenant,** the rent paid for such premises and the amount paid on account of cost of repairs, if the assessee has undertaken to bear such repairs to the premises.
- **Occupation of premises by the assessee being the owner:** Where the assessee himself is owner of the premises and occupies them for his business purposes, no notional rent would be allowed under this section. However, where a firm runs its business in the premises owned by one of its partners, the rent payable to the partner will be an allowable deduction to the extent it is reasonable and is not excessive.
- **Repairs of the premises:** Apart from rent, this section allows deductions in respect of expenses incurred on account of repairs to building in case where
  - the assessee is the owner of the building or
  - the assessee is a tenant who has undertaken to bear the cost of repairs to the premises.
  - Even if the assessee occupies the premises otherwise than as a tenant or owner, i.e., as a lessee, licensee or mortgagee with possession, he is entitled to a deduction under the section in respect of current repairs to the premises.
- **Cost of repairs and current repairs of capital nature not to be allowed as deduction [*Explanation* to section 30]:** Amount paid on account of the cost of repairs to the premises occupied by the assessee as a tenant and the amount paid on account of current repairs to the premises occupied by the assessee, otherwise than as a tenant, shall not include any capital nature expenditure. In other words, cost of repairs and current repairs other than of capital nature is allowed as deduction while computing business income.
- **Other expenses**: In addition, deductions are allowed in respect of expenses by way of land revenue, local rates, municipal taxes and insurance in respect of the premises used for the purposes of the business or profession. Cesses, rates and taxes levied by a foreign Government are also allowed.
- **Premises used partly for business and partly for other purposes:** Where the premises are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the premises used for purposes of business will be allowed as a deduction [Section 38(1)].

(2) Repairs and insurance of machinery, plant and furniture [Section 31]

Section 31 allows deduction in respect of the expenses on current repairs and insurance of machinery, plant and furniture in computing the income from business or profession.

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- **Usage of the asset:** In order to claim this deduction, the assets must have been used for purposes of the assessee's own business the profits of which are being taxed i.e., the assessee should be the beneficial owner of the asset.

> The word 'used' has to be read in a wide sense so as to include active as well as passive use. However, insurance and repair charges of assets which are owned by the assessee but have not been used for the business during the previous year would not be allowed as a deduction.
>
> Even if an asset is used for a part of the previous year, the assessee is entitled to the deduction of the full amount of expenses on repair and insurance charges and not merely an amount proportionate to the period of use.

- **Repairs exclude replacement or reconstruction:** The term 'repairs' will include renewal or renovation of an asset but not its replacement or reconstruction.

> The deduction allowable under this section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction under section 37(1).

- **Insurance premium:** The deduction allowable in respect of premia paid for insuring the machinery, plant or furniture is subject to the following conditions:
  - The insurance must be against the risk of damage or destruction of the machinery, plant or furniture.
  - The assets must be used by the assessee for the purposes of his business or profession during the accounting year.
  - The premium should have been actually paid (or payable under the mercantile system of accounting).

  The premium may even take the form of contribution to a trade association which undertakes to indemnify and insure its members against loss; such premium or contribution would be deductible as an allowance under this section even if a part of it is returnable to the insured in certain circumstances.

  It does not matter if the payment of the claim will enure to the benefit of someone other than the owner.

- **Current repairs of capital nature not to be allowed [*Explanation* to section 31]:** Amount paid on account of current repairs of machinery, plant or furniture shall not include any capital nature expenditure. In other words, current repairs other than of capital nature expenditure is allowed as deduction in the computation of income under the head "profits and gains of business or profession".

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- **Machinery, plant and furniture used partly for business and partly for other purposes:** Where the machinery, plant and furniture are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the machinery, plant and furniture used for purposes of business will be allowed as a deduction [Section 38(2)].

(3) Depreciation [Section 32]

(1) ***Charge of depreciation mandatory:*** Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets.

The *Explanation 5* to this section provides that deduction on account of depreciation shall be made compulsorily, whether or not the assessee has claimed the deduction in computing his total income.

(2) ***Conditions to be satisfied for allowance of depreciation:*** The allowance of depreciation which is regulated by Rule 5 of the Income-tax Rules, 1962, is subject to the following conditions which are cumulative in their application.

(a) **The assets in respect of which depreciation is claimed must belong to either of the following categories, namely:**

(1) buildings, machinery, plant or furniture, being tangible assets;

(2) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1st April, 1998, not being goodwill of a business or profession.

- ❖ The depreciation in the value of any other capital assets cannot be claimed as a deduction from the business income.
- ❖ No depreciation is allowable on the cost of the land on which the building is erected because the term 'building' refers only to superstructure but not the land on which it has been erected.
- ❖ The term 'plant' as defined in section 43(3) includes ships, vehicle, books, scientific apparatus and surgical equipments used for the purpose of the business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.

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- However, the word 'plant' does not include an animal, human body or stock-in-trade. Thus, plant includes all goods and chattels, fixed or movable, which a businessman keeps for employment in his business with some degree of durability.
- The expression 'plant' includes part of a plant (e.g., the engine of a vehicle); machinery includes part of machinery and building includes a part of the building.
- Similarly, the term 'buildings' includes within its scope roads, bridges, culverts, wells and tubewells.

(b) **The assets should be actually used by the assessee for purposes of his business or profession during the previous year -** The asset must be put to use at any time during the previous year. The amount of depreciation allowance is not proportionate to the period of use during the previous year. If the asset is acquired during the previous year and is not put to use in the same year, then the depreciation shall not be allowed for such asset but the cost of such asset would be added to the block of asset.

Asset used for less than 180 days - Where any asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, depreciation shall be allowed **at 50 per cent** of the allowable depreciation according to the percentage prescribed in respect of the block of assets comprising such asset. It is significant to note that this restriction applies only to the year of acquisition and not for subsequent years.

> If the assets are not used exclusively for the business of the assessee but for other purposes as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. This is provided in section 38.

Depreciation would be allowable to the owner even in respect of assets which are actually worked or utilized by another person e.g., a lessee or licensee. The deduction on account of depreciation would be allowed under this section to the owner who has let on hire his building, machinery, plant or furniture provided that letting out of such assets is the business of the assessee. In other cases where the letting out of such assets does not constitute the business of the assessee, the deduction on account of depreciation would still be allowable under section 57(ii).

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Use includes passive use in certain circumstances: One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". Depreciation is allowed when asset is actually put to use and not ready to use. However, in certain circumstances, Courts have held that, an asset can be said to be in use even when it is "kept ready for use".

For example, stand by equipment and fire extinguishers can be capitalized if they are 'ready for use''.

Likewise, machinery spares which can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, has to be capitalised. Hence, in such cases, the term "use" embraces both active use and passive use. However, such passive use should also be for business purposes.

(c) **The assessee must own the assets, wholly or partly –** Depreciation is allowed only to the owner of the asset. If the assessee has taken an asset on lease, he, being the lessee, cannot avail depreciation in respect of such asset. On the other hands, the lessor will be entitled to depreciation on such asset as he is the owner.

However, in this connection, students may note that the *Explanation 1* to section 32 provides that where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy, and any capital expenditure is incurred by the assessee for the purposes of the business or profession or the construction of any structure or doing of any work by way of renovation, extension or improvement to the building, then depreciation will be allowed as if the said structure or work is a building owned by the assessee.

Depreciation is allowable not only in respect of assets "wholly" owned by the assessee but also in respect of assets "partly" owned by him and used for the purposes of his business or profession.

(3) ***Computation of Depreciation Allowance:*** Depreciation allowance will be calculated on the following basis:

(i) **Power generation undertakings:** In the case of assets of an undertaking engaged in generation or generation and distribution of power, such percentage on the actual cost to the assessee as prescribed by Rule 5(1A).

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Rule 5(1A) - As per this rule, the depreciation on the abovementioned assets shall be calculated at the percentage of the actual cost at rates specified in Appendix IA of these rules. However, the aggregate depreciation allowed in respect of any asset for different assessment years shall not exceed the actual cost of the asset. It is further provided that such an undertaking as mentioned above has the option of being allowed depreciation on the written down value of such block of assets as are used for its business at rates specified in Appendix I to these rules.

However, such option must be exercised before the due date for furnishing return under section 139(1) for the assessment year relevant to the previous year in which it begins to generate power.

It is further provided that any such option once exercised shall be final and shall apply to all subsequent assessment years.

(ii) **Block of assets:** In the case of any block of assets, at such percentage of the written down value of the block, as may be prescribed by Rule 5(1).

Block of Assets: A "block of assets" is defined in section 2(11), as a group of assets falling within a class of assets comprising—

(a) tangible assets, being buildings, machinery, plant or furniture;

(b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession,

in respect of which the same percentage of depreciation is prescribed.

Block of asset simply means "same class of assets with same rate of depreciation".

Know-how - In this context, 'know-how' means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil-well or other sources of mineral deposits (including searching for discovery or testing of deposits for the winning of access thereto).

(iii) **Additional depreciation on Plant & Machinery [Section 32(1)(iia)]**: Additional depreciation is allowed on any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or

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transmission or distribution of power at the rate of 20% of the actual cost of such machinery or plant.

Asset put to use for less than 180 days: As per second proviso to section 32(1)(ii), 50% of additional depreciation to be allowed, where the plant and machinery is put to use for less than 180 days during the previous year in which such asset is acquired.

Further, third proviso to section 32(1)(ii) also provides that the balance 50% of the additional depreciation on new plant or machinery acquired and used for less than 180 days which has not been allowed in the year of acquisition and installation of such plant or machinery, shall be allowed in the immediately succeeding previous year.

Note - *In case of an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person, additional depreciation is not allowable under the default tax regime under section 115BAC. Additional depreciation would be allowable only if such person has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A) and pays tax as per the optional tax regime under the regular provisions of the Act.*

In case of companies and co-operative societies, additional depreciation would not be allowable if they opted for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, additional depreciation would be allowable only if companies and co-operative societies pay tax under the normal provisions of the Act.

Plant and Machinery not qualifying for additional depreciation

Such additional depreciation will not be available in respect of:

(i) any machinery or plant which, before its installation by the assessee, was used within or outside India by any other person (second hand machinery); or

(ii) any machinery or plant installed in office premises, residential accommodation, or in any guest house; or

(iii) office appliances or road transport vehicles; or

(iv) any machinery or plant, the whole or part of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and Gains of Business or Profession" of any one previous year.

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Note: Additional depreciation is not allowed to power generation undertakings opting Appendix 1A of Rule 5 i.e., depreciation calculated as a percentage on the actual cost to the assessee.

Eligibility for grant of additional depreciation under section 32(1)(iia) in the case of an assessee engaged in printing or printing and publishing [Circular No. 15/2016, dated 19-5-2016]

An assessee, engaged in the business of manufacture or production of an article or thing, is eligible to claim additional depreciation under section 32(1)(iia) in addition to the normal depreciation under section 32(1).

The CBDT has, vide this Circular, clarified that the **business of printing or printing and publishing amounts to manufacture or production** of an article or thing and is, therefore, eligible for additional depreciation under section 32(1)(iia).

(iv) **Terminal depreciation:** In case of a power concern as covered under clause (i) above, if any asset is sold, discarded, demolished or otherwise destroyed in the previous year (other than the previous year in which it is first brought into use) the depreciation amount will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, falls short of the written down value thereof. The depreciation will be available only if the deficiency is actually written off in the books of the assessee.

Example: *Mahapower Ltd. purchased an asset on 20.7.2021. The actual cost of the asset was ₹ 100 lakhs. Mahapower Ltd. claimed depreciation @5% on the actual cost of the asset. WDV of the asset as on 1.4.2025 is ₹ 80 lakhs. On 15.5.2025, Mahapower Ltd. sold the asset for ₹ 55 lakhs. Deduction allowed as terminal depreciation u/s 32(1)(ii) for P.Y. 2025-26 is ₹ 25 lakhs (₹ 80 lakhs - ₹ 55 lakhs) provided the deficiency of ₹ 25 lakhs is actually written off in the books of Mahapower Ltd.*

Meaning of certain terms

Term	Meaning
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.,

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Sold	Includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force. However, it does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company or a transfer of any asset by a banking company to a banking institution in a scheme of amalgamation of such banking company with the banking institution, sanctioned and brought into force by the Central Government.

Clarification regarding treatment of expenditure incurred on purchase of participating interest by the Oil Exploration and Production (E&P) Companies [Circular No. 20/2019, dated 19.08.2019]

Over the life cycle of an Oil & Gas block, Oil Exploration and Production (E&P) companies generally buy ('Farm in') and sell ('Farm out') their participating interests (PI) in the 'Production Sharing Agreement' (PSC). 'Farm-in' expenditure is incurred when an entity in this line of business acquires a PI from another entity(s) in oil/gas block(s) and becomes part of the PSC entered into with the Central Government.

The Government of India (GoI) offers exploration and development rights through global bidding for specified blocks in various rounds under the New Exploration and Licensing Policy (NELP), Hydrocarbon Exploration & Licensing Policy (HELP), Open Acreage Licensing Policy (OALP) etc. by signing the Production Sharing Contracts (PSC's) with the Oil & Gas companies. The successful Oil & Gas Companies are granted license to explore, develop and carry out production operations in Oil & Gas blocks and in India under a PSC with the GoI. Typically, owing to the large investments required and the risks involved, multiple E&P companies execute the PSC with the GoI in which each member has its agreed and defined PI.

It is common international practice for the upstream companies to buy (farm-in) and sale (farm-out) their PI in the PSC or similar contracts with the Government and thereby to share risk, bring new and niche expertise and technologies. In such transactions, PI are treated as interests in rights, licences and obligation under the PSC. Such farm-in purchase price is accounted as an asset as per guidance note issued by the Institute of Chartered Accountants of India. International accounting rules for Oil & Gas followed in Australia, Indonesia, UK etc. also require that such acquisition cost to be capitalized and depreciated. A perusal of the Model PSC's {as per the website of the Director General of Hydrocarbon (DGH)} indicates that participating interests are share in rights and obligation to explore, exploit and sell petroleum under the PSC along with related licences, permits etc. A few of the case-laws on this issue also support treatment of acquisition rights in a PSC as Intangible asset.

In this regard, it is relevant to mention that earlier vide Notification No. G.S.R. 117(E) dated 08.03.1996, in exercise of its powers under section 293A of the Act, Central Government had laid down that the persons with whom it enters into agreement for the association or

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participation in any business consisting of the prospecting for or extraction or production of mineral oils on or after the 1st day of April,1992 -

a) shall not be assessed on the income as association of persons or body of individuals consisting of such persons; but

b) each of the persons referred to above be assessed in respect of his or its share of income, as the case may be, in the same status in which the person enters into the agreement with the Central Government.

Thus, as persons participating in an E&P contract are assessed individually in respect of their share of income, the sum expended on acquisition of whole or part of such 'Participating Interest' in an E&P contract where such acquisition is approved by the Government of India, represents the amount paid to acquire the underlying share (expressed as a percentage) being interests in rights, licences and obligations under the E&P contract.

In view of the above legal position, it is hereby clarified as under:-

i. amount paid for acquiring the 'Participating Interest' shall not be treated either as cost for acquiring the share in partnership or investment for acquisition of a member's interest in an association of persons or body of individuals, rather it would be treated as an amount paid to acquire the underlying assets; and

ii. the amount paid for acquiring the 'Participating Interest', after reducing component of cost attributable to tangible assets for purposes of section 32(1)(i), would be treated as an 'intangible asset' (being a business or commercial right akin to a licence), eligible for claim of depreciation for purposes of section 32(1)(ii).

(4) ***Rates of depreciation:*** All assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are given below:

PART A TANGIBLE ASSETS		
I	**Buildings**	
Block 1.	Buildings which are used mainly for residential purposes except hotels and boarding houses	5%
Block 2.	Buildings which are not used mainly for residential purposes and not covered by Block (1) above and (3) below	10%
Block 3.	Buildings acquired on or after 1st September, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities	40%
Block 4.	Purely temporary erections such as wooden structures	40%

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II	Furniture and Fittings	
Block 1.	Furniture and fittings including electrical fittings ["Electrical fittings" include electrical wiring, switches, sockets, other fittings and fans, etc.]	10%
III	Plant & Machinery	
Block 1.	Motor cars other than those used in a business of running them on hire, acquired during the period from 23.8.2019 to 31.3.2020 and put to use on or before 31.3.2020	30%
Block 2.	Motor cars other than those used in a business of running them on hire, acquired or put to use on or after 1-4-1990 [Other than motor cars mentioned in Block 1 above]	15%
Block 3.	Motor buses, motor lorries and motor taxis used in a business of running them on hire, acquired during the period from 23.8.2019 to 31.3.2020 and put to use on or before 31.3.2020	45%
Block 4.	Motors buses, motor lorries, motor taxis used in the business of running them on hire [Other than motor cars mentioned in Block 4 above]	30%
Block 5.	Moulds used in rubber and plastic goods factories	30%
Block 6.	Aeroplanes, Aeroengines	40%
Block 7.	Specified air pollution control equipments, water pollution control equipments, solid waste control equipment and solid waste recycling and resource recovery systems	40%
Block 8.	Plant & Machinery used in semi-conductor industry covering all Integrated Circuits (ICs) (other than mentioned in Block 7 Above)	30%
Block 9.	Life saving medical equipments	40%
Block 10.	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	40%
Block 11.	Containers made of glass or plastic used as re-fills	40%
Block 12	Energy Saving Devices (as specified)	40%
Block 13.	Renewable Energy Saving Devices (as specified) including the devices specified in (i) to (iii) below	40%
	(i) Electrically operated vehicles including battery powered or fuel-cell powered vehicles	40%

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	(ii) Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014	40%
	(iii) Any special devices including electric generators and pumps running on wind energy installed on or after 1.4.2014	40%
Block 14.	Windmills and any specially designed devices running on windmills installed on or before 31.3.2014 and any special devices including electric generators and pumps running on wind energy installed on or before 31.3.2014	15%
Block 15.	Computers including computer software (See Note below)	40%
Block 16.	Books (annual publications or other than annual publications) owned by assessees carrying on a profession	40%
Block 17.	Books owned by assessees carrying on business in running lending libraries	40%
Block 18.	Plant & machinery (General rate)	15%
IV	**Ships**	
Block 1.	Ocean-going ships	20%
Block 2.	Vessels ordinarily operating on inland waters not covered by Block 3 below	20%
Block 3.	Speed boats operating on inland water	20%

PART B INTANGIBLE ASSETS	
Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature	25%

Note - *Mobile phones and EPABX are* ***not*** *considered as computers and hence, not eligible for 40% rate of depreciation while computer accessories such as UPS, printers' scanners, etc. are eligible for 40% rate of depreciation.*

Note: Students should refer to Income-tax Rules, 1962 for the detailed classification of assets under Rule 5(1) and the rate of depreciation applicable thereto.

(5) Increased rate of depreciation for certain assets [Rule 5(2)]

Any new machinery or plant installed to manufacture or produce any article or thing by using any technology or other know-how developed in or is an article or thing invented in a laboratory owned or financed by the Government or a laboratory owned by a public sector company or a University or an institution recognized by the Secretary, Department of

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Scientific and Industrial Research, Government of India shall be treated as a part of the block of assets qualifying for depreciation @40% of written down value.

Conditions to be fulfilled:

1. The right to use such technology or other know-how or to manufacture or produce such article or thing has been acquired from the owner of such laboratory or any person deriving title from such owner.
2. The return filed by the assessee for any previous year in which the said machinery is acquired, should be accompanied by a certificate from the Secretary, Department of Scientific and Industrial Research, Government of India to the effect that such article or thing is manufactured or produced by using such technology or other know-how developed in such laboratory or such article or thing has been invented in that laboratory.
3. The machinery or plant is not used for the purpose of business of manufacture or production of any article or thing specified in the Eleventh Schedule [The exclusion list comprises of beer, wine and other alcoholic spirits, tobacco and tobacco preparations, cosmetic and toilet preparations, tooth paste, dental cream, tooth powder and soap, confectionery and chocolates, office machines and apparatus, steel furniture etc.].

The depreciation ordinarily allowable to an assessee in respect of any block of assets shall be calculated at the above specified rates on the WDV of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year.

ILLUSTRATION 1

XYZ (P) Ltd., engaged in manufacturing business since 2016, furnishes the following particulars:

	Particulars	*₹*
(1)	*Opening WDV of plant and machinery as on 1.4.2025 (i.e., WDV as on 31.3.2025 after reducing depreciation for P.Y. 2024-25)*	*30,00,000*
(2)	*New plant and machinery purchased and put to use on 08.06.2025*	*20,00,000*
(3)	*New plant and machinery acquired and put to use on 15.12.2025*	*8,00,000*
(4)	*Computer acquired and installed in the office premises on 2.1.2026*	*3,00,000*

Compute the amount of depreciation and additional depreciation as per the Income-tax Act, 1961 for the A.Y. 2026-27. Assume that all the assets were purchased by way of account payee cheque and that the company does not opt for section 115BAA.

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SOLUTION

Computation of depreciation and additional depreciation for A.Y. 2026-27

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

Working Note:

Computation of written down value of Plant & Machinery

Particulars	Plant & Machinery (₹)	Computer (₹)
Written down value as on 1.4.2025	30,00,000	-
Add: Plant & Machinery purchased on 08.6.2025 (put to use for more than 180 days)	20,00,000	-
Add: Plant & Machinery acquired on 15.12.2025 (put to use for less than 180 days)	8,00,000	-
Computer acquired and installed in the office premises (put to use for less than 180 days)	-	3,00,000
Written down value as on 31.03.2026	**58,00,000**	**3,00,000**

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Composition of plant and machinery included in the WDV

Particulars	Plant & Machinery (₹)	Computer (₹)
Plant and machinery put to use for 180 days or more [₹ 30,00,000 (WDV) + ₹ 20,00,000 (purchased on 8.6.2025)]	50,00,000	
Plant and machinery put to use for less than 180 days	8,00,000	-
Computers put to use for less than 180 days	-	3,00,000
	58,00,000	**3,00,000**

Notes:

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

   Therefore, normal depreciation on plant and machinery acquired and put to use on 15.12.2025 and computer acquired and installed on 02.01.2026, is restricted to 50% of 15% and 40%, respectively. The additional depreciation on the said plant and machinery is restricted to ₹ 80,000, being 10% (i.e., 50% of 20%) of ₹ 8 lakh.

2. As per third proviso to section 32(1)(ii), the balance additional depreciation of ₹ 80,000 being 50% of ₹ 1,60,000 (20% of ₹ 8,00,000) would be allowed as deduction in the A.Y.2027-28 if XYZ (P) Ltd. does not opt for the provisions of section 115BAA.

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

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

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

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ILLUSTRATION 2

A newly qualified Chartered Accountant, Mr. Dhaval, commenced practice and has acquired the following assets in his office during F.Y. 2025-26 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y.2026-27. Assume that all the assets were purchased by way of account payee cheque.

Sl. No.	Description	Date of acquisition	Date when put to use	Amount ₹
1.	Computer including computer software	27 Sept., 25	1 Oct., 25	35,000
2.	Computer UPS	2 Oct., 25	8 Oct., 25	8,500
3.	Computer printer	1 Oct., 25	1 Oct., 25	12,500
4.	Books (of which books being annual publications are of ₹ 12,000)	1 Apr., 25	1 Apr., 25	13,000
5.	Office furniture (Acquired from a practising C.A.)	1 Apr., 25	1 Apr., 25	3,00,000
6.	Laptop	26 Sep., 25	8 Oct., 25	43,000

SOLUTION

Computation of depreciation allowable for A.Y.2026-27

Asset		Rate	Depreciation
Block 1	Furniture **[See working note below]**	10%	30,000
Block 2	Plant (Computer including computer software, computer UPS, laptop, computer printer & books)	40%	34,500
Total depreciation allowable			**64,500**

Working Notes:

Computation of depreciation

Block of Assets	₹
Block 1: Furniture – [Rate of depreciation - 10%]	
Put to use for more than 180 days [₹ 3,00,000@10%]	**30,000**
Block 2: Plant [Rate of depreciation - 40%]	
(a) Computer including computer software (put to use for more than 180 days) [₹ 35,000@40%]	14,000

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(b)	Computer UPS (put to use for less than 180 days) [₹ 8,500@20%] **[See Note below]**	1,700
(c)	Computer Printer (put to use for more than 180 days) [₹ 12,500@40%]	5,000
(d)	Laptop (put to use for less than 180 days) [₹ 43,000@20%] **[See Note below]**	8,600
(e)	Books (being annual publications or other than annual publications) (Put to use for more than 180 days) [₹ 13,000@40%]	5,200
		34,500

Note - Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, the deduction on account of depreciation would be restricted to 50% of the prescribed rate. In this case, since Mr. Dhaval commenced his practice in the P.Y.2025-26 and acquired the assets during the same year, the restriction of depreciation to 50% of the prescribed rate would apply to those assets which have been put to use for less than 180 days in that year, namely, laptop and computer UPS.

(6) Depreciation in case of succession of firm/sole proprietary concern by a company or business reorganization, amalgamation or demerger of companies or succession of business otherwise than on death

As per the sixth proviso to section 32(1)(ii), depreciation allowable in the hands of

- predecessor and the successor in case of succession of firm/ sole proprietary concern by a company fulfilling the conditions mentioned in section 47(xiii)/(xiv) or
- predecessor company and successor LLP in case of conversion of a private company or an unlisted public company into an LLP fulfilling the conditions mentioned in section 47(xiiib) or
- predecessor and the successor in case of succession of business otherwise than on death
- amalgamating/ amalgamated company or demerged or resulting company in case of amalgamation or demerger of companies

shall not exceed the amount of depreciation calculated at the prescribed rates as if the succession, business reorganization, amalgamation or demerger had not taken place.

It is also provided that such amount of depreciation shall be apportioned between the two entities **in the ratio of the number of days for which the assets were used by them**.

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ILLUSTRATION 3

Sai Ltd. has a block of assets carrying 15% rate of depreciation, whose WDV as on 31.3.2025 after reducing depreciation for P.Y. 2024-25 was ₹ 40 lakhs. It purchased another asset (second-hand plant and machinery) of the same block on 01.11.2025 for ₹ 14.40 lakhs and put to use on the same day. Sai Ltd. was amalgamated with Shirdi Ltd. with effect from 01.01.2026.

You are required to compute the depreciation allowable to Sai Ltd. & Shirdi Ltd. for the previous year ended on 31.03.2026 assuming that the assets were transferred to Shirdi Ltd. at ₹ 60 lakhs. Also assume that the plant and machinery were purchased by way of account payee cheque.

SOLUTION

Statement showing computation of depreciation allowable to Sai Ltd. & Shirdi Ltd. for A.Y. 2026-27

Particulars		₹
Opening WDV as on 1.4.2025 [i.e., WDV as on 31.3.2025 after reducing depreciation for P.Y. 2024-25		40,00,000
Addition during the P.Y. 2025-26 (used for less than 180 days)		14,40,000
Total		**54,40,000**
Depreciation on ₹ 40,00,000 @15%		6,00,000
Depreciation on ₹ 14,40,000 @7.5%		1,08,000
Total depreciation for the P.Y. 2025-26		**7,08,000**
Apportionment between two companies:		
(a)	Amalgamating company, Sai Ltd.	
	₹ 6,00,000 × 275/365	4,52,055
	₹ 1,08,000 × 61/151	43,629
		4,95,684
(b)	Amalgamated company, Shirdi Ltd.	
	₹ 6,00,000 × 90/365	1,47,945
	₹ 1,08,000 × 90/151	64,371
		2,12,316

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Notes:

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

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

(7) ***Hire purchase****:* In the case of assets under the hire purchase system the allowance for depreciation would under *Circular No. 9 of 1943 R. Dis. No. 27(4) I.T. 43 dated 23-3-1943*, be granted as follows:

- In every case of payment purporting to be for hire purchase, production of the agreement under which the payment is made would be insisted upon by the department.
- Where the effect of an agreement is that the ownership of the asset is at once transferred on the lessee, the transaction should be regarded as one of purchase by instalments and consequently no deduction in respect of the hire amount should be made. This principle will be applicable in a case where the lessor obtains a right to sue for arrears of installments but has no right to recover the asset back from the lessee. Depreciation in such cases should be allowed to the lessee on the hire purchase price determined in accordance with the terms of hire purchase agreement.
- Where the terms of an agreement provide that the asset shall eventually become the property of the hirer or confer on the hirer an option to purchase an asset, the transaction should be regarded as one of hire purchase. In such case, periodical payments made by the hirer should for all tax purposes be regarded as made up of

  (i) the consideration for hirer which will be allowed as a deduction in assessment, and

  (ii) payment on account of the purchase price, to be treated as capital outlay and depreciation being allowed to the lessee on the initial value namely, the amount for which the hired assets would have been sold for cash at the date of the agreement.

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The allowance to be made in respect of the hire should be the amount of the difference between the aggregate amount of the periodical payments under the agreement and the initial value as stated above. The amount of this allowance should be spread over the duration of the agreement evenly. If, however, agreement is terminated either by outright purchase of the asset or by its return to the seller, the deduction should cease as from the date of termination of agreement.

For the purpose of allowing depreciation, an assessee claiming deduction in respect of the assets acquired on hire purchase would be required to furnish a certificate from the seller or any other suitable documentary evidence in respect of the initial value or the cash price of the asset.

In cases where no such certificate or other evidence is furnished the initial value of the assets should be arrived at by computing the present value of the amount payable under the agreement at an appropriate per centum.

For the purpose of allowing depreciation the question whether in a particular case the assessee is the owner of the hired asset or not is to be decided on a consideration of all the facts and circumstances of each case and the terms of the hire purchase agreement. Where the hired asset is originally purchased by the assessee and is registered in his name, the mere fact that the payment of the price is spread over the specified period and is made in installments to suit the needs of the purchaser does not disentitle the assessee from claiming depreciation in respect of the asset, since the assessee would be the real owner although the payment of purchase price is made subsequent to the date of acquisition of the asset itself.

(8) Actual Cost [Section 43(1)]

The expression "actual cost" means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

However, where an assessee incurs any expenditure for acquisition of any asset or part thereof 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 or use of electronic clearing system through a bank account or through such other prescribed electronic mode, exceeds **₹ 10,000**, such expenditure shall not form part of actual cost of such asset [Second proviso to section 43(1)].

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The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

Actual cost in certain special situations *[Explanations* to section 43(1)]

Explanation	Situation	Actual cost of the asset to the assessee
1	Where an asset is used for the purposes of business after it ceases to be used for scientific research related to that business	Actual cost to the assessee as reduced by any deduction allowed u/s 35(1)(iv). **Note -** Actual cost of such asset would be Nil as already 100% deduction would have been claimed u/s 35(1)(iv)
1A	Where inventory is converted or treated as a capital asset and is used for the purpose of business or profession	Fair market value of such inventory as on the date of its conversion into capital asset determined in the prescribed manner
2	Where an asset is acquired by way of gift or inheritance	Actual cost to the previous owner *minus* depreciation allowable to the assessee as if asset was the only asset in the relevant block of assets. Further, any expenditure incurred by the assessee such as expenditure on freight, installation etc. of such asset would also be includible in the actual cost.
3	Where, before the date of its acquisition by the assessee, the asset was at any time used by any other person for the purposes of his business or profession, and the Assessing Officer is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was the reduction of liability of income-tax directly or indirectly to the assessee (by claiming depreciation with reference to an enhanced cost)	An amount which the Assessing Officer may, with the previous approval of the Joint Commissioner, determine, having regard to all the circumstances of the case

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4	Where any asset which had once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter ceased to be his property by reason of transfer or otherwise, is re-acquired by him	(a) the actual cost when he first acquired the asset *minus* depreciation allowable to the assessee as if 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 whichever is less
4A	Where before the date of acquisition by the assessee, say, Mr. A, the assets were at any time used by any other person, say Mr. B, for the purposes of his business or profession and depreciation allowance has been claimed in respect of such assets in the case of Mr. B and such person acquires on lease, hire or otherwise, assets from Mr. A	Actual cost of the transferred assets, in the case of Mr. A, shall be the same as the written down value of the said assets at the time of transfer thereof by Mr. B.
5	Where a building which was previously the property of the assessee is brought into use for the purposes of the business or profession	Actual cost of the building to the assessee, as reduced by an amount equal to the depreciation calculated at the rates in force on that date that would have been allowable had the building been used for the purposes of the business or profession since the date of its acquisition by the assessee
6	When any capital asset is transferred by a holding company to its wholly owned Indian subsidiary company or by a subsidiary company to its 100% holding company, being an Indian company then, the transaction not being regarded as a transfer of a capital asset	The actual cost of the transferred capital asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the capital asset for the purposes of its own business

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7	In a scheme of amalgamation, if any capital asset is transferred by the amalgamating company to the amalgamated Indian company	The actual cost of the transferred capital assets to the amalgamated company will be taken at the same amount as it would have been taken in the case of the amalgamating company had it continued to hold it for the purposes of its own business
7A	In the case of a demerger, where any capital asset is transferred by the demerged company to the resulting Indian company	The actual cost of the transferred asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business. However, the actual cost shall not exceed the WDV of the asset in the hands of the demerged company

Explanation 4A* overrides *Explanation 3

Explanation 3 to section 43(1) deals with a situation where a transfer of any asset is made with the main purpose of reduction of tax liability (by claiming depreciation on enhanced cost), and the Assessing Officer, having satisfied himself about such purpose of transfer with the prior approval of the joint commissioner, may determine the actual cost having regard to all the circumstances of the case.

In the *Explanation 4A*, a *non-obstante* clause has been included to the effect that *Explanation 4A* will have an overriding effect over *Explanation 3*. The result of this is that there is no necessity of finding out whether the main purpose of the transaction is reduction of tax liability. *Explanation 4A* is activated in every situation described above without inquiring about the main purpose.

Example:

A person (say "B") owns an asset and uses it for the purposes of his business or profession. B has claimed depreciation in respect of such asset. The said asset is transferred by B to another person (say "A"). B then acquires the same asset back from A on lease, hire or otherwise. A being the new owner will be entitled to depreciation. In the above situation, the cost of acquisition of the transferred assets in the hands of A shall be the same as the written down value of the said assets at the time of transfer in the hands of B.

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Actual cost in other special situations

(i) **Capitalization of interest paid or payable in connection with acquisition of an asset:** Certain taxpayers have, with a view to obtain more tax benefits and reduce the tax outflow, resorted to the method of capitalising interest paid or payable in connection with acquisition of an asset relatable to the period after such asset is first put to use.

This capitalisation implies inclusion of such interest in the 'Actual Cost' of the asset for the purposes of claiming depreciation under the Income-tax Act, 1961. This was never the legislative intent nor was it in accordance with recognised accounting practices. Therefore, with a view to counter-acting tax avoidance through this method and placing the matter beyond doubt, *Explanation 8* to section 43(1) provides that any amount paid or payable as interest in connection with the acquisition of an asset and relatable to period after asset is first put to use shall not be included and shall be deemed to have never been included in the actual cost of the asset.

(ii) **Amount of duty of excise or additional duty leviable shall be reduced if credit is claimed:** Where an asset is or has been acquired by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944[6] *[Explanation 9*].

(iii) **Subsidy or grant or reimbursement:** Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee.

However, where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee *[Explanation 10*].

[6] Now Central Excise Rules, 2002

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Note: *ICDS VII requires Government grants relatable to depreciable assets to be reduced from actual cost of the asset/WDV of the block of asset. It further provides that where the Government grant is not directly relatable to the asset acquired, then a pro-rata reduction of the amount of grant should be made in the same proportion as such asset bears to all assets with reference to which the Government grant is so received.*

(iv) **Asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India:** Where an asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India and used for the purposes of his business or profession, the actual cost of asset to the assessee shall be the actual cost of the asset to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee *[Explanation 11*].

(v) **Capital asset is acquired under a scheme for corporatization:** Where any capital asset is acquired under a scheme for corporatization of a recognised stock exchange in India approved by the SEBI, the actual cost shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatization *[Explanation 12*].

Note: *Under the scheme of corporatization, recognised stock exchange gets converted into 'Company' from the status of being 'Association of persons' or 'Body of Individuals'.*

(vi) **Capital asset on which deduction is allowable under section 35AD:** *Explanation 13* to section 43(1) provides that the actual cost of any capital asset, on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be nil.

This would be applicable in the case of transfer of asset by the assessee where –

(1) the assessee himself has claimed deduction under section 35AD; or

(2) the previous owner has claimed deduction under section 35AD. This would be applicable where the capital asset is acquired by the assessee by way of –

(a) gift, will or an irrevocable trust;

(b) any distribution on liquidation of the company;

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(c) any distribution of capital assets on total or partial partition of a HUF;

(d) any transfer of a capital asset by a holding company to its 100% subsidiary company, being an Indian company;

(e) any transfer of a capital asset by a subsidiary company to its 100% holding company, being an Indian company;

(f) any transfer of a capital asset by the amalgamating company to an amalgamated company in a scheme of amalgamation, if the amalgamated company is an Indian company;

(g) any transfer of a capital asset by the demerged company to the resulting company in a scheme of demerger, if the resulting company is an Indian company;

(h) any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualization or corporatisation of a recognized stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company (fulfilling the conditions specified);

(i) any transfer of a capital asset or intangible asset by a sole proprietary concern to a company, where the sole proprietary concern is succeeded by a company (fulfilling the conditions specified).

(j) any transfer of a capital asset or intangible asset by a private company or unlisted public company to an LLP as a result of conversion of the company into LLP (fulfilling the conditions prescribed).

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

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(9) *Written down value [Section 43(6)]*

(i) Assets acquired by the assessee during the previous year: In the case of assets acquired by the assessee during the previous year, the written down value means the actual cost to the assessee.

(ii) Assets acquired before the previous year: In the case of assets acquired before the previous year, the written down value would be the actual cost to the assessee *less* the aggregate of all deductions actually allowed in respect of depreciation.

For this purpose, any depreciation carried forward is deemed to be depreciation actually allowed [Section 43(6)(c)(i) read with *Explanation 3*].

(iii) In case of any block of assets: The written down value of any block of assets shall be worked out as under in accordance with section 43(6)(c):

(1)	W.D.V. of the block of assets in immediately preceding previous year (P.Y. 2024-25)	xxx
(2)	*Less:* Depreciation actually allowed in respect of that block of assets in said preceding previous year (i.e., in P.Y. 2024-25)	xxx
Opening balance as on 1st April of the current P.Y. (i.e., on 1.4.2025)		xxx
Increased by		
(3)	Actual cost of assets acquired during the previous year 2025-26, not being on account of acquisition of goodwill of a business or profession	xxx
(4)	Total (1) - (2) + (3)	xxx
Reduced by		
(5)	Money receivable in respect of any asset falling within the block which is sold, discarded, demolished or destroyed during that previous year. However, such amount cannot exceed the amount in (4).	xxx
(6)	**In case of slump sale**, actual cost of the asset (-) amount of depreciation that would have been allowable to the assessee for any assessment year as if the asset was the only asset in the block. However, such amount of reduction cannot exceed the WDV.	xxx
(7)	W.D.V at the end of the year (as on 31.3.2026, on which depreciation is allowable) [(4) – (5) – (6)]	xxx
(8)	Depreciation at the prescribed rate (Rate of Depreciation × WDV arrived at in (7) above)	xxx

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(iv) **Succession to business or profession otherwise than on death:** When in the case of a succession to business or profession otherwise than on death, an assessment is made on the successor under section 170(2), the written down value of an asset or block of assets shall be the amount which would have been taken as the written down value if the assessment had been made directly on the person succeeded to [*Explanation 1* to section 43(6)].

Example: *Tapan succeeded his father's business due to retirement of his father. The WDV of the assets in the hands of Tapan would be the WDV of the assets in the hands of his father.*

(v) **Transfer of block of assets by a holding company to a subsidiary company or *vice versa* or by amalgamating company to amalgamated company:** Where in any previous year any block of assets is transferred by a holding company to its wholly owned Indian subsidiary company or by a subsidiary company to its 100% holding company, being an Indian company or by an amalgamating company to an amalgamated company, the latter being an Indian company, then the actual cost of the block of assets in the case of transferee-company or amalgamated company as the case may be, shall be the written down value of the block of assets as in the case of the transferor company or amalgamating company, as the case may be, for the immediately preceding year as reduced by depreciation actually allowed in relation to the said previous year [*Explanation 2* to section 43(6)].

(vi) **Block of assets is transferred by demerged company to the resulting company:** Where in any previous year any asset forming part of a block of assets is transferred by demerged company to the resulting company, the written down value of the block of assets of the demerged company for the immediately preceding year shall be reduced by the written down value of the assets transferred to the resulting company [*Explanation 2A* to section 43(6)].

(vii) **Block of assets is transferred by a demerged company to the resulting company:** Where any asset forming part of a block of assets is transferred by a demerged company to the resulting company, the written down value of the block of assets in the case of resulting company shall be the written down value of the transferred assets of the demerged company immediately before the demerger [*Explanation 2B* to section 43(6)].

(viii) **Block of assets in the case of the successor LLP:** The actual cost of the block of assets in the case of the successor LLP on conversion of private or unlisted

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company to a LLP and the conditions of clause 47(xiiib) are satisfied, shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion [*Explanation 2C* to section 43(6)].

(ix) Block of assets transferred by a recognised stock exchange in India to a company under a scheme for corporatization: Where any asset forming part of a block of assets is transferred in any previous year by a recognised stock exchange in India to a company under a scheme for corporatisation approved by SEBI, the written down value of the block shall be the written down value of the transferred assets immediately before the transfer [*Explanation 5* to section 43(6)].

(x) Depreciation provided in the books of account deemed to be depreciation actually allowed: Section 32(1)(ii) provides that depreciation shall be allowed at the prescribed percentage on the written down value (WDV) of any block of assets. Section 43(6)(b) provides that written down value in the case of assets acquired before the previous year means the actual cost to the assessee *less* all depreciation actually allowed to him under the Income-tax Act, 1961.

Persons who were exempt from tax were not required to compute their income under the head "Profits and gains of business or profession". However, when the exemption is withdrawn subsequently, such persons became liable to income-tax and hence, were required to compute their income for income-tax purposes. In this regard, a question arises as to the basis on which depreciation is to be allowed under the Income-tax Act, 1961 in respect of assets acquired during the years when the person was exempt from tax.

Explanation 6 to section 43(6) provides that -

(a) the actual cost of an asset has to be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;

(b) the total amount of depreciation on such asset provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under the Income-tax Act, 1961 for the purposes of section 43(6);

(c) the depreciation actually allowed as above has to be adjusted by the amount of depreciation attributable to such revaluation.

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(xi) **Composite Income:** *Explanation 7* provides that in cases of 'composite income', for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee is chargeable under the head "Profits and Gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

Rule 8 prescribes the taxability of income from the manufacture of tea. Under the said rule, income derived from the sale of tea grown and manufactured by seller shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

***Example*:** If the turnover is, say, ₹ 20 lakh, the depreciation ₹ 1 lakh and other expenses ₹ 4 lakh, then, the income would be ₹ 15 lakh. Business income would be ₹ 6 lakh (being 40% of ₹ 15 lakh). In this case, ₹ 1 lakh, being the amount of depreciation would be deemed to have been actually allowed.

The WDV is required to be computed by deducting the full depreciation attributable to composite income i.e. ₹ 1 lakh. *Explanation 7* clarifies this legislative intent.

(xii) **Cases where the Written Down Value reduced to Nil:** The written down value of any block of assets, may be reduced to nil for any of the following reasons:

(a) The moneys receivable by the assessee in regard to the assets sold or otherwise transferred during the previous year together with the amount of scrap value may exceed the written down value at the beginning of the year as increased by the actual cost of any new asset acquired, or

(b) All the assets in the relevant block may be transferred during the year.

(10) Carry forward and set-off of depreciation [Section 32(2)]

Section 32(2) provides for carry forward of unabsorbed depreciation. Where, in any previous year the profits or gains chargeable are not sufficient to give full effect to the depreciation allowance, the unabsorbed depreciation shall be added to the depreciation allowance for the following previous year and shall be deemed to be part of that allowance. If no depreciation allowance is available for that previous year, the unabsorbed depreciation of the earlier previous year shall become the depreciation allowance of that year. The effect of this provision is that the unabsorbed depreciation shall be carried forward indefinitely till it is fully set off.

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***Example**: Profits and gains from business or profession of Mr. X for P.Y. 2024-25, before charging depreciation of ₹ 20 lakhs u/s 32, was ₹ 16 lakhs. In such a case, after setting off the depreciation, the unabsorbed depreciation of P.Y. 2024-25 would be ₹ 4 lakhs. If profits and gains from business or profession for P.Y. 2025-26 before depreciation is ₹ 11 lakhs and depreciation allowance u/s 32 for the said previous year is ₹ 5 lakhs, then, the unabsorbed depreciation of ₹ 4 lakhs for the P.Y. 2024-25 would be added to the depreciation allowance of ₹ 5 lakhs. Consequently, ₹ 9 lakhs would be allowed to be set-off against the profits of ₹ 11 lakhs and the taxable profits for P.Y. 2025-26 would be ₹ 2 lakhs.*

Order of set-off

However, in the order of set-off of losses under different heads of income, effect shall first be given to current year depreciation then brought forward business losses and only then to unabsorbed depreciation.

The provisions in effect are as follows:

- Since the unabsorbed depreciation forms part of the current year's depreciation, it can be set off against any other head of income except "Salaries".
- The unabsorbed depreciation can be carried forward for indefinite number of previous years.
- Set off will be allowed even if the same business to which it relates is no longer in existence in the year in which the set off takes place.

Current depreciation to be deducted first - The Supreme Court, in *CIT v. Mother India Refrigeration (P.) Ltd. [1985] 23 Taxman 8,* has categorically held that current depreciation must be deducted first before deducting the unabsorbed carried forward business losses of the earlier years in giving set off while computing the total income of any particular year.

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ILLUSTRATION 4

Lights and Power Ltd. engaged in the business of generation of power, furnishes the following particulars pertaining to P.Y. 2025-26. Compute the depreciation allowable under section 32 for A.Y.2026-27 and the opening balance of written down value of the block of assets as on 01.04.2026, while computing his income under the head "Profits and gains of business or profession". The company has opted for the depreciation allowance on the basis of written down value. Assume that all the assets were purchased by way of account payee cheque and that the company has not opted for the special tax regimes under section 115BAA or under section 115BAB.

	Particulars	(₹)
1.	Opening Written down value of Plant and Machinery (15% block) as on 01.04.2025 (Purchase value ₹ 8,00,000) [WDV for P.Y. 2024-25 less depreciation for that year]	5,78,000
2.	Purchase of second hand machinery (15% block) on 29.12.2025 for business purpose	2,00,000
3.	Machinery Y (15% block) purchased and installed on 12.07.2025 for the purpose of power generation	8,00,000
4.	Acquired and installed for use a new air pollution control equipment on 31.7.2025	2,50,000
5.	New air conditioner purchased and installed in office premises on 8.9.2025	3,00,000
6.	New machinery Z (15% block) acquired and installed on 23.11.2025 for the purpose of generation of power	3,25,000
7.	Sale value of an old machinery X, sold during the year (Purchase value ₹ 4,80,000, WDV as on 01.04.2025 ₹ 3,46,800)	3,10,000

SOLUTION

Computation of depreciation allowance under section 32 for the A.Y. 2026-27

Particulars	(₹)	Plant and Machinery (15%) (₹)	Plant and Machinery (40%) (₹)
Opening WDV as on 01.04.2025		5,78,000	-
Add: Plant and Machinery acquired during the year			
- Second hand machinery	2,00,000		

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- Machinery Y	8,00,000		
- Air conditioner for office	3,00,000		
- Machinery Z	3,25,000	16,25,000	-
- Air pollution control equipment		-	2,50,000
		22,03,000	2,50,000
Less: Asset sold during the year		3,10,000	Nil
Written down value as on 31.3.2026 before charging depreciation		18,93,000	2,50,000
Normal depreciation			
40% on air pollution control equipment (₹ 2,50,000 x 40%)		-	1,00,000
Depreciation on plant and machinery put to use for less than 180 days@ 7.5% (i.e., 50% of 15%)			
- Second hand machinery (₹ 2,00,000 × 7.5%)	15,000		
- Machinery Z (₹ 3,25,000 × 7.5%)	24,375	39,375	
15% on the balance WDV being put to use for more than 180 days (₹ 13,68,000 × 15%)		2,05,200	
Additional depreciation			
- Machinery Y (₹ 8,00,000 × 20%)	1,60,000		
- Machinery Z (₹ 3,25,000 × 10%, being 50% of 20%)	32,500	1,92,500	**-**
- Air pollution control equipment (₹ 2,50,000× 20%)		**-**	**50,000**
Total depreciation		**4,37,075**	**1,50,000**
WDV as on 1.4.2026 [WDV of P.Y. 2025-26 *less* depreciation for that year]		**14,55,925**	**1,00,000**

Notes:

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

(ii) Additional depreciation is not allowed in respect of second hand machinery and air conditioner installed in office premises.

(iii) The balance 50% additional depreciation in respect of Machinery Z of ₹ 32,500 (10% x ₹ 3,25,000) can be claimed as deduction in the subsequent financial year i.e., F.Y. 2026-27.

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(11) Building, machinery, plant and furniture not exclusively used for business purpose [Section 38(2)]

Where any building, plant and machinery, furniture is not exclusively used for the purposes of business or profession, the deduction on account of expenses on account of current repairs to the premises, insurance premium of the premises, current repairs and insurance premium of machinery, plant and furniture and depreciation in respect of these assets shall be restricted to a fair proportionate part thereof, which the Assessing Officer may determine having regard to the user of such asset for the purposes of the business or profession.

(12) Balancing Charge

Section 41(2) provides for the manner of calculation of the amount which shall be chargeable to income-tax as income of the business of the previous year in which the moneys payable for the building, machinery, plant or furniture on which depreciation has been claimed under section 32(1)(i), i.e., in the case of power undertakings, is sold, discarded, demolished or destroyed. The balancing charge will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, exceeds the written down value. However, the amount of balancing charge should not exceed the difference between the actual cost and the WDV. The tax shall be levied in the year in which the moneys payable become due.

The *Explanation* below section 41(2) makes it clear that where the moneys payable in respect of the building, machinery, plant or furniture referred to in section 41(2) become due in a previous year in which the business, for the purpose of which the building, machinery, plant or furniture was being used, is no longer in existence, these provisions will apply as if the business is in existence in that previous year.

Example: *Mahapower Ltd. purchased an asset on 20.7.2021. The actual cost of the asset was ₹ 100 lakhs. Mahapower Ltd. claimed depreciation @5% on the actual cost of the asset. WDV of the asset as on 1.4.2025 is ₹ 80 lakhs. On 15.5.2025, Mahapower Ltd. sold the asset for ₹ 90 lakhs. The balancing charge of ₹ 10 lakhs (₹ 90 lakhs - ₹ 80 lakhs) would be taxable as income u/s 41(2).*

(4) Tea Development Account/ Coffee Development Account/ Rubber Development Account [Section 33AB]

(i) Eligibility for deduction: This section provides for a deduction in the computation of the taxable profits in the case of an assessee carrying on business of growing and manufacturing tea or coffee or rubber in India.

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(ii) **Quantum of deduction:** It provides that where the assessee has before the expiry of six months from the end of the previous year or before the due date of furnishing the return of income, **whichever is earlier**,

(a) deposited with a National Bank any amount in a special account maintained by the assessee with that Bank in accordance with a scheme approved by Tea Board or Coffee Board or Rubber Board, or

(b) deposited any amount in an account to be known as Deposit Account opened by the assessee in accordance with the scheme framed by the Tea Board or Coffee Board or Rubber Board, as the case may be, (hereinafter referred to as the deposit scheme) with the previous approval of the Central Government,

the assessee shall be allowed a deduction of:

(a) A sum equal to the aggregate of the deposits made or

(b) 40% of the profits of such business (as computed under the head 'Profits and gains of business or profession before making any deduction under this section),

whichever is less.

The above deduction will be allowed before the setting off of brought-forward loss under section 72.

(iii) **No deduction to partner of assessee-firm or member of assessee-AOP/ BOI:** Where the assessee is a firm or any association of persons or any body of individuals, the deduction under this section shall not be allowed in the computation of the income of any partner or member of such firm, AOP or BOI.

(iv) **Non-eligibility of deduction in any other previous year:** Where any deduction in respect of any amount deposited in the special account or Deposit Account has been allowed in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.

(v) **Audit of books of accounts:** This deduction shall not be allowed unless the accounts of such business of the assessee for the previous year have been audited by a chartered accountant before the date specified in section 44AB i.e., one month prior to the due date for furnishing return of income u/s 139(1), and the assessee furnishes by that date the report of such audit in the prescribed form duly signed and verified by such accountant.

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Particulars	Due date of filing of return	Specified Date
Assessees (other than a company) subject to tax audit	31st October of the relevant A.Y.	30th September of the relevant A.Y.
	For A.Y.2026-27, on or before 31st October, 2026	For A.Y.2026-27, on or before 30th September, 2026

However, where the assessee is required by any other law to get his accounts audited it shall be sufficient compliance with the provision of this section if such assessee gets the accounts of such business audited under any such law and furnishes the report of the audit and a further report in the prescribed form under this section.

(vi) **Condition to withdraw the amount from special account or deposit account:** Any amount standing to the credit of the assessee in the special account or deposit account cannot be withdrawn except for the purposes specified in the scheme, or, as the case may be, in the deposit scheme.

The above amount can also be withdrawn in the following circumstances:

(a) Closure of business

(b) Death of an assessee

(c) Partition of HUF

(d) Dissolution of a firm

(e) Liquidation of a company.

(vii) **Amount withdrawn and utilised for purchase of specified assets would be chargeable to tax as business income:** Where the sum standing to the credit of the assessee in the Special account or in the Deposit account is released by the National Bank or is withdrawn by the assessee from the Deposit account and is utilised for the purchase of:

(a) Any machinery or plant installed in any office premises or residential accommodation including a guest house.

(b) Any office appliances (other than computers)

(c) Any machinery or plant, the whole of 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;

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(d) Any new machinery or plant to be installed in an industrial undertaking for the purpose of the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule.

the whole of such amount so utilised will be treated as taxable profits of that year and taxed accordingly.

(viii) Amount withdrawn on the closure of business or dissolution of a firm: Where any amount is withdrawn by the assessee from the special account or deposit account during any previous year on the closure of his business or dissolution of a firm, the whole of such withdrawal shall be deemed to be the profits and gains of business of that previous year and shall be chargeable to tax as the income of that previous year, as if the business had not closed or the firm had not been dissolved.

(ix) Utilisation from scheme for business purpose not available as a deduction: Where any amount standing to the credit of the assessee in the special account or in the deposit account is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme or deposit scheme, such expenditure shall not be allowed in computing the business income.

(x) Consequences of non-utilisation of withdrawn amount: Where any amount in the special account which is released during any previous year by the National Bank or is withdrawn by the assessee from the Deposit Account, for being utilised by the assessee for the purposes of such business and is not utilized in accordance with the scheme or deposit scheme in that year, the unutilised amount shall be deemed to be profits and gains and chargeable to income-tax as the income of that previous year.

However, where such amount is released during the previous year at the closing of the account on the death of the assessee, partition of a HUF or liquidation of a company, the above restriction will not apply.

(xi) Consequences of sale or transfer: Where an 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 8 years from the end of the previous year in which it was acquired, such portion of the cost relatable to the deduction allowed under section 33AB(1) shall be deemed to be profits and gains of business or profession of the previous year in which the asset is sold or transferred and shall be chargeable to income-tax as the income of that previous year.

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Exceptions: Such restriction will not apply in the following cases:

(a) Where the asset is sold or otherwise transferred to Government, local authority, statutory corporation or a Government company.

(b) Where the sale or transfer is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers any asset to the company and the scheme or deposit scheme continues to apply to the company in the same manner as applicable to the firm.

Further, all the properties and liabilities of the firm relating to the business or profession immediately before the succession should become the properties and liabilities of the company and all the shareholders of the company should have been partners of the firm immediately before the succession.

(xii) Power to Central Government for specified period: The Central Government has the power to direct that the deduction allowable under this section shall not be allowed after a specified date.

(xiii) Meaning of National Bank: "National Bank" means the National Bank for Agricultural and Rural Development (NABARD).

(5) Site Restoration Fund [Section 33ABA]

(i) Eligibility for deduction: This section provides for a deduction in the computation of the taxable profits in the case of an assessee carrying on business of prospecting for, or extraction or production, of petroleum or natural gas or both in India and in relation to which the Central Government has entered into an agreement with such assessee for such business.

(ii) Quantum of deduction: It provides that where the assessee has before the end of the previous year -

(a) deposited any sum with the State Bank of India in a special account maintained by the assessee with that bank in accordance with the scheme approved in this behalf by the Government of India in the Ministry of Petroleum and Natural Gas, or

(b) deposited any amount in a Site Restoration Account opened by the assessee for the purposes specified in a scheme framed by the said Ministry (hereinafter referred to as the deposit scheme),

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the assessee shall be entitled to a deduction of —

- a sum equal to the sum deposited; or
- a sum equal to **20%** of its profits (as computed under the head "Profits and gains of business or profession" before making any deduction under this section),

whichever is less.

For this purpose, it is provided that any amount credited in the special account or Site Restoration Account by way of interest shall also be deemed to be a deposit.

The above deduction will be allowed before the setting off of brought-forward loss under section 72.

(iii) **No deduction to partner of assessee-firm or member of assessee-AOP/ BOI:** Where the assessee is a firm or any association of persons or anybody of individuals the deduction under this section shall not be allowed in the computation of the income of any partner or member of such firm, AOP or BOI.

(iv) **Non-eligibility of deduction in any other previous year:** Where any deduction in respect of any amount deposited in the special account or Site Restoration Account has been allowed in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.

(v) **Audit of books of accounts:** This deduction shall not be allowed unless the accounts of such business of the assessee for the previous year have been audited by a chartered accountant before the date specified in section 44AB i.e., one month prior to the due date for furnishing return of income u/s 139(1) and the assessee furnishes by that date the report of such audit in the prescribed form duly signed and verified by such accountant.

However, where the assessee is required by any other law to get his accounts audited it shall be sufficient compliance with the provision of this section if such assessee gets the accounts of such business audited under any such law and furnishes the report of the audit and a further report in the prescribed form under this section.

(vi) **Condition to withdraw the amount -** Any amount standing to the credit in the special account or the Site Restoration Account will not be allowed to be withdrawn except for the purposes specified in the scheme or in the deposit scheme.

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(vii) No deduction: No deduction shall be allowed in respect of any amount utilised for the purchase of the following items:

(a) any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest house;

(b) any office appliances (not being computers);

(c) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head 'Profits and gains of business or profession' of any one previous year;

(d) any new machinery or plant to be installed in an industrial undertaking for the purpose of the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule.

(viii) Withdrawal on closure of account: 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 in no longer in existence, these provisions will apply as if the business is in existence in that previous year.

(ix) Utilisation from scheme for business purpose not available as a deduction: Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme or deposit scheme, such expenditure shall not be allowed in computing the business income.

(x) Consequences of non-utilisation of withdrawn amount: Where any amount in the special account or Site Restoration Account is released in the previous year by the State Bank of India or is withdrawn from the Site Restoration Account for being utilised by the assessee for the purposes of such business and is not utilised in accordance with the scheme or the deposit scheme in that year, the unutilised amount shall be deemed to be profits and gains and chargeable to income-tax as the income of that previous year.

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(xi) **Consequences of sale or transfer -** Where any asset acquired in accordance with the scheme or the deposit scheme is sold or otherwise transferred in any previous year by the assessee to any person at any time before the expiry of 8 years from the end of the previous year in which such assets were acquired, such part of the cost of such asset as is relatable to the deduction allowed under section 33ABA(1) shall be deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and shall accordingly be chargeable to income-tax as the income of that previous year.

Exceptions: This restriction will not apply in the following cases:

(a) Where the asset is sold or otherwise transferred to Government, local authority, statutory corporation or a Government company.

(b) Where the sale or transfer of the asset is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the scheme or the deposit scheme continues to apply to the company in the manner applicable to the firm.

Further, all the properties and liabilities of the firm relating to the business or profession immediately before the succession should become the properties and liabilities of the company and all the shareholders of the company should have been partners of the firm immediately before the succession.

(xii) **Power to Central Government for specified period:** The Central Government has the power to direct that the deduction allowable under this section shall not be allowed after a specified date.

(6) Expenditure on Scientific Research [Section 35]

This section allows a deduction in respect of any expenditure on scientific research related to the business of assessee.

Meaning of certain terms:

Term	Meaning
Scientific research	Activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries [Section 43(4)(i)].
Scientific research expenditure	Expenditure incurred on scientific research would include all expenditure incurred for the prosecution or the provision of facilities for the prosecution of scientific research but does not include any

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	expenditure incurred in the acquisition of rights in or arising out of scientific research.
Scientific research related to a business or a class of business	Scientific research related to a business or a class of business would include (i) any scientific research which may lead to or facilitate an extension of that business or all the business of that class, as the case may be; (ii) any scientific research of a medical nature which has a special relation to the welfare of the workers employed in that business or all the business of that class, as the case may be.

The deduction allowable under this section consists of –

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(I) Incurred by assessee:

(i) Revenue Expenditure: Any revenue expenditure incurred by the assessee on scientific research **related to his business** would be allowed as deduction in the year in which it was incurred. Expenditure incurred within 3 years immediately preceding the commencement of the business on payment of salary to research personnel engaged in scientific research related to his business carried on by the taxpayer or on purchase of material inputs for such scientific research will be allowed as deduction in the year in which the business is commenced. The deduction will be limited to the amount certified by the prescribed authority [Section 35(1)(i)]

(ii) Capital Expenditure: Any expenditure of a capital nature on scientific research **related to the business** carried on by the assessee would be deductible in full in the previous year in which it is incurred [Section 35(1)(iv)].

(a) Capital expenditure prior to commencement of business

The *Explanation 1* to section 35(2)(ia) specifically provides that where any capital expenditure has been incurred prior to the commencement of the business, the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced and will rank for deduction as expenditure for scientific research incurred during the previous year.

Expenditure on land disallowed

No deduction will be allowed in respect of capital expenditure incurred on the acquisition of any land whether the land is acquired as such or as part of any property.

(b) Carry forward of deficiency

Capital expenditure incurred on scientific research which cannot be absorbed by the business profits of the relevant previous year can be carried forward to the immediately succeeding previous year and shall be treated as the allowance for that year. In effect, this means that there is no time bar on the period of carry forward. It shall be accordingly allowable for that previous year against any head of income other than salaries [Section 35(4)].

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(c) No depreciation

Section 35(2)(iv) clarifies that no depreciation will be admissible on any capital asset represented by expenditure which has been allowed as a deduction under section 35 whether in the year in which deduction under section 35 was allowed or in any other previous year.

(d) Sale of asset representing expenditure of capital nature on scientific research

Section 41, *inter alia*, seeks to tax the profits arising on the sale of an asset representing expenditure of a capital nature on scientific research.

Where the asset representing expenditure of a capital nature on scientific research is sold without having been used for other purposes, the provisions of section 41(3) would be attracted. If the proceeds of sale together with the total amount of the deductions made under section 35(1)(iv) exceed the amount of capital expenditure, the excess or the amount of deduction so made, whichever is less, will be charged to tax as income of the business of the previous year in which the sale took place.

In simple words, since amount of deduction under section 35(1)(iv) is equal to the amount of expenditure, lower of amount of sale proceeds or deduction allowed under section 35(1)(iv) will be the charged to tax as income of the business in the previous year in which the asset is sold.

Example - If capital expenditure incurred for scientific research in P.Y. 2024-25 is ₹ 3 lakhs, then deduction u/s 35(1)(iv) would have been ₹ 3 lakhs in that P.Y. If the asset is sold for ₹ 4 lakhs in P.Y.2025-26, ₹ 3 lakhs, being lower of sale proceeds of ₹ 4 lakhs and deduction u/s 35(1)(iv) of ₹ 3 lakhs, would be charged to tax u/s 41(3) in the P.Y. 2025-26, being the year of sale.

Note - *Deduction under section 35(1)(i) and 35(1)(iv) read with section 35(2) would be available to an assessee under the special concessional tax regimes under section 115BAA/115BAB/115BAC/115BAD/115BAE as well as the regular provisions of the Act.*

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(II) Amount contributed or paid to:

(i) Notified approved research association, university, college or other institution: An amount equal to any sum 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.

provided that such university, college, institution or association is approved for this purpose and notified by the Central Government. [Section 35(1)(ii)]

The payments so made to such institutions would be allowable irrespective of whether:

(a) the field of scientific research is related to the assessee's business or not, and

(b) the payment is of a revenue nature or of a capital nature.

Note - *Deduction u/s 35(1)(ii) would be available to an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person only if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A) and pay tax as per the optional tax regime under the regular provisions of the Act.*

In case of companies and co-operative societies, deduction u/s 35(1)(ii) would not be allowable if they opt for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction u/s 35(1)(ii) would be allowable only if they pay tax under the normal provisions of the Act.

(ii) Approved Indian company for scientific research: A sum equal to any amount paid to a company to be used by it for scientific research [Section 35(1)(iia)]

However, such deduction would be available only if;

- the company is registered in India and
- has as its main object the scientific research and development.

Further, it should be approved by the prescribed authority and should fulfill the other prescribed conditions.

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Note - *Deduction u/s 35(1)(iia) would be available to an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person only if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A) and pay tax as per the optional tax regime under the regular provisions of the Act.*

In case of companies and co-operative societies, deduction u/s 35(1)(iia) would not be allowable if they opt for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction u/s 35(1)(iia) would be allowable only if they pay tax under the normal provisions of the Act.

(iii) Approved notified research association, university, college or other institution: A sum equal to any amount paid to

- a research association which has as its object the undertaking of research in social science or statistical research or
- a university, college or other institution to be used for research in any social science or statistical research

provided that they are approved for this purpose and notified by the Central Government. [Section 35(1)(iii)]

Further, it has been clarified that the deduction to which an assessee (i.e. donor) is entitled on account of payment of any sum to a research association or university or college or other institution for scientific research or research in a social science or statistical research or to a company for scientific research, shall not be denied merely on the ground that subsequent to payment of such sum by the assessee, the approval granted to any of the aforesaid entities is withdrawn.

Note - *Deduction u/s 35(1)(iii) would be available to an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person only if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A) and pay tax as per the optional tax regime under the regular provisions of the Act.*

In case of companies and co-operative societies, deduction u/s 35(1)(iii) would not be allowable if they opt for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction u/s 35(1)(iii) would be allowable only if they pay tax under the normal provisions of the Act.

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Approval -

The research association, university, college or other institution for scientific research or research in a social science or statistical research has to make an application in the prescribed form and manner to the Central Government for the purpose of grant of approval, or continuance thereof.

The Central Government before granting approval, call for such documents or information as it thinks necessary in order to satisfy itself about the genuineness of the activities of the research association, university, college or other institution and that Government may also make such inquiries as it may deem necessary.

Every notification in respect of research association, university, college or other institution or Indian company for scientific research issued on or before 1.4.2021 shall be deemed to have been withdrawn unless such association/institution/ university/college/company makes an intimation to the prescribed income-tax authority in the prescribed form. Such intimation has to be made within 3 months from 1.4.2021. Such notification shall be valid for a period of 5 consecutive assessment years beginning with the A.Y. 2022-23 or thereafter subject to the intimation made by the association/institution/university/college/company.

However, where any notification is issued by the Central Government after 29.9.2020, it shall, at any time, have effect for such assessment year(s), but not exceeding 5 assessment years as may be specified in the notification.

Requirements –

Research association, university, college or other institution or Indian company for scientific research has to

(i) prepare prescribed statement for prescribed period and deliver or cause to be delivered such statement to the prescribed income-tax authority or the person authorized by such authority in such form, verified in such manner, setting forth such particulars and within such prescribed time.

Such association/institution/university/college/company may also deliver to the prescribed authority a correction statement for rectification of any mistake or to add, delete or update the information furnished in the statement delivered in the prescribed form and verified in prescribed manner.

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(ii) furnish to the donor, a certificate specifying the amount of donation in the such manner, containing such particulars and within such time from the date of receipt of sum, as may be prescribed.

The deduction with respect to the donation given by the assessee to any research association, university, college or other institution referred to in section 35(1)(ii)/(iii) or the company referred to in section 35(1)(iia) would not be allowed unless such research association, university, college or other institution or company complies with the above requirements stipulated under section 35(1A) .

(iv) **Sum paid to National Laboratory, etc. [Section 35(2AA)]:** Section 35(2AA) provides that any sum paid by an assessee to a National Laboratory or University or Indian Institute of Technology or a specified person for carrying out programmes of scientific research approved by the prescribed authority will be eligible for deduction of the amount so paid.

No other deduction under the Act: No contribution which qualifies for deduction under this clause will be entitled to deduction under any other provision of the Act.

Further, it has been clarified that the deduction to which an assessee is entitled on account of payment of any sum by him to an approved National Laboratory, University, Indian Institute of Technology or a specified person for the approved programme shall not be denied to the donor-assessee merely on the ground that after payment of such sum by him, the approval granted to any of the aforesaid donee-entities or the programme has been withdrawn.

Term	Meaning
Specified person	A person who is approved by the prescribed authority

Note - *Deduction u/s 35(2AA) would be available to an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person only if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A) and pay tax as per the optional tax regime under the regular provisions of the Act.*

In case of companies and co-operative societies, deduction u/s 35(2AA) would not be allowable if they opt for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction u/s 35(2AA) would be allowable only if they pay tax under the normal provisions of the Act.

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(III) Company engaged in Business of bio-technology or manufacturing of article or thing etc. [Section 35(2AB)]

Where a company engaged **in the business of bio-technology or in any business of manufacture or production of any article or thing**, not being an article or thing specified in the list of the Eleventh Schedule [The exclusion list comprises of beer, wine and other alcoholic spirits, tobacco and tobacco preparations, cosmetic and toilet preparations, tooth paste, dental cream, tooth powder and soap, confectionery and chocolates, office machines and apparatus, steel furniture etc] incurs any expenditure on scientific research on in-house research and development facility as approved by the prescribed authority, a deduction of a **sum equal to the expenditure** will be allowed. Such expenditure **should not be in the nature of cost of any land or building**.

"Expenditure on scientific research" in relation to drugs and pharmaceuticals shall include expenditure incurred on clinical drug trial, obtaining approval from any state regulatory authority, and filing an application for a patent under the Patents Act, 1970.

No other deduction under the Act: No deduction will be allowed in respect of the above expenditure under any other provision of the Income-tax Act, 1961.

Agreement with the prescribed authority: No company will be entitled to this deduction unless it enters into an agreement with the prescribed authority for co-operation in such research and development facility and fulfills the prescribed conditions with regard to maintenance and audit of accounts and also furnishes prescribed reports in the prescribed manner.

Approval of the Authority: The prescribed authority shall submit its report in relation to the approval of the said facility to the Principal Chief Commissioner or the Chief Commissioner or Principal Director General Director General in such form and within such time as may be prescribed.

Note - *In case of companies, deduction u/s 35(2AB) would not be allowable if they opt for the special provisions u/s 115BAA/115BAB. In other words, deduction u/s 35(2AB) would be allowable only if they pay tax under the normal provisions of the Act.*

ILLUSTRATION 5

A Ltd., engaged in the business of manufacturing since 2015, furnishes the following particulars for the P.Y.2025-26. Compute the deduction allowable under section 35 for A.Y.2026-27, while computing its income under the head "Profits and gains of business or profession", assuming that it does not opt for special tax regime under section 115BAA.

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	Particulars	₹
1.	*Amount paid to notified approved Indian Institute of Science, Bangalore, for scientific research*	*1,00,000*
2.	*Amount paid to IIT, Delhi for an approved scientific research programme*	*2,50,000*
3.	*Amount paid to X Ltd., a company registered in India which has as its main object scientific research and development, as is approved by the prescribed authority*	*4,00,000*
4.	*Expenditure incurred on in-house research and development facility as approved by the prescribed authority*	
	(a) Revenue expenditure on scientific research	*3,00,000*
	(b) Capital expenditure (including cost of acquisition of land ₹ 5,00,000) on scientific research	*7,50,000*

SOLUTION

Computation of deduction under section 35 for the A.Y.2026-27

Particulars	₹	Section	% of deduction	Amount of deduction (₹)
Payment for scientific research				
Indian Institute of Science	1,00,000	35(1)(ii)	100%	1,00,000
IIT, Delhi	2,50,000	35(2AA)	100%	2,50,000
X Ltd.	4,00,000	35(1)(iia)	100%	4,00,000
Expenditure incurred on in-house research and development facility				
Revenue expenditure	3,00,000	35(2AB))	100%	3,00,000
Capital expenditure (excluding cost of acquisition of land ₹ 5,00,000)	2,50,000	35(2AB)	100%	2,50,000
Deduction allowable under section 35				**13,00,000**

(7) Expenditure for obtaining right to use spectrum for telecommunication services [Section 35ABA]

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

(ii) The Government has introduced spectrum fee for auction of airwaves.

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(iii) In order to resolve the uncertainty in tax treatment of payments in respect of spectrum i.e., whether spectrum is an intangible asset and the spectrum fees paid is eligible for depreciation under section 32 or whether it is in the nature of a 'licence to operate telecommunication business' and eligible for deduction under section 35ABB, section 35ABA provides for tax treatment of spectrum fee.

(iv) Tax treatment of spectrum fee:

	Transaction	Manner of deduction	
(1)	**Acquisition of right to use spectrum**		
	Any capital expenditure incurred for acquisition of any right to use spectrum for telecommunication services either before the commencement of the business or thereafter at any time during any previous year and for which **payment has actually been made** to obtain a right to use spectrum.	Appropriate fraction of the amount of such expenditure [1/ total number of relevant previous years]	
		Meaning of relevant previous years:	
		Case	**Meaning**
		Where the spectrum fee is actually paid before the commencement of business to operate telecommunication services	The previous years beginning with the P.Y. in which such business commenced and the subsequent P.Y. or P.Y.s during which the spectrum, for which the fee is paid, shall be in force.
		In any other case	The previous years beginning with the P.Y. in which the spectrum fee is actually paid and the subsequent P.Y. or years during which the spectrum, for which the fee is paid, shall be in force.
	Meaning of 'payment has actually been made'.		
	Payment has actually been made means actual payment of expenditure irrespective of the previous year in which the liability for expenditure was incurred according to the method of accounting regularly employed by the assessee or payable in the prescribed manner.		
	Rule 6A substantiates the meaning of the phrase 'payment has actually been made'		
	(a)	**In a case where full upfront payment of spectrum fee has been made:** Where an assessee has opted and been allowed by the Department of	

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		Telecommunications, Government of India to make full upfront payment of spectrum fee, the actual payment of expenditure irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee;
	(b)	**<u>In a case where deferred payment is made:</u>** Where an assessee has opted and been allowed by the Department of Telecommunications, Government of India to make deferred payment, the amount which would have been payable by the assessee had he opted for full upfront payment of spectrum fee irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.
	However, in case of deferred payment referred to in clause (b) above, where there is failure by the assessee to comply with any of the conditions specified by the scheme of the Department of Telecommunications, Government of India and Department of Telecommunications terminates the allotment or assignment of spectrum, the Assessing Officer shall, in exercise of power vested in him under section 35ABA(3), re-compute the total income of the assessee for the previous year in which the deduction has been claimed and granted to him by deeming that,- (i) the total amount of spectrum fee paid up to the date of termination is the amount of "payment actually been made"; (ii) the spectrum was in force up to the date of its termination for the purpose of computing "relevant previous year".	
(2)	**Transfer of the spectrum**	
	Case 1: Where the proceeds of the transfer of spectrum are **less than** the expenditure incurred remaining unallowed	The expenditure remaining unallowed **as reduced by** the proceeds of transfer shall be allowed in the previous year in which the spectrum has been transferred. **Amount of deduction** = Expenditure remain unallowed – Sale proceeds
	Case 2: Where the proceeds of the transfer of whole or any part of the spectrum **exceed** the amount of expenditure remaining unallowed	The excess amount or expenditure allowed till date (i.e., difference between expenditure incurred to obtain spectrum and the expenditure remain unallowed), **whichever is less**, shall be chargeable to tax as profits and gains of business in the previous year in which the spectrum has been transferred.
		Taxable as profits and gains from business and profession = Sale proceeds – Expenditure remain unallowed **OR** Expenditure allowed till date } Whichever is less

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		If the spectrum is transferred in a previous year in which the business is no longer in existence, the taxability would arise in the above manner as though the business is in existence in that previous year.
	Case 3: Where the proceeds of the transfer of whole or any part of the spectrum **are not less than** the amount of expenditure incurred remaining unallowed.	No deduction for such expenditure shall be allowed in the previous year in which spectrum is transferred or in respect of any subsequent previous year or years. Amount of deduction = NIL
	Case 4: Where a part of the spectrum is transferred and the case is not covered under Case 2 above i.e., the proceeds of transfer of a part of the spectrum does not exceed the amount of expenditure remaining unallowed	Unallowed expenditure would be amortised in the following manner – (i) subtracting the proceeds of transfer from the expenditure remaining unallowed; and (ii) dividing the remainder by the number of relevant previous years which have not expired at the beginning of the previous year during which the spectrum is transferred. Amount of deduction = $\frac{\text{Unallowed expenditure} - \text{Sale proceeds}}{\text{Unexpired number of relevant P.Y.s}}$
(3)	**Transfer of spectrum in a scheme of amalgamation**	
	If the amalgamating company sells or transfers the spectrum to the amalgamated company, being an Indian company under the scheme of amalgamation	The provisions of section 35ABA will apply to amalgamated company as they would have applied to amalgamating company as if the latter has not transferred the spectrum. The tax treatment in cases 1, 2 & 3 given in (2) above will not apply to the amalgamating company.
(4)	**Transfer of spectrum in a scheme of demerger**	
	If the demerged company sells or transfers the spectrum to the resulting company, being an Indian company under the scheme of demerger	The provisions of section 35ABA will apply to resulting company as they would have applied to demerged company as if the latter has not transferred the spectrum. The tax treatment in cases 1, 2 & 3 given in (2) above will not apply to the demerged company.

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(v) No depreciation

Where a deduction is claimed and allowed for any previous year under this section, then no depreciation on capital expenditure so incurred shall be allowed by way of depreciation under section 32(1) for the same previous year or in any other previous year.

(vi) Consequences of failure to comply with the conditions after grant of deduction:

Where, in a previous year, any deduction has been claimed and granted to an assessee and subsequently, there is failure to comply with any of the provisions of this section, then –

(1) the deduction shall be deemed to have been wrongly allowed;

(2) the Assessing Officer may recompute the total income of the assessee for the said previous year and make the necessary rectification. This is notwithstanding anything contained in the Income-tax Act, 1961;

(3) the provisions under section 154 for rectification of mistake apparent from the record would apply. The period of four years would be reckoned from the end of the previous year in which the failure to comply with the provisions of section 35ABA takes place.

(8) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB]

(i) Tax treatment of licence fee:

	Transaction	Manner of deduction	
(1)	Acquisition of right to operate telecommunication services		
	Any capital expenditure incurred for acquisition of any right to operate telecommunication services either before the commencement of the business or thereafter at any time during any previous year and for which **payment has actually been made** (actual payment of expenditure) to obtain a licence.	Appropriate fraction of the amount of such expenditure [1/ total number of relevant previous years]	
		Meaning of relevant previous years:	
		Case	Meaning
		Where the licence fee is actually paid before the commencement of business to operate telecommunication services	The previous years beginning with the P.Y. in which such business commenced and the subsequent P.Y. or P.Y.s during which the licence, for which the fee is paid, shall be in force.
		In any other case	The previous years beginning with the P.Y. in which the licence fee is actually paid and the subsequent

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			P.Y. or years during which the licence, for which the fee is paid, shall be in force.
	Payment has actually been made means the actual payment of expenditure irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.		
(2)	**Transfer of the licence**		
	Case 1: Where the proceeds of the transfer of licence are **less than** the expenditure incurred remaining unallowed	The expenditure remaining unallowed **as reduced by** the proceeds of transfer shall be allowed in the previous year in which the licence has been transferred. **Amount of deduction** = Expenditure remain unallowed – Sale proceeds	
	Case 2: Where the proceeds of the transfer of whole or any part of the licence **exceed** the amount of expenditure remaining unallowed	The excess amount shall be chargeable to tax as profits and gains of business in the previous year in which the licence has been transferred. However, the excess should not exceed the difference between the expenditure incurred to obtain the licence and the amount of expenditure remaining unallowed.	
		Taxable as profits and gains from business and profession = Sale proceeds – Expenditure remain unallowed **OR** Expenditure allowed till date } Whichever is less	
		If the licence is transferred in a previous year in which the business is no longer in existence, the taxability would arise in the above manner as if the business is in existence in that previous year.	
	Case 3: Where the proceeds of the transfer of whole or any part of the licence **are not less than** the amount of expenditure incurred remaining unallowed.	No deduction for such expenditure shall be allowed in the previous year in which licence is transferred or in respect of any subsequent previous year or years. Amount of deduction = NIL	
	Case 4: Where a part of the licence is transferred and the case is not covered under Case 2 above	Unallowed expenditure would be amortised in the following manner – (i) subtracting the proceeds of transfer from the expenditure remaining unallowed; and (ii) dividing the remainder by the number of relevant	

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	i.e., the proceeds of transfer of a part of the licence does not exceed the amount of expenditure remaining unallowed	previous years which have not expired at the beginning of the previous year during which the licence is transferred. Amount of deduction= $\frac{\text{Unallowed expenditure} - \text{Sale proceeds}}{\text{Unexpired number of relevant P.Y.s}}$
(3)	**Transfer of licence in a scheme of amalgamation**	
	If the amalgamating company sells or transfers the licence to the amalgamated company, being an Indian company, under the scheme of amalgamation	The provisions of section 35ABB will apply to amalgamated company as they would have applied to amalgamating company as if the latter has not transferred the licence. The tax treatment in cases 1, 2 & 3 given in (2) above will not apply to the amalgamating company.
(4)	**Transfer of licence in a scheme of demerger**	
	If the demerged company sells or transfers the licence to the resulting company, being an Indian company, under the scheme of demerger	The provisions of section 35ABB will apply to resulting company as they would have applied to demerged company as if the latter has not transferred the licence. The tax treatment in cases 1, 2 & 3 given in (2) above will not apply to the demerged company.

(ii) <u>No depreciation</u>

Where a deduction is claimed and allowed for any previous year under this section, then no depreciation on capital expenditure so incurred shall be allowed by way of depreciation under section 32(1) for the same previous year or in any other previous year.

ILLUSTRATION 6

X Ltd., providing telecommunication services, acquired a telecom licence at cost of ₹ 50 lakhs on 01.04.2023 for a period of 10 years. Assuming the telecom licence is transferred by X Ltd. in P.Y. 2025-26, say for: (a) ₹ 32 lakhs; (b) ₹ 43 lakhs or (c) ₹ 52 lakhs, and if:

(i) Whole of the license is transferred

(ii) Part of the license is transferred.

Explain, how the transfer shall be dealt with under the Income-tax Act, 1961 and the amount, if any, deductible for A.Y. 2026-27.

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SOLUTION

(i) Whole of the license is transferred:

Particulars	₹ (in lakhs)
Cost of the licence	50
Less: Deduction u/s 35ABB for P.Y. 2023-24	5
	45
Less: Deduction u/s 35ABB for P.Y. 2024-25	5
Expenditure remaining unallowed	40
(a) If transferred for ₹ 32 lakhs	
Proceeds from transfer	32
Deduction allowed u/s 35ABB in P.Y. 2025-26 (Expenditure remaining unallowed **as reduced by** the proceeds of transfer)	8
(b) If transferred for ₹ 43 lakhs	
Proceeds from transfer	43
Taxable as profits and gains from business and profession (Lesser of: ₹ 3 lakhs i.e., Proceed from transfer - Expense remain unallowed i.e. ₹ 43 lakhs - ₹ 40 lakhs **or** ₹ 10 lakhs i.e., expense allowed till date)	3
(c) If transferred for ₹ 52 lakhs	
Proceeds from transfer	52
Taxable as profits and gains from business and profession (Lesser of: ₹ 12 lakhs i.e., Proceed from transfer - Expense remain unallowed i.e. ₹ 52 lakhs - ₹ 40 lakhs **or** ₹ 10 lakhs i.e., expense allowed till date)	10
Short Term Capital Gains (₹ 52 lakhs - ₹ 40 lakhs - ₹ 10 lakhs)	2

(ii) Part of the license is transferred:

Particulars	₹ (in lakhs)
Cost of the licence	50
Less: Deduction u/s 35ABB for P.Y. 2023-24	5
	45
Less: Deduction u/s 35ABB for P.Y. 2024-25	5
Expenditure remaining unallowed	**40**

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(a)	**If transferred for ₹ 32 lakhs**	
	Proceeds from transfer	32
	Deduction allowed u/s 35ABB in P.Y. 2025-26 [₹ 40 lakhs - ₹ 32 lakhs)/ 8 years	1
(b)	**If transferred for ₹ 43 lakhs**	
	Proceeds from transfer	43
	Taxable as profits and gains from business and profession (Lesser of: ₹ 3 lakhs i.e., Proceeds from transfer - Expense remaining unallowed i.e. ₹ 43 lakhs - ₹ 40 lakhs **or** ₹ 10 lakhs i.e., expense allowed till date)	3
(c)	**If transferred for ₹ 52 lakhs**	
	Proceeds from transfer	52
	Amount taxable as profits and gains from business and profession (Lesser of: ₹ 12 lakhs i.e., Proceeds from transfer - Expense remaining unallowed i.e. ₹ 52 lakhs - ₹ 40 lakhs **or** ₹ 10 lakhs i.e., expense allowed till date)	10
Short Term Capital Gains (₹ 52 lakhs - ₹ 40 lakhs - ₹ 10 lakhs)		2

(9) "Investment-linked tax incentives" for specified businesses [Section 35AD]

(i) List of specified businesses: With the specific objective of creating rural infrastructure and environment friendly alternate means for transportation of bulk goods, investment-linked tax incentives have been introduced for specified businesses, namely –

- setting-up and operating 'cold chain' facilities for specified products;
- setting-up and operating warehousing facilities for storing agricultural produce;
- laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network;
- building and operating a hotel of two-star or above category, anywhere in India;
- building and operating a hospital, anywhere in India, with at least 100 beds for patients;
- developing and building a housing project under a notified scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government.

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- developing and building a housing project under a notified scheme for affordable housing framed by the Central Government or State Government;
- production of fertilizer in India;
- setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962;
- bee-keeping and production of honey and beeswax;
- setting up and operating a warehousing facility for storage of sugar;
- laying and operating a slurry pipeline for the transportation of iron ore;
- setting up and operating a semiconductor wafer fabrication manufacturing unit, if such unit is notified by the Board in accordance with the prescribed guidelines;
- developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility.

(ii) **Deduction for Capital Expenditure:** 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above businesses would be allowed as deduction from the business income to the assessee opting for deduction under section 35AD.

However, expenditure incurred on acquisition of any **land, goodwill or financial instrument** would **not** be eligible for deduction.

Further, any expenditure in respect of which payment or aggregate of payment made to a person of an amount exceeding **₹ 10,000 in a day** otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic mode would not be eligible for deduction. The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [Notification No. 8/2020 dated 29.01.2020].

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Note - *In case of an individual/HUF/AoP/BoI carrying on specified business, deduction u/s 35AD would be available only if such person exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). If such person is paying concessional rates of tax under the default tax regime u/s 115BAC, deduction u/s 35AD would not be available.*

A company/ cooperative society would not be eligible for deduction under section 35AD, if it opted for the special provisions of section 115BAA/115BAB or section 115BAD/115BAE, respectively.

(iii) Expenditure prior to commencement of operation: Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business.

The amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

(iv) Conditions to be fulfilled: For claiming deduction under section 35AD, the specified business should fulfill the following conditions –

General Conditions:	
To be fulfilled by every specified business	
(i)	it should not be set up by splitting up, or the reconstruction, of a business already in existence;
(ii)	it should not be set up by the transfer to the specified business of machinery or plant previously used for any purpose; In order to satisfy this condition, the total value of the plant or machinery so transferred should not exceed 20% of the value of the total plant or machinery used in such specified business. For the purpose of this condition, machinery or plant would not be regarded as previously used if it had been used outside India by any person other than the assessee provided the following conditions are satisfied: (a) such plant or machinery was not used in India at any time prior to the date of its installation by the assessee; (b) the plant or machinery was imported into India from a foreign country; (c) no deduction in respect of depreciation of such plant or machinery has been allowed to any person at any time prior to the date of installation by the assessee.

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Conditions required to be fulfilled by certain specified businesses:	
I. Business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network	
(i)	Such business should be owned by a company formed and registered in India under the Companies Act, 1956[7] 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;
(ii)	It should have been approved by the Petroleum and Natural Gas Regulatory Board and notified by the Central Government in the Official Gazette
(iii)	It should have made not less than such proportion of its total pipeline capacity available for use on common carrier basis by any person other than the assessee or an associated person.
(iv)	It should fulfill any other prescribed condition.
II. Business of developing or operating and maintaining or developing, operating and maintaining a new infrastructure facility	
(i)	The business should be owned by a company registered in India or by a consortium of such companies or by an authority or a board or corporation or any other body established or constituted under any Central or State Act.
(ii)	The entity should have entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for developing or operating and maintaining or developing, operating and maintaining, a new infrastructure facility.

(v) No deduction under section 10AA or Chapter VI-A under the heading "C.-Deductions in respect of certain incomes": Where a deduction under this section is claimed and allowed in respect of the specified business for any assessment year, no deduction under the provisions of Chapter VI-A under the heading "C - Deductions in respect of certain incomes" or section 10AA is permissible in relation to such specified business for the same or any other assessment year.

Correspondingly, section 80A has been amended to provide that where a deduction under any provision of this Chapter under the heading "C – Deductions in respect of certain incomes" is claimed and allowed in respect of the profits of such specified business for any assessment year, no deduction under section 35AD is permissible in relation to such specified business for the same or any other assessment year.

In short, once the assessee has claimed the benefit of deduction under section 35AD for a particular year in respect of a specified business, he cannot claim benefit under Chapter VI-A under the heading "C.-Deductions in respect of certain incomes" or section 10AA, **for the same or any other year and *vice versa*.**

[7] Now Companies Act, 2013

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(vi) **No deduction allowable under the Act in respect of expenditure for which deduction allowed under this section:** The assessee cannot claim deduction in respect of such expenditure incurred for specified business under any other provision of the Income-tax Act, 1961 in the current year or under this section for any other year, if the deduction has been claimed or opted by him and allowed to him under section 35AD.

(vii) **Date of Commencement of specified businesses:**

S. No.	Specified business	Date of commencement of operations
1.	Laying and operating a cross country natural gas pipeline network for distribution, including storage facilities being an integral part of such network	on or after 1st April, 2007
2.	(a) building and operating anywhere in India, a hotel of two-star or above category as specified by the Central Government (b) building and operating a hospital with at least 100 beds for patients (c) notified scheme for slum redevelopment or rehabilitation housing projects	on or after 1st April, 2010
3.	(a) notified scheme for affordable housing projects and (b) production of fertilizer in a new plant or in a newly installed capacity in an existing plant	on or after 1st April, 2011
4.	(a) setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962, (b) bee-keeping and production of honey and beeswax and (c) setting up and operating a warehousing facility for storage of sugar	on or after 1st April, 2012
5.	(a) laying and operating a slurry pipeline for the transportation of iron ore or (b) setting up and operating a semi-conductor wafer fabrication manufacturing unit	on or after 1st April, 2014
6.	developing or operating and maintaining or developing, operating and maintaining, any infrastructure facility	on or after 1st April, 2017
7.	In any other case, namely, setting and operating - (a) "cold-chain" facilities for specified products or (b) warehousing facilities for storing agricultural produce	on or after 1st April, 2009

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(viii) Meaning of certain terms

Term	Meaning
Cold chain facility	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.
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 26% 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 10% of the total borrowings of the assessee.
Infrastructure facility	(i) A road including toll road, a bridge or a rail system. (ii) A highway project including housing or other activities being an integral part of the highway project. (iii) A water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system. (iv) A port, airport, inland waterway, inland port or navigational channel in the sea.

(ix) Set-off or carry forward and set-off of loss from specified business:

The loss of an assessee claiming deduction under section 35AD in respect of a specified business can be set-off against the profit of another specified business under section 73A, irrespective of whether the latter is eligible for deduction under section 35AD.

Such loss can, however, be carried forward indefinitely for set-off against profits of the same or any other specified business but the assessee has to file return of income on or before the due date of filling return of income under section 139 for carry forward of losses from specified business.

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Example:

A assessee can therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April, 2010 and which is eligible for deduction section 35AD, against the profits of the existing business of operating a hospital (with atleast 100 beds for patients) or a hotel (of two-star or above category) started before 1st April, 2010, even if the latter is not eligible for deduction under section 35AD.

ILLUSTRATION 7

Mr. A commenced operations of the businesses of setting up a warehousing facility for storage of food grains, sugar and edible oil on 1.4.2025. He incurred capital expenditure of ₹ 80 lakh, ₹ 60 lakh and ₹ 50 lakh, respectively, on purchase of land and building during the period January, 2025 to March, 2025 exclusively for the above businesses, and capitalized the same in its books of account as on 1st April, 2025. The cost of land included in the above figures is ₹ 50 lakh, ₹ 40 lakh and ₹ 30 lakh, respectively. During the P.Y. 2025-26, he incurred capital expenditure of ₹ 20 lakh, ₹ 15 lakh & ₹ 10 lakh, respectively, for extension/ reconstruction of the building purchased and used exclusively for the above businesses.

The profits from the business of setting up a warehousing facility for storage of food grains, sugar and edible oil (before claiming deduction under section 35AD and section 32) for the A.Y. 2026-27 is ₹ 16 lakhs, ₹ 14 lakhs and ₹ 31 lakhs, respectively. Assume in respect of expenditure incurred, the payments are made by account payee cheque or use of ECS through bank account.

Compute the income under the head "Profits and gains of business or profession" for the A.Y.2026-27 and the loss to be carried forward, assuming that Mr. A is exercising the option of shifting out of the default tax regime provided under section 115BAC(1A) and has fulfilled all the conditions specified for claim of deduction under section 35AD and wants to claim deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading "C. – Deductions in respect of certain incomes".

SOLUTION

Computation of profits and gains of business or profession for A.Y. 2026-27

Particulars	₹ (in lakhs)
Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)	31
Less: Depreciation under section 32	
10% of ₹ 30 lakh, being (₹ 50 lakh – ₹ 30 lakh + ₹ 10 lakh)	3
Income chargeable under "Profits and gains from business or profession"	**28**

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Computation of income/loss from specified business under section 35AD

	Particulars	Food Grains	Sugar	Total
		₹ (in lakhs)		
(A)	Profits from the specified business of setting up a warehousing facility (before providing deduction under section 35AD)	16	14	30
	***Less*: Deduction under section 35AD**			
(B)	Capital expenditure incurred prior to 1.4.2025 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2025 (excluding the expenditure incurred on acquisition of land) = ₹ 30 lakh (₹ 80 lakh – ₹ 50 lakh) and ₹ 20 lakh (₹ 60 lakh – ₹ 40 lakh)	30	20	50
(C)	Capital expenditure incurred during the P.Y.2025-26	20	15	35
(D)	**Total capital expenditure (B + C)**	**50**	**35**	**85**
(E)	**Deduction under section 35AD**			
	100% of capital expenditure (food grains/sugar)	50	35	85
	Total deduction u/s 35AD for A.Y.2026-27	**50**	**35**	**85**
(F)	**Loss from the specified business of setting up and operating a warehousing facility (after providing for deduction under section 35AD) to be carried forward as per section 73A (A-E)**	**(34)**	**(21)**	**(55)**

Notes:

(i) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2026-27 in respect of specified business of setting up and operating a warehousing facility for storage of sugar and setting up and operating a warehousing facility for storage of agricultural produce where operations are commenced on or after 01.04.2012 or on or after 01.04.2009, respectively.

(ii) However, since setting up and operating a warehousing facility for storage of edible oils is not a specified business, Mr. A is not eligible for deduction under section 35AD in respect of capital expenditure incurred in respect of such business.

(iii) Mr. A can, however, claim depreciation@10% under section 32 in respect of the capital expenditure incurred on buildings. It is presumed that the buildings were put to use for more than 180 days during the P.Y. 2025-26.

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(iv) Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of ₹ 55 lakh from the specified businesses of setting up and operating a warehousing facility for storage of food grains and sugar cannot be set-off against the profits of ₹ 28 lakh from the business of setting and operating a warehousing facility for storage of edible oils, since the same is not a specified business. Such loss can, however, be carried forward indefinitely for set-off against profits of the same or any other specified business provided Mr. A file his return of income on or before the due date as specified u/s 139.

ILLUSTRATION 8

XYZ Ltd. commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on 1.4.2025. The company incurred capital expenditure of ₹ 50 lakh during the period January, 2025 to March, 2025 exclusively for the above business, and capitalized the same in his books of account as on 1st April, 2025. Further, during the P.Y. 2025-26, it incurred capital expenditure of ₹ 2 crore (out of which ₹ 1.50 crore was for acquisition of land) exclusively for the above business.

Compute the income under the head "Profits and gains of business or profession" for the A.Y.2026-27, assuming that XYZ Ltd. has fulfilled all the conditions specified for claim of deduction under section 35AD and opted for claiming deduction under section 35AD; and has not claimed any deduction under Chapter VI-A under the heading "C. – Deductions in respect of certain incomes". The company is not opting for the concessional tax regime under section 115BAA.

The profits from the business of running this hotel (before claiming deduction under section 35AD) for the A.Y.2026-27 is ₹ 25 lakhs. Assume that the company also has another existing business of running a four-star hotel in Coimbatore, which commenced operations fifteen years back, the profits from which are ₹ 120 lakhs for the A.Y.2026-27. Also, assume that expenditure incurred during the previous year 2025-26 were paid by account payee cheque or use of ECS through bank account.

SOLUTION

Computation of profits and gains of business or profession for A.Y. 2026-27

Particulars		₹ (in lakhs)
Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)		25
***Less*: Deduction under section 35AD**		
Capital expenditure incurred during the P.Y.2025-26 (excluding the expenditure incurred on acquisition of land) = ₹ 200 lakhs – ₹ 150 lakhs	50 lakh	

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Capital expenditure incurred prior to 1.4.2025 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2025	50 lakh	
Total deduction under section 35AD for A.Y.2026-27		100
Loss from the specified business of new hotel in Madurai		**(75)**
Profit from the existing business of running a hotel in Coimbatore		120
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A		**45**

(x) Transfer of hotel built by the assessee: Where the assessee builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation of the said hotel to another person, the assessee shall be deemed to be carrying on the specified business of building and operating a hotel. Therefore, he would be eligible to claim investment-linked tax deduction under section 35AD.

Therefore, in effect, the assessee shall be deemed to be carrying on the specified business of building and operating hotel if –

(i) The assessee builds a hotel of two-star or above category;

(ii) Thereafter, he transfers the operation of the hotel to another person;

(iii) He, however, should continue to own the hotel.

(xi) Other conditions contained under section 35AD

S. No.	Particulars	Condition
1.	**Transfer of goods and services**	Where any goods or services held for the purposes of the specified business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the specified business shall be computed as if the transfer was made at market value. **Market value** means the price such goods or services would ordinarily fetch in the open market, subject to statutory or regulatory restrictions, if any.
2.	**Close connection between assessee**	Where due to the close connection between the assessee and the other person or for any other reason, it appears to

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	and any other person	the Assessing Officer that the profits of specified business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits of such eligible business on a reasonable basis for allowing the deduction.
2.	**Audit of accounts**	The deduction shall be allowed to the assessee only if the accounts of the assessee for the relevant previous year have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant along with his return of income.
3.	**Asset to be used for specified business for eight years**	Section 35AD(7A) provides that any asset in respect of which a deduction is claimed and allowed under section 35AD shall be used only for the specified business for a period of eight years beginning with the previous year in which such asset is acquired or constructed.
4.	**Asset demolished, destroyed, discarded or transferred for which a deduction has been allowed** If any asset on which a deduction under section 35AD has been claimed and allowed, is demolished, destroyed, discarded or transferred, the sum received or receivable for the same is chargeable to tax under clause (vii) of section 28. This does not take into account a case where asset on which deduction under section 35AD has been claimed is used for any purpose other than the specified business by way of a mode other than that specified above.	
5.	**Asset used for any other business other than specified business during 8 years [Section 35AD(7B)]** If asset is **used for any purpose other than the specified business** during 8 years beginning with the previous year in which such asset is acquired, the total amount of deduction so claimed and allowed in any previous year(s) in respect of such asset, as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction had been allowed under section 35AD, shall be deemed to be income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the asset is so used. In such a case, as per the proviso to *Explanation 13* to Section 43(1), the actual cost of such asset for the assesse shall be the actual cost as reduced by amount of depreciation would have been allowable had the asset been used for the purpose of business since the date of its acquisition. However, the deeming provision under sub-section (7B) shall not be applicable to a company which has become a sick industrial company under section 17(1) of the Sick Industrial Companies (Special Provisions) Act, 1985, during the intervening period of eight years specified in sub-section (7A).	

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ILLUSTRATION 9

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

Unit A commenced operations on 1.4.2024 and it claimed deduction of ₹ 100 lakhs incurred on purchase of two buildings for ₹ 50 lakhs each (for operating a warehousing facility for storage of sugar) under section 35AD for A.Y. 2025-26. However, in February, 2026, Unit A transferred one of its buildings to Unit B.

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

SOLUTION

Since the capital asset, in respect of which deduction of ₹ 50 lakhs was claimed under section 35AD, has been transferred by Unit A carrying on specified business to Unit B carrying on non-specified business in the P.Y.2025-26, the deeming provision under section 35AD(7B) is attracted during the A.Y. 2026-27.

Particulars	₹
Deduction allowed under section 35AD for A.Y.2025-26	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2025-26 [10% of ₹ 50 lakhs]	5,00,000
Deemed income under section 35AD(7B)	**45,00,000**

ABC Ltd., however, by virtue of *proviso to Explanation 13 to* section 43(1), can claim depreciation under section 32 on the building in Unit B for A.Y. 2026-27. For the purpose of claiming depreciation on building in Unit B, the actual cost of the building would be:

Particulars	₹
Actual cost to the assesse	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2025-26 [10% of ₹ 50 lakhs]	5,00,000
Actual cost in the hands of ABC Ltd. in respect of building in Unit B	**45,00,000**

(10) Contributions for Rural Development [Section 35CCA]

This section allows a deduction of the following payment or contribution made by the assessee during the previous year to:

(1) **Notified rural development fund -** Payment to a rural development fund set up and notified by the Central Government.

(2) **Notified National Urban Poverty Eradication Fund -** Payments made to "National Urban Poverty Eradication Fund" (NUPEF) set up and notified by the Central Government.

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No other deduction - It has been specifically provided that in every case where any deduction under this section is claimed by the assessee and allowed to him for any assessment year in respect of any expenditure incurred by way of payment of contribution to such notified fund, no deduction in respect of the same expenditure can again be claimed by the assessee under any other relevant provision for the same or any other assessment year.

(11) Deduction in respect of expenditure incurred on notified agricultural extension project [Section 35CCC]

(i) **Eligible project and Quantum of Deduction:** In order to incentivize the business entities to provide better and effective agriculture extensive services, section 35CCC provides a deduction of a sum equal to expenditure incurred by an assessee on agricultural extension project in accordance with the prescribed guidelines.

(ii) **No other deduction:** In case deduction in respect of such expenditure is allowed under this section then, no deduction in respect of such expenditure shall be allowed under any other provisions of the Act in the same or any other assessment year.

(iii) **Project must be notified:** The agricultural extension project eligible for this deduction shall be notified by the CBDT.

The agricultural extension project shall be considered for notification if it fulfils **all** of the following conditions, namely:—

(a) the project shall be undertaken by an assessee for training, education and guidance of farmers;

(b) the project shall have prior approval of the Ministry of Agriculture, Government of India; and

(c) an expenditure (not being expenditure in the nature of cost of any land or building) exceeding the amount of ₹ 25 lakhs is expected to be incurred for the project.

Components of expenditure: All expenses (not being expenditure in the nature of cost of any land or building), as reduced by the amount received from beneficiary, if any, incurred wholly and exclusively for undertaking an eligible agricultural extension project **shall be eligible for deduction** under section 35CCC.

However, expenditure incurred on the agricultural extension project which is reimbursed or reimbursable to the assessee by any person, whether directly or indirectly, shall not be eligible for deduction under section 35CCC.

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(iv) **Conditions for claiming deduction:** Deduction in respect of expenditure incurred for notified agricultural extension project would be available, if

- assessee maintain separate books of account of such agricultural extension project and get such books of account audited by an Accountant and
- furnish the following on or before the due date of furnishing the return of income to the Commissioner of Income-tax or Director of Income-tax, as the case may be :-
  - the audited statement of accounts of the agricultural extension project along with the audited report and amount of deduction claimed under this section,
  - a note on agricultural project undertaken and programme of agricultural extension project to be undertaken during the current year and financial allocation for such programme and
  - a certificate from Ministry of Agriculture, Government of India, regarding the genuineness of such project.

Note - *In case of an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person, deduction u/s 35CCC would be available only if such person exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). If such person is paying concessional rates of tax under the default tax regime u/s 115BAC, deduction u/s 35CCC would not be available.*

A company/ cooperative society would not be eligible for deduction under section 35CCC, if it opted for the special provisions of section 115BAA/115BAB or section 115BAD/115BAE, respectively.

(12) Deduction in respect of expenditure incurred by companies on notified skill development project [Section 35CCD]

(i) **Quantum of Deduction:** In order to encourage **companies** to invest on skill development projects in the manufacturing sector, section 35CCD provides for a deduction of a sum equal to the expenditure (not being expenditure in the nature of cost of any land or building) on skill development project incurred by the company in accordance with the prescribed guidelines. However, expenditure incurred on the notified skill development project which is reimbursed or reimbursable to the company by any person, whether directly or indirectly, shall not be eligible for deduction under section 35CCD.

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(ii) **No other deduction allowed:** In case deduction in respect of such expenditure is allowed under this section then, no deduction of such expenditure shall be allowed under any other provisions of the Act in the same or any other assessment year.

(iii) **Only notified projects are eligible:** The skill development project eligible for this deduction shall be notified by the CBDT.

A skill development project would be considered for notification if it is undertaken by an eligible company (a company engaged in the business of manufacture or production of any article or thing, not being beer, wine and other alcoholic spirits and tobacco and tobacco preparations or engaged in providing specified services) and the project is undertaken in separate facilities in a training institute.

Skill development project in respect of existing employees of the company, however, would not be eligible for notification, where the training of such employees commences after six months of their recruitment.

Further, the deduction would be available, if the company undertaking such project

- maintain separate books of account of the skill development project and get such books of account audited by an accountant.
- furnish the audited statement of accounts of the skill development project along with the audited report and amount of deduction claimed under this section, to the Commissioner of Income-tax or Director of Income-tax, as the case may be.

Note - *A company would not be eligible for deduction under section 35CCD, if it opted for the special provisions of section 115BAA/115BAB.*

(13) Amortisation of Preliminary Expenses [Section 35D]

(i) **Nature of expenditure:** Section 35D provides for the amortisation of preliminary expenses incurred by Indian companies and other resident non-corporate taxpayers for the establishment of business concerns or the expansion of the business of existing concerns.

(ii) **Applicable:** This section applies

(a) only to Indian companies and resident non-corporate assessees;

(b) in the case of new companies to expenses incurred before the commencement of the business;

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(c) in the case of extension of an existing undertaking to expenses incurred till the extension is completed, i.e., in the case of the setting up of a new unit - expenses incurred till the new unit commences production or operation.

(iii) **Amount eligible for deduction:** Such preliminary expenditure incurred shall be amortised over a period of 5 years. In other words, 1/5th of such expenditure is allowable as a deduction for each of the five successive previous years beginning with the previous year in which the business commences or, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation, as the case may be.

(iv) **Eligible expenses** - The following expenditure are eligible for amortisation:

(I) Expenditure in connection with –

(a) the preparation of feasibility report

(b) the preparation of project report;

(c) conducting market survey or any other survey necessary for the business of the assessee;

(d) engineering services relating to the assessee's business;

The assessee has to furnish a statement containing the particulars of above expenditure within one month prior to the due date for furnishing the return of income as specified under section 139(1) to the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be, or any person authorised by the Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems) in the Form No. 3AF in prescribed manner for each previous year [Rule 6ABBB].

(II) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up to conduct the business of assessee.

(III) **Where the assessee is a company,** in addition to the above, expenditure incurred –

(f) by way of legal charges for drafting the Memorandum and Articles of Association of the company;

(g) on printing the Memorandum and Articles of Association;

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(h) by way of fees for registering the company under the Companies Act; 1956[8],

(i) in connection with the issue, for public subscription, of the shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, printing and advertisement of the prospectus; and

(IV) Such other items of expenditure (not being expenditure qualifying for any allowance or deduction under any other provision of the Act) as may be prescribed by the Board for the purpose of amortisation. However, the Board, so far, has not prescribed any specific item of expense as qualifying for amortisation under this clause.

(v) **Overall Limits** - The maximum aggregate amount of the qualifying expenses that can be amortised is

In case of resident non-corporate assessee - 5% of the cost of the project

In the case of an Indian company – 5% of the cost of the project or, at the option of the company, 5% of the capital employed in the business of the company, whichever is higher.

The excess, if any, of the qualifying expenses shall be ignored.

[8] Now Companies Act, 2013

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(vi) Meaning of certain terms:

Terms	Meaning
Cost of the project	(i) **Expenses incurred before the commencement of business:** The actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings, railway sidings (including expenditure on the development of land, buildings) which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences; (ii) **Expenses incurred for extension of the business or setting up of a new unit:** The cost of the fixed assets being land, buildings, leaseholds, plant, machinery, furniture, fittings, and railway sidings (including expenditure on the development of land and buildings) which are shown in the books of the assessee as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, in so far as such assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit.
Capital employed in the business of the company	(i) **In the case of new company**: The aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the business of the company commences; (ii) **In the case of extension of the business or the setting up of a new unit**: The aggregate of the issued share capital, debentures, and long-term borrowings as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the unit commences production or operation in so far as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or the setting up of the new undertaking or the setting up of the new unit of the company.
Long-term borrowing	(i) Any moneys borrowed in India by the company from the Government or the Industrial Finance Corporation of India or the Industrial Credit and Investment Corporation of India or any other financial institution eligible for deduction under section 36(1)(viii) or any banking institution, or (ii) any moneys borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of plant and machinery where the terms under which such moneys are borrowed or the debt is incurred provide for the repayment thereof during a period of not less than 7 years.

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(vii) **Audit of accounts:** In cases where the assessee is a person other than a company or a co-operative society, the deduction would be allowable only if the accounts of the assessee for the year or years in which the expenditure is incurred have been audited by a Chartered Accountant before the date specified in section 44AB i.e., one month prior to the due date for furnishing return of income u/s 139(1); and the assessee has, by that date, furnished for the first year in which the deduction is claimed, the report of such audit in the prescribed form duly signed and verified by the auditor and setting forth such other particulars as may be prescribed.

Particulars	Due date of filing of return	Specified Date
Assessees (other than a company) subject to tax audit	31st October of the relevant A.Y.	30th September of the relevant A.Y.
	For A.Y.2026-27, on or before 31st October, 2026	For A.Y.2026-27, on or before 30th September, 2026

(viii) **Special provisions for amalgamation and demerger-** Where the undertaking of an Indian company is transferred, before the expiry of the period of five years, to another Indian company under a scheme of amalgamation, the aforesaid provisions will apply to the amalgamated company as if the amalgamation had not taken place. But no deduction will be admissible in the case of the amalgamating company for the previous year in which the amalgamation takes place.

Likewise, in the scheme of demerger where the resulting company will be able to claim amortisation of preliminary expenses as if demerger had not taken place, and no deduction shall be allowed to the demerged company in the year of demerger.

(ix) **No other deduction under any provision of the Act:** It has been clarified that in case where a deduction under this section is claimed and allowed for any assessment year in respect of any item of expenditure, the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any other provision of the Act for the same or any other assessment year.

(14) Amortisation of expense for Amalgamation/demerger [Section 35DD]

(i) **Nature of expenditure:** This section applies where an assessee, being an Indian company, incurs expenditure, wholly and exclusively for the purpose of amalgamation or demerger.

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(ii) **Amount of deduction:** 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.

(iii) **No other deduction under any provision of the Act:** No deduction shall be allowed in respect of the above expenditure under any other provisions of the Act.

(15) Amortisation of expenditure incurred under voluntary retirement scheme [Section 35DDA]

(i) **Nature of expenditure:** This section applies to an assessee who has incurred expenditure in any previous year in the form of payment to any employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement.

(ii) **Amount of deduction:** The amount of **deduction allowable is one-fifth of the amount paid** for that previous year, and the balance in four equal installments in the four immediately succeeding previous years.

(iii) **Transfer of business:** In case of amalgamation, demerger, reorganisation or succession of business during the intervening period of the said 5 years, the benefit of deduction will be available to the "new company" for the balance period including the year in which such amalgamation/ demerger/ reorganisation or succession takes place.

Conditions to be satisfied - This will be applicable in the following situations:

(i) where an Indian company is transferred to another Indian company in a scheme of amalgamation;

(ii) where the undertaking of an Indian company is transferred to another company in a scheme of demerger;

(iii) where due to a re-organisation of business, a firm is succeeded by a company fulfilling the conditions in section 47(xiii) or a proprietary concern is succeeded by a company fulfilling the conditions in section 47(xiv);

(iv) where a private company or unlisted company is succeeded by LLP fulfilling the conditions laid down in section 47(xiiib).

In the above cases, the **deduction shall be available to the successor** company as such deduction would have applied to the original entity if such transfer had not taken place at all.

It is further provided that **no deduction shall be available to the original entity** being the amalgamating company, demerged company, or the firm or proprietary concern or private company (as the case may be) **for the previous year in which the amalgamation, demerger or succession takes place.**

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(iv) No other deduction under any provision of the Act: No deduction shall be allowed in respect of the above expenditure under any other provision of the Act.

(16) Amortisation of expenses for prospecting and development of certain minerals [Section 35E]

(i) Eligible assessee: This provision applies only to expenditure incurred by an Indian company or other resident non-corporate taxpayer. In order to qualify for amortisation, the assessee should be engaged in any operations relating to prospecting for or the extraction or production of any mineral.

(ii) Eligible expenses - The nature and kind of expenditure qualifying for amortisation are –

(i) It must have been incurred during the year of commercial production and any one or more of the four years immediately preceding that year,

(ii) It must be incurred wholly and exclusively on any operations relating to the prospecting for any mineral or group of certain minerals listed in the Seventh Schedule of the Income-tax Act, 1961 or on the development of a mine or other natural deposit of any mineral or group of associated minerals.

(iii) Expenditure not allowed for deduction - Any portion of the expenditure which is met directly or indirectly by any other persons or authority and the sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or rights brought into existence as a result of the expenditure should be excluded from the amount of expenditure qualifying for amortisation.

Further, specific provision has been made to the effect that the following items of expenses do not qualify for amortisation at all viz.:

(a) Expenditure incurred on the acquisition of the site of the source of any minerals or group of associated minerals stated above or of any right in or over such site;

(b) Expenditure on the acquisition of the deposits of minerals or group of associated minerals referred to above or to any rights in or over such deposits; or

(c) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is permissible under section 32.

(iv) Amount of deduction - The assessee will be allowed for each of ten relevant previous years, **a deduction of an amount equal to one-tenth** of the aggregate amount of the qualifying expenditure.

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Thus, the deduction to be allowed for any relevant previous year is

(i) one-tenth of the expenditure or

(ii) such amount as will reduce to nil the income of the previous year arising from the commercial exploration of any minerals or other natural deposit of the mineral or minerals in a group of associated minerals in respect of which the expenditure was incurred,

whichever figure is less.

The amount of the deduction admissible in respect of any relevant previous year to the extent to which it remains unallowed, shall be carried forward and added to the installment relating to the previous year next following and shall be deemed to be a part of the installment and so on, for ten previous years beginning from the year of commercial production.

(v) Meaning of certain terms:

Term	Meaning
Operation relating to prospecting	Any operation undertaken for the purpose of exploiting, locating or proving deposits of any minerals and includes any such operation which proves to be infructuous or abortive.
Year of commercial production	The previous year in which as a result of any operation relating to prospecting or commercial production of any material or one or more of the minerals in a group of associated minerals specified in Part A or Part B, respectively, of the Seventh Schedule to Act actually commences.
Relevant previous year	Ten previous years beginning with the year of commercial production

(vi) Audit of accounts: The provisions with regard to audit of accounts relating to the qualifying expenditure are similar to those applicable for amortisation of preliminary expenses discussed earlier.

(vii) Special provisions for amalgamation or demerger: In the case of amalgamation, such deduction would continue to be admissible to the amalgamated company as if the amalgamation had not taken place.

Likewise, in case of demerger where such deduction can be availed of by the resulting company as if the demerger had not taken place.

Further, no deduction will be admissible to the amalgamating/ demerged company in the year of amalgamation/ demergers.

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(viii) **No other deduction allowed in respect of the expenditure for which deduction is claimed under this section:** Where a deduction is claimed and allowed on account of amortisation of the expenses under section 35E in any year in respect of any expenditure, the expenditure in respect of which deduction is so allowed shall not again qualify for deduction from the profits and gains under any other provisions of the Act for the same or any other assessment year.

(17) Other Deductions [Section 36]

This section authorises deduction of certain specific expenses. The items of expenditure and the conditions under which such expenditures are deductible are:

(1) **Insurance premia paid [Section 36(1)(i)]** - If insurance policy has been taken out against risk, damage or destruction of the stock or stores of the business or profession, the premia paid is deductible. But the premium in respect of any insurance undertaken for any other purpose is not allowable under the clause.

(2) **Insurance premia paid by a Federal Milk Co-operative Society [Section 36(1)(ia)]** - Deduction is allowed in respect of the amount of premium paid by a Federal Milk Co-operative Society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society, being a primary society engaged in supply of milk raised by its members to such Federal Milk Co-operative Society. The deduction is admissible without any monetary or other limits.

(3) **Premia paid by employer for health insurance of employees [Section 36(1)(ib)]** - This clause seeks to allow a deduction to an employer in respect of premia paid by him by any mode of payment other than cash to effect or to keep in force an insurance on the health of his employees in accordance with a scheme framed by

(i) the General Insurance Corporation of India and approved by the Central Government; or

(ii) any other insurer and approved by the IRDA.

(4) **Bonus and Commission [Section 36(1)(ii)]** - These are deductible in full provided the sum paid to the employees as bonus or commission shall not be payable to them as profits or dividends if it had not been paid as bonus or commission.

It is a provision intended to safeguard against a private company or an association escaping tax by distributing a part of its profits by way of bonus amongst the members, or employees of their own concern instead of distributing the money as dividends or profits.

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(5) **Interest on borrowed capital [Section 36(1)(iii)]** - Deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession".

Capital may be borrowed for several purposes like for acquiring a capital asset, or to pay off a trading debt or loss etc. The scope of the expression 'for the purposes of business' is very wide. Capital may be borrowed in the course of the existing business as well as for acquiring assets for extension of existing business.

As per proviso to section 36(1)(iii), deduction in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use shall not be allowed.

Explanation 8 to section 43(1) clarifies that interest relatable to a period after the asset is first put to use cannot be capitalised. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should, therefore, be capitalised.

Note: In the case of genuine business borrowings, the department cannot disallow any part of the interest on the ground that the rate of interest is unreasonably high except in cases falling under section 40A.

(6) **Discount on Zero Coupon Bonds (ZCBs) [Section 36(1)(iiia)]** - Section 36(1)(iiia) provides deduction for the discount on ZCB on pro rata basis having regard to the period of life of the bond to be calculated in the manner prescribed.

Term	Meaning
Discount	Difference of the amount received or receivable by an infrastructure capital company/ infrastructure capital fund/ public sector company/ scheduled bank on issue of the bond and the amount payable by such company or fund or bank on maturity or redemption of the bond.
Period of life of the bond	The period commencing from the date of issue of the bond and ending on the date of the maturity or redemption.

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Meaning of Infrastructure Capital Company [Section 2(26A)]

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

(1) any enterprise or undertaking wholly engaged –

(a) in the business referred to in section 80-IA(4) i.e. business of

(i) developing/ operating and maintaining/ developing, operating and maintaining any infrastructure facility fulfilling the specified conditions

(ii) providing telecom services, whether basic or cellular

(iii) developing, developing and operating or maintaining and operating an industrial park or special economic zone notified by the Central Government

(iv) generating, transmitting or distributing power or undertaking substantial renovation and modernization of the existing network of transmission or distribution lines.

(b) in the business referred to in section 80-IAB(1) i.e. any business of developing a SEZ.

(2) an undertaking developing and building a housing project referred to in section 80-IB(10) i.e. approved before 31.3.2008 by a local authority and commences or commenced development and construction on or after 1.10.98 and completes or completed development and construction within the time specified.

(3) a project for constructing a hotel of not less than three-star category as classified by the Central Government or

(4) a project for constructing a hospital with at least 100 beds for patients.

Meaning of Infrastructure Capital Fund [Section 2(26B)]

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

(1) any enterprise or undertaking wholly engaged in the business referred to in section 80-IA(4) or section 80-IAB(1); or

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(2) an undertaking developing and building a housing project referred to in section 80-IB(10); or

(3) a project for constructing a hotel of not less than three star category as classified by the Central Government; or

(4) a project for constructing a hospital with at least 100 beds for patients.

(7) Contributions to provident and other funds [Section 36(1)(iv) and (v)] - Contribution to the employees' recognised provident fund/approved superannuation fund is allowable subject to the limits laid down for the purpose of recognizing the provident fund or approving superannuation fund.

Contribution to an approved gratuity fund is allowable subject to the condition that the gratuity fund should be for exclusive benefit of the employees under an irrevocable trust

The nature of the benefit available to the employees from the fund is not material; it may be pension, gratuity or provident fund.

(8) Employer's contribution to the account of the employee under a Pension Scheme referred to in section 80CCD [Section 36(1)(iva)]

(i) Section 36(1)(iva) to provide that the employer's contribution to the account of an employee under a Pension Scheme as referred to in section 80CCD would be allowed as deduction while computing business income.

(ii) However, deduction would be restricted to 14% of salary of the employee in the previous year.

(iii) Salary, for this purpose, includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.

(iv) Correspondingly, section 40A(9), which provides for disallowance of any sum paid by an employer towards contribution to any fund or trust has been amended to exclude from the scope of its disallowance, contribution by an employer to the pension scheme referred to in section 80CCD, to the extent to which deduction is allowable under section 36(1)(iva).

ILLUSTRATION 10

X Ltd. contributes 20% of basic salary to the account of each employee under a pension scheme referred to in section 80CCD. Dearness Allowance is 40% of basic salary and it forms part of pay of the employees.

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Compute the amount of deduction allowable under section 36(1)(iva), if the basic salary of the employees aggregate to ₹ 10 lakh. Would disallowance under section 40A(9) be attracted, and if so, to what extent?

SOLUTION

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

Particulars	₹
Basic Salary	10,00,000
Dearness Allowance@40% of basic salary [DA forms part of pay]	4,00,000
Salary for the purpose of section 36(1)(iva) (Basic Salary + DA)	**14,00,000**
Actual contribution (20% of basic salary i.e., 20% of ₹10 lakh)	2,00,000
***Less:* Permissible deduction under section 36(1)(iva) [14% of (basic salary *plus* dearness pay) = 14% of ₹ 14,00,000 = ₹ 1,96,000]**	**1,96,000**
Excess contribution disallowed under section 40A(9)	4,000

(9) Amount received by assessee-employer as contribution from his employees towards their welfare fund to be allowed only if such amount is credited on or before due date – Section 36(1)(va) and section 57(ia) provide that deduction in respect of <u>any sum received</u> by the taxpayer <u>as contribution from his employees towards any welfare fund of such employees</u> will be allowed only if such sum is credited by the taxpayer to the employee's account in the relevant fund on or before the due date.

Due date	The date by which the assessee is required as an employer to credit such contribution to the employee's account in the relevant fund under the provisions of any law on term of contract of service or otherwise.

As per the Employees Provident Funds Scheme, 1952, the amounts under consideration in respect of wages of the employees for any particular month shall be paid within 15 days of the close of every month.

Note - It is clarified that the provisions of section 43B regarding allowability of certain expenditure in a previous year only on actual payment basis on or before due date of filing of return of income for relevant assessment year, does not apply and would deemed never to be applied on employee's contribution received by employer towards any welfare fund of such employee. In effect, the extended time upto due date of filing of return for is not available for credit of employees contribution towards any welfare fund received by the employer.

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(10) Allowance for animals [Section 36(1)(vi)] – This clause grants an allowance in respect of animals which have died or become permanently useless.

The amount of the allowance is the difference between the actual cost of the animals and the price realized on the sale of the animals themselves or their carcasses.

The allowance under the clause would thus recoup to the assessee the entire capital expenditure in respect of animal.

(11) Bad debts [Section 36(1)(vii) and section 36(2)] – These can be deducted subject to the following conditions:

(a) The debts or loans should be in respect of a business which was carried on by the assessee during the relevant previous year.

(b) The debt should have been taken into account in computing the income of the assessee of the previous year in which such debt is written off or of an earlier previous year or should represent money lent by the assessee in the ordinary course of his business of banking or money lending.

I. Deduction under section 36(1)(vii) for bad debts limited to the amount by which bad debts exceed credit balance in the provision for doubtful debts account under section 36(1)(viia)

Under section 36(1)(vii), bad debt actually written off as irrecoverable in the books of account of the assessee is deductible. However, in the case of entities for which provision for bad and doubtful debts is allowable under section 36(1)(viia), deduction for bad debts written off under said clause (vii) shall be limited to the amount by which the bad debt written off exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia). This is provided in the proviso to section 36(1)(vii).

The CBDT has, clarified vide Circular no. 12/2016, dated 30-05-2016, that claim for any debt or part thereof in any previous year, shall be admissible under section 36(1)(vii), if it is written off as irrecoverable in the books of accounts of the assessee for that previous year and it fulfills the conditions stipulated in section 36(2).

However, no such requirement is there in law that the assessee has to establish that the debt has, in fact, become irrecoverable.

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Further, the provisions of section 36(1)(vii) are subject to the provisions of section 36(2). Section 36(2)(v) provides that where the debt or part thereof relates to advances made by an assessee, to which section 36(1)(viia) applies, no deduction shall be allowed unless the assessee has debited the amount of such debt or part of such debt in that previous year to the provision for bad and doubtful debts account made under section 36(1)(viia).

Explanation 2 to section 36(1)(vii) states that for the purposes of the proviso to section 36(1)(vii) and section 36(2)(v), only one account as referred to therein shall be made in respect of provision for bad and doubtful debts under section 36(1)(viia) and such account shall relate to all types of advances, including advances made by rural branches.

Therefore, in the case of an assessee to which section 36(1)(viia) applies, the amount of deduction in respect of the bad debts actually written off under section 36(1)(vii) shall be limited to the amount by which such bad debts exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) without any distinction between rural advances and other advances.

II. Amount of debt taken into account in computing the income of the assessee on the basis of notified ICDSs to be allowed as deduction in the previous year in which such debt or part thereof becomes irrecoverable [Second proviso to section 36(1)(vii)]

(i) Under section 36(1)(vii), deduction is allowed in respect of the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year.

(ii) Therefore, write off in the books of account is an essential condition for claim of bad debts under section 36(1)(vii).

(iii) Amount of debt taken into account in computing the income of the assessee on the basis of notified ICDSs to be allowed as deduction in the previous year in which such debt or part thereof becomes irrecoverable.

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If a debt, which has not been recognized in the books of account as per the requirement of the accounting standards but has been taken into account in the computation of income as per the notified ICDSs, has become irrecoverable, it can still be claimed as bad debts under section 36(1)(vii) since **it shall be deemed that the debt has been written off as irrecoverable in the books of account by virtue of the second proviso to section 36(1)(vii).** This is because some ICDSs require recognition of income at an earlier point of time (prior to the point of time such income is recognised in the books of account). Consequently, if the whole or part of such income recognised at an earlier point of time for tax purposes becomes irrecoverable, it can be claimed as bad debts on account of the second proviso to section 36(1)(vii).

III. Deduction of differential amount of debts due as bad debts in the year of recovery, to the extent of deficiency in recovery

If on the final settlement the amount recovered in respect of any debt, where deduction had already been allowed, falls short of the difference between the debt due and the amount of debt allowed, the deficiency can be claimed as a deduction from the income of the previous year in which the ultimate recovery out of the debt is made. It is permissible for the Assessing Officer to allow deduction in respect of a bad debt or any part thereof in the assessment of a particular year and subsequently

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to allow the balance of the amount, if any, in the year in which the ultimate recovery is made, that is to say, when the final result of the process of recovery comes to be known.

Recovery of a bad debt subsequently [Section 41(4)] - If a deduction has been allowed in respect of a bad debt under section 36, and subsequently the amount recovered in respect of such debt is more than the amount due after the allowance had been made, the excess shall be deemed to be the profits and gains of business or profession and will be chargeable as income of the previous year in which it is recovered, whether or not the business or profession in respect of which the deduction has been allowed is in existence at the time.

Example: *For P.Y. 2024-25, bad debts of ₹ 40,000 was allowed by the Assessing Officer out of total bad debts of ₹ 75,000. Subsequently, ₹ 44,000 is recovered during P.Y. 2025-26.*

Actual bad debts of the assessee after recovery = ₹ 75,000 – ₹ 44,000 i.e. ₹ 31,000 but the bad debts allowed in P.Y. 2024-25 were ₹ 40,000, so the excess ₹ 9,000 that was allowed in P.Y. 2024-25 would be deemed to be the profits and gains of business or profession of P.Y. 2025-26 and will be chargeable as income of the P.Y. 2025-26 in which it is recovered.

(12) Provision for bad and doubtful debts in cases of specified banks [Section 36(1)(viia)]

(i) A scheduled bank which is not a bank incorporated by or under the laws of a country outside India or a non-scheduled bank or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank, the following deductions will be allowed:

(a) an amount **not exceeding 8.5%** of the total income (computed before making any deduction under this clause and Chapter VI-A), and

(b) an amount **not exceeding 10%** of the aggregate average advances made by the rural branches of such bank computed in the manner prescribed by the CBDT.

Accordingly, Rule 6ABA prescribed the manner for computation of aggregate average advance. The aggregate average advances made by the rural branches of a scheduled bank shall be computed in the following manner–

(i) the amounts of advances made by each rural branch as outstanding at the end of the last day of each month comprised in the previous year shall be aggregated separately;

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(ii) the sum so arrived at in the case of each such branch shall be divided by the number of months for which the outstanding advances have been taken into account for the purposes of clause (i)

(iii) the aggregate of the sums so arrived at in respect of each of the rural branches shall be the aggregate average advances made by the rural branches of the scheduled bank.

Such scheduled bank or a non-scheduled bank shall, at its option, be allowed in any of the relevant assessment years, deduction in respect of any provision made by it for any assets classified by the RBI as doubtful assets or loss assets in accordance with the guidelines issued by it in this behalf, for an amount not exceeding 5% of the amount of such assets shown in the books of account of the bank on the last day of the previous year.

Such scheduled bank or a non-scheduled bank shall, at its option, be allowed a further deduction in excess of the limits specified in the foregoing provisions, for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the Central Government.

It is also provided that this deduction shall not be allowed unless such income has been disclosed in the return of income under the head "Profits and gains of business or profession".

Meaning of certain terms:

Term	Meaning
Scheduled Bank	It refers to the State Bank of India or any of its subsidiaries or any of the nationalised banks and would also include any other bank which is listed in the Second Schedule to the Reserve Bank of India Act, 1934.
Non-Scheduled Bank	This refers to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 which is not a scheduled bank.
Rural branch	A branch of a scheduled bank or a non-scheduled bank situated in a place which has a population of not more than 10,000 according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

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Co-operative bank, primary agriculture credit society, primary co-operative agricultural and rural development bank	Shall have the same meaning assigned in *Explanation* to section 80P(4).

(ii) **Foreign Banks**: In the case of foreign banks the deduction will be an amount **not exceeding 5%** of the total income (computed before making any deduction under this clause and Chapter VI-A).

(iii) **Public financial institutions:** A public financial institution, a State Financial Corporation and a State Industrial Investment Corporation will be entitled to a deduction in respect of provision for bad and doubtful debts made out of profits. The maximum amount to be allowed as a deduction will be **limited to 5%** of its total income before making any deduction in respect of the provision for bad and doubtful debt or in respect of any deduction in Chapter VI-A.

(iv) **Non-Banking Financial Companies (NBFCs):** Since Non-Banking Financial Companies (NBFCs) are also engaged in financial lending to different sectors of society, deduction on account of provision for bad and doubtful debts of an amount **not exceeding 5%** of total income (before making any deduction under section 36(1)(viia) and Chapter VI-A) would be allowed in the case of NBFCs also.

Meaning of certain terms:

Terms	Meaning
Public Financial Institution	Shall have the meaning assigned to it in section 4A of the Companies Act, 1956[9]
State Financial Corporation	A financial corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporations Act, 1951.
State Industrial Investment Corporation	A Government company within the meaning of Section 617 of the Companies Act, 1956[10] engaged in the business of providing long-term finance for industrial projects and eligible for deduction under clause (viii) of this sub-section.

[9] Now section 2(72) of the Companies Act, 2013
[10] Now section 2(45) of the Companies Act, 2013

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Non-Banking Financial Company	Shall have the same meaning assigned to it in Section 45-I(f) of the Reserve Bank of India Act, 1934. Accordingly, it means (i) a financial institution which is a company (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner (iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

Provision for bad and doubtful debts in cases of specified banks/FIs/NBFCs

* other than a primary agricultural credit society or primary co-operative agricultural and rural development bank

(13) Special deduction to specified entities engaged in eligible business [Section 36(1)(viii)]

(i) This section provides deduction in respect of any special reserve created and maintained by a specified entity.

(ii) **Amount of deduction:** The quantum of deduction, however, **should not exceed 20%** of the profits derived from eligible business computed under the head "Profits and gains of business or profession" (before making any deduction under this clause) carried to such reserve account.

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However, where the aggregate amount carried to such reserve account exceeds twice the amount of paid up share capital and general reserve, no deduction shall be allowed in respect of such excess.

In simple terms**, quantum of deduction shall be the least of the following**

(i) Amount transferred to special reserve

(ii) 20% of profit derived from eligible business (before this deduction)

(iii) 200% of paid up capital and general reserve *less* aggregate amount carried to Special Reserve account.

(iii) **Eligible business for specified entities:** The eligible business for different entities specified are given in the table below –

	Specified entity	Eligible business
1.	(a) Financial Corporation specified in section 4A of the Companies Act, 1956[11] (b) Financial corporation which is a public sector company (c) Banking company (d) Co-operative bank (other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank)	**Business of providing long-term finance for -** **(i) industrial or agricultural development or** (ii) development of infrastructure facility in India; or (iii) development of housing in India.
2.	A housing finance company	Business of providing long-term finance for the construction or purchase of residential house in India.
3.	Any other financial corporation including a public company	Business of providing long-term finance for development of infrastructure facility in India.

[11] Section 2(72) of the Companies Act, 2013

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(iv) **Infrastructure facility has been defined to mean -**

(a) (1) an infrastructure facility as defined in the Explanation to clause (i) of sub-section (4) of section 80-IA i.e.

(i) a road including toll road, a bridge or a rail system;

(ii) a highway project including housing or other activities being an integral part of the highway project;

(iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; and

(iv) a port, airport, inland waterway or inland port or a navigational channel in the sea

(2) any other public facility of a similar nature as may be notified by the CBDT in this behalf in the Official Gazette and which fulfils the prescribed conditions;

Notification of public facilities as infrastructure facility for the purpose of section 36(1)(viii) [*Notification No. 188/2006, dated 20.7.2006*]

The following public facilities have been notified by the CBDT as infrastructure facility for purposes of section 36(1)(viii)-

(i) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962

(ii) Mass Rapid Transit system

(iii) Light Rail Transit system

(iv) Expressways

(v) Intra-urban or semi-urban roads like ring roads or urban by-passes or flyovers

(vi) Bus and truck terminals

(vii) Subways

(viii) Road dividers

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(ix) Bulk Handling Terminals which are developed or maintained or operated for development of rail system

(x) Multilevel Computerized Car Parking.

Conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility *[Notification No.187/2006 dated 20.7.2006]:*

Rule 6ABAA has been inserted in the Income-tax Rules, 1962 which specifies the conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility in accordance with the provisions of clause (d) of the Explanation to clause (viii) of sub-section (1) of section 36. The conditions specified therein are -

(i) it is owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act;

(ii) it has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (a) developing or (b) operating and maintaining or (c) developing, operating and maintaining a new infrastructure facility similar in nature to an infrastructure facility referred to in the *Explanation* to section 80-IA(4)(i);

(iii) it has started or starts operating and maintaining such infrastructure facility on or after 1st April, 1995.

(b) an undertaking referred to in clause (ii) or clause (iii) or clause (iv) of sub-section (4) of section 80-IA (i.e. an undertaking providing telecommunication services, an undertaking developing, developing and operating, maintaining and operating an industrial park or SEZ notified by the Central Government, an undertaking generating, distributing or transmitting power, substantial renovation and modernization of existing network of transmission or distribution lines); and

(c) an undertaking referred to in sub-section (10) of section 80-IB i.e. an undertaking developing and building housing projects approved by a local authority.

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(v) **Long term finance** - 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 5 years.

Amount withdrawal from special reserve [Section 41(4A)] - Where a deduction has been allowed in respect of any special reserve created and maintain under section 36(1)(viii), and subsequently the amount is withdrawn from such special reserve then such amount shall be deemed to be the profits and gains of business or profession and will be chargeable as income of the previous year in which such amount is withdrawn.

If the amount is withdrawn in a previous year in which the business is no longer in existence, the taxability would arise in the above manner as though the business is in existence in that previous year.

(14) Expenses on family planning by a company [Section 36(1)(ix)] - Any expenditure of revenue nature *bona fide* incurred by a company for the purpose of promoting family planning amongst its employees will be allowed as a deduction in computing the company's business income;

- Where, the expenditure is of a capital nature, **one-fifth of such expenditure** will be deducted in the previous year in which it was incurred and in each of the four immediately succeeding previous years.
- This deduction is **allowable only to companies** and not to other assessees.
- The assessee would be **entitled to carry forward and set off** the unabsorbed part of the allowance in the same way as unabsorbed depreciation.

The capital expenditure on promoting family planning will be treated in the same way as capital expenditure for scientific research for purposes of dealing with the profit or loss on the sale or transfer of the asset including a transfer on amalgamation.

(15) Deduction for expenditure incurred by entities established under any Central, State or Provincial Act [Section 36(1)(xii)] - Any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate, by whatever name called, if –

(i) it is constituted or established by a Central, State or Provincial Act;

(ii) such corporation or body corporate is notified by the Central Government in the Official Gazette for this purpose having regard to the objects and purposes of the Act;

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(iii) the expenditure is incurred for the objects and purposes authorised by the Act under which it is constituted and established.

Accordingly, the Central Government has notified the Oil Industry Development Board for the purpose of deduction under section 36(1)(xii).

(16) Deduction of contribution by a public financial institution to Credit guarantee fund trust for small industries [Section 36(1)(xiv)]

(i) Section 36(1)(xiv) provides for deduction of any sum paid by a public financial institution by way of contribution to such credit guarantee fund trust for small industries notified by the Central Government in the Official Gazette.

(ii) Public financial institution has the meaning assigned to it in section 4A[12] of the Companies Act, 1956.

(17) Deduction of securities transaction tax paid [Section 36(1)(xv)] - The amount of securities transaction tax paid by the assessee during the year in respect of taxable securities transactions entered into in the course of business shall be allowed as deduction under section 36 subject to the condition that such income from taxable securities transactions is included under the head 'Profits and gains of business or profession'.

Thus, securities transaction tax paid would be allowed as a deduction like any other business expenditure.

(18) Deduction for commodities transaction tax paid in respect of taxable commodities transactions [Section 36(1)(xvi)]

(i) Section, 36(1)(xvi) provides that an amount equal to the CTT paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year shall be allowable as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".

(ii) A 'taxable commodities transaction' means a transaction of sale of commodity derivatives or sale of commodity derivatives based on prices or indices of prices of commodity derivatives or option on commodity derivatives or option in goods in respect of commodities, other than agricultural commodities, traded in recognised stock exchange.

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[12] Section 2(72) of the Companies Act, 2013

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(iii) A "**commodity derivative**" means –

(a) A contract for delivery of goods which is not a ready delivery contract

(b) A contract for differences which derives its value from prices or indices of prices -

(i) of such underlying goods; or

(ii) of related services and rights, such as warehousing and freight; or

(iii) with reference to weather and similar events and activities having a bearing on the commodity sector.

(19) Amount of expenditure incurred by a co-operative society for purchase of sugarcane at price fixed by the Government allowable as deduction [Section 36(1)(xvii)] - Section 36(xvii) provides for deduction of expenditure incurred by a co-operative society engaged in the business of manufacture of sugar for purchase of sugarcane at a price equal to or less than the price fixed or approved by the Government.

The CBDT has, vide Circular no. 18/2021 dated 25.10.2021, clarified that the phrase 'price fixed or approved by the Government' includes price fixation by State Governments through State-level Acts/Orders or other legal instruments that regulate the purchase price for sugarcane, including State Advised Price, which may be higher than the Statutory Minimum Price/ Fair and Remunerative Price fixed by the Central Government.

(20) Marked to market loss [Section 36(1)(xviii)] - Marked to market loss or other expected loss as computed in accordance with the ICDS notified under section 145(2), shall be allowed as deduction. ICDS I provides that marked to market losses would not be allowed unless the same is in accordance with any other ICDS. Therefore, only marked to market losses specifically permitted under any other ICDS would be allowable as deduction under section 36.

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(18) Residuary Expenses [Section 37]

(1) **Revenue expenditure incurred for purposes of carrying on the business, profession or vocation -** This is a residuary section under which only business expenditure is allowable but not the business losses, e.g., those arising out of embezzlement, theft, destruction of assets, misappropriation by employees etc. The deduction is limited only to the amount actually expended and does not extend to a reserve created against a contingent liability.

(2) **Conditions for allowance**: The following conditions should be fulfilled in order that a particular item of expenditure may be deductible under this section:

(a) The expenditure should **not** be of the nature described in **sections 30 to 36**.

(b) It should have been **incurred by the assessee** in the accounting year.

(c) It should be in respect of a business carried on by the assessee the profits of which are being computed and assessed.

(d) It must have been incurred after the business was set up.

(e) It should **not** be in the nature of **any personal expenses** of the assessee.

(f) It should have been laid out or expended **wholly and exclusively for the purposes of such business**.

(g) It should **not** be in the nature of **capital expenditure**.

(h) The expenditure should **not** have been incurred by the assessee for any purpose which is an **offence or is prohibited by law**.

This section is thus limited in scope. It does not permit an assessee to make all deductions which a prudent trader would make in ascertaining his own profit. It might be observed that the section requires that the expenditure should be wholly and exclusively laid out for purpose of the business but not that it should have been necessarily laid out for such purpose. Therefore, expenses wholly and exclusively laid out for the purpose of trade are, subject to the fulfilment of other conditions, allowed under this section even though the outlay is unnecessary.

(3) **Expenditure incurred on Keyman insurance policy:** CBDT *Circular no. 762/1998 dated 18.02.1998* clarifies that the premium paid on the Keyman Insurance Policy is allowable as business expenditure.

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Taking into account the *Explanation* to Section 10(10D) and the CBDT *Circular no. 762 dated 18.02.1998,* Courts have held that a Keyman Insurance Policy is not confined to a policy taken for an employee but also extends to an insurance policy taken with respect to the life of another person who is connected in any manner whatsoever with the business of the subscriber (assessee).

The High Court of Punjab and Haryana has, in the case of *M/s. Ramesh Steels, ITA No. 437 of 2015*, vide judgement dated 2.2.2016, reiterating the above view, held that, "the said policy when obtained to secure the life of a partner to safeguard the firm against a disruption of the business is equally for the benefit of the partnership business which may be effected as a result of premature death of a partner. Thus, the premium on the Keyman Insurance Policy of partner of the firm is wholly and exclusively for the purpose of business and is allowable as business expenditure".

In view of the above, the CBDT has clarified that in case of a firm, premium paid by the firm on the Keyman Insurance Policy of a partner, to safeguard the firm against a disruption of the business, is an admissible expenditure under section 37 of the Act.

(4) ***Explanation 1* to section 37(1) -** This Explanation provides that any expenditure incurred by the assessee for any purpose which is an offence or is prohibited by law shall not be allowed as a deduction or allowance.

(5) ***Explanation* 3 to section 37(1) –** It is clarified that the expression "expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law" in (4) above would include and would be deemed to have always included the expenditure incurred by an assessee, -

(i) for any purpose which is an offence under any law for the time being in force, in India or outside India or which is prohibited by any law for the time being in force, in India or outside India; or

(ii) to provide any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guidelines, as the case may be, for the time being in force, governing the conduct of such person; or

(iii) to compound an offence under any law for the time being in force, in India or outside India [*Explanation 3* to section 37(1)].

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(v) to settle proceedings initiated in relation to contravention under such law as may be notified by the Central Government in this behalf.

W.e.f. 23.4.2025, the Central Government has, vide notification no. 38/2025 dated 23.4.2025, notified that any expenditure incurred to settle proceedings initiated in relation to contravention or defaults under the following laws shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure –

(a) the Securities and Exchange Board of India Act, 1992;

(b) the Securities Contracts (Regulation) Act, 1956;

(c) the Depositories Act, 1996;

(d) the Competition Act, 2002.

For eg: expenses incurred in providing freebies to medical practitioner by pharmaceutical and allied health sector industry are in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations. Hence, such expenditure is considered to be expenses prohibited by the law and not allowed in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies.

The Supreme Court, in *Apex Laboratories Pvt. Ltd. v. DCIT (2022) 442 ITR 1*, held that the incentives (or "freebies") given by the pharmaceutical company, to the doctors, had a direct result of exposing the recipients to the odium of sanctions, leading to a ban on their practice of medicine. Those sanctions are mandated by law, as they are embodied in the code of conduct and ethics, which are normative, and have legally binding effect. The conceded participation of the assessee – Pharmaceutical company, i.e., the provider or donor, was plainly prohibited, as far as their receipt by the medical practitioners was concerned. That medical practitioners were forbidden from accepting such gifts, or "freebies" was no less a prohibition on the part of their giver, or donor, i.e., pharmaceutical company.

Thus, pharmaceutical companies' gifting freebies to doctors is clearly "prohibited by law" and not allowed to be claimed as a deduction under section 37(1). Doing so would wholly undermine public policy.

Explanation 3 inserted in section 37(1) is in consonance with the above Supreme Court judgement.

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(6) Disallowance of CSR expenditure [*Explanation 2* to Section 37(1)]

(i) Section 135 of the Companies Act, 2013 read with Schedule VII thereto and Companies (Corporate Social Responsibility) Rules, 2014 are the special provisions under the new company law regime imposing mandatory CSR obligations in respect of companies having net worth/turnover/net profit exceeding specified threshold limits. Such companies have to spend a specified percentage of their average net profits on CSR activities.

(ii) Under section 37(1) of the Income-tax Act, 1961, only expenditure, not covered under sections 30 to 36, and incurred wholly and exclusively for the purposes of the business is allowed as a deduction while computing taxable business income. The issue under consideration is whether CSR expenditure is allowable as deduction under section 37.

(iii) It has now been clarified that for the purposes of section 37(1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall not be allowed as deduction under section 37.

(iv) The rationale behind the disallowance is that CSR expenditure, being an application of income, is not incurred wholly and exclusively for the purposes of carrying on business.

(v) However, the Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that CSR expenditure, which is of the nature described in sections 30 to 36, shall be allowed as deduction under those sections subject to fulfillment of conditions, if any, specified therein.

(7) Advertisements in souvenirs of political parties: Section 37(2B) disallows any deduction on account of advertisement expenses representing contributions made by any person carrying on business or profession in computing the profits and gains of the business or profession. It has specifically been provided that this provision for disallowance would apply notwithstanding anything to the contrary contained in section 37(1).

In other words, the expenditure representing contribution for political purposes would become disallowable even in those cases where the expenditure is otherwise incurred by the assessee in his character as a trader and the amount is wholly and exclusively incurred for the purpose of the business.

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Accordingly, a taxpayer would not be entitled to any deduction in respect of expenses incurred by him on advertisement in any souvenir, brochure, tract or the like published by any political party, whether it is registered with the Election Commission of India or not.

(8) Deduction in respect of cost of production allowable under section 37 in the case of Abandoned Feature Films *[Circular No. 16, dated 6.10.2015]*

The deduction in respect of the cost of production of a feature film certified for release by the Board of Film Censors in a previous year is provided in Rule 9A.

In the case of abandoned films, however, since certificate of Board of Film Censors is not received, in some cases no deduction was allowed by applying Rule 9A of the Rules or by treating the expenditure as capital expenditure.

The CBDT has examined the matter in light of judicial decisions on this subject. The order of the Hon'ble Bombay High Court dated 28.1.2015 in ITA 310 of 2013 in the case of *Venus Records and Tapes Pvt. Ltd.* on this issue has been accepted and the aforesaid disputed issue has not been further contested.

Consequently, it is clarified that Rule 9A does not apply to abandoned feature films and that the expenditure incurred on such abandoned feature films is **not** to be treated as a capital expenditure. The cost of production of an abandoned feature film is to be treated as revenue expenditure and allowed as per the provisions of section 37 of the Income-tax Act, 1961.

ILLUSTRATION 11

Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31.03.2026 is ₹ 35,25,890 after debiting the following items:

S. No.	Particulars	₹
1.	Purchase price of raw material used for the purpose of in-house research and development	11,80,000
2.	Purchase price of asset used for in-house research and development	
	(a) Land	5,00,000
	(b) Building	3,00,000
3.	Expenditure incurred on notified agricultural extension project	25,50,000
4.	Expenditure on notified skill development project:	

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	(a) Purchase of land	*40,00,000*
	(b) Expenditure on training for skill development	*32,50,000*
5.	*Expenditure incurred on advertisement in the souvenir published by a political party*	*75,000*
6.	*Expenditure incurred on issue of right shares*	*80,000*
7.	*Expenditure incurred on issue of debentures*	*50,000*
8.	*Penalty paid under GST Act*	*35,000*
9.	*Interest paid on loan taken from bank for payment of advance income-tax*	*60,000*
10.	*Provision for loss of subsidiary*	*85,000*

Compute the income under the head "Profits and gains of business or profession" for the A.Y. 2026-27 of Isac Ltd assuming that the company does not opt for the provisions of section 115BAA.

SOLUTION

Computation of income under the head "Profits and gains of business or profession" for the A.Y.2026-27

Particulars	₹	₹
Net profit as per profit and loss account		**35,25,890**
Add: **Items debited to profit and loss account, but to be disallowed**		
Purchase price of raw material used for the purpose of in-house research and development – qualifies for 100% deduction u/s 35(2AB)	-	
Purchase price of Land used in in-house research and development - being capital expenditure not allowable as deduction under section 35	5,00,000	
Purchase price of building used in in-house research and development - being capital expenditure, 100% of which is allowable as deduction u/s 35(1)(iv) read with section 35(2)	-	
Expenditure incurred on notified agricultural extension project – 100% deduction is allowed under section 35CCC	-	
Expenditure incurred on notified skill development project - Purchase of land - being capital expenditure not qualifying for deduction under section 35CCD	40,00,000	

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Expenditure incurred on notified skill development project - Expenditure on training for skill development – 100% deduction is allowed under section 35CCD	-	
Expenditure incurred on advertisement in the souvenir published by a political party not allowed as deduction as per section 37(2B)	75,000	
Expenditure incurred on issue of right shares not allowed as deduction since expenses is of capital nature	80,000	
Expenditure incurred on issue of debentures [allowable]	-	
Penalty paid under GST Act - Not allowed as deduction	35,000	
Interest paid on loan taken from bank for payment of advance income-tax not allowed as deduction since the same is not for the purpose of business or profession	60,000	
Provision for loss of subsidiary not allowed as deduction	85,000	**48,35,000**
Profit and gains from business		**83,60,890**

Note: The expenditure incurred on advertisement in the souvenir published by a political party is disallowed as per section 37(2B) while computing income under the head "Profit and Gains of Business or Profession" but the same would be allowed as deduction under section 80GGB from the gross total income of the company.

(9) In case of an assessee carrying on business, it is relevant to see whether an outlay constitutes an expenditure "for the purpose of business" as used in section 37(1), for the purpose of claiming deduction thereunder. The source of funds from which the expenditure is made is not relevant. Every application of income towards the business objective of the assessee is a business expenditure. There can be an amount treated as a capital receipt while the same amount expended may be a revenue expenditure. ***[National Co-operative Development Corporation v. CIT [2020] 427 ITR 288 (SC)]***

(19) Clarification regarding treatment of expenditure incurred for development of roads/ highways in Build-Operate-Transfer (BOT) agreements under the Income-tax Act, 1961 [*Circular No. 09/2014, dated 23.04.2014*]

The CBDT has, vide this Circular, clarified the tax treatment of expenditure incurred on development and construction of infrastructural facilities like roads/highways on Build-Operate-Transfer (BOT) basis with right to collect toll - whether the same is entitled to depreciation under section 32(1)(ii) or can be amortized by treating it as an allowable business expenditure under the relevant provisions of the Income- tax Act, 1961.

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Generally, the BOT basis projects are entered into between the developer and the government or the notified authority, on the following terms:

(i) In such projects, the developer, in terms of concessionaire agreement with Government or its agencies, is required to construct, develop and maintain the infrastructural facility of roads/highways which, *inter alia*, includes laying of road, bridges, highways, approach roads, culverts, public amenities etc. at its own cost and its utilization thereof for a specified period.

(ii) The possession of land is handed over to the assessee (i.e., the developer) by the Government/ notified authority for the purpose of construction of the project without any actual transfer of ownership. The assessee, therefore, has only a right to develop and maintain such asset. It also enjoys the benefits arising from the use of asset through collection of toll for a specified period, without having actual ownership over such asset. Therefore, the rights in the land remain vested with the Government/notified agencies.

(iii) Since the assessee does not hold any rights in the project except recovery of toll fee to recoup the expenditure incurred, it cannot be treated as an owner of the property, either wholly or partly, for purposes of allowability of depreciation under section 32(1)(ii). Thus, claim of depreciation on toll ways is not allowable due to non-fulfillment of ownership criteria in such cases.

(iv) Where the assessee incurs expenditure on a project for development of roads/highways, it is entitled to recover cost incurred towards development of such facility (comprising of construction cost and other pre-operative expenses) during construction period. Further, expenditure incurred by the assessee on such BOT projects brings to it an enduring benefit in the form of right to collect the toll during the period of agreement.

The Supreme Court, in *Madras Industrial Investment Corporation Ltd. vs. CIT [1997] 225 ITR 802,* allowed the spreading over of liability over a number of years on the ground that there was continuing benefit to the company over a period. Therefore, analogously, expenditure incurred on an infrastructure project for development of roads/highways under BOT agreement may be treated as having been made/ incurred for the purposes of business or profession of the assessee and same shall be allowed to be spread during the tenure of concessionaire agreement.

In view of the above, the CBDT, in exercise of the powers conferred under section 119, clarifies that the cost of construction on development of infrastructure facility, being roads/highways under BOT projects, may be amortized and claimed as allowable business expenditure under the Act in the following manner:

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(i) The amortization allowable may be computed at the rate which ensures that the whole of the cost incurred in creation of infrastructural facility of road/highway is amortised evenly over the period of concessionaire agreement after excluding the time taken for creation of such facility.

(ii) Where an assessee has claimed any deduction out of initial cost of development of infrastructure facility of roads/highways under BOT projects in earlier years, the total deduction so claimed for the assessment years prior to assessment year under consideration may be deducted from the initial cost of infrastructure facility of roads/highways and the cost so reduced shall be amortised equally over the remaining period of toll concessionaire agreement.

The clarification given in this Circular is applicable only to those infrastructure projects for development of road/highways on BOT basis where ownership is not vested with the assessee under the concessionaire agreement.

3.7 INADMISSIBLE DEDUCTIONS [SECTION 40]

By dividing the assessees into distinct groups, this section places absolute restraint on the deductibility of certain expenses as follows:

In the case of any assessee, the following expenses are not deductible:

(1) Section 40(a)(i)

Any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable,-

(a) outside India;

(b) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source under Chapter XVIIB and such tax has not been deducted or, after deduction, has not been paid on or before the due date of filing of return specified under section 139(1).

It is also provided that where in respect of any such sum, where tax has been deducted in any subsequent year, or has been deducted in the previous year but paid after the due date of filing of return under section 139(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such payee –

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(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed,

it would be deemed that the assessee has deducted and paid the tax on such sum on the date on which return of income has been furnished by the payee.

Since the date of furnishing the return of income by the payee is taken to be the date on which the payer has deducted tax at source and paid the same, such expenditure/payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(i) in the year in which the said expenditure is incurred. However, such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the payee, since tax is deemed to have been deducted and paid by the payer in that year.

Clarification regarding disallowance of 'other sum chargeable' under section 40(a)(i) [*Circular No. 3/2015, dated 12-02-2015*]

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

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

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

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

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(2) Section 40(a)(ia)

Section 40(a)(ia) provides that **30% of any sum payable to a resident**, on which tax is deductible at source under Chapter XVII-B**,** shall be disallowed if –

(i) such tax has not been deducted; or

(ii) such tax, after deduction, has not been paid on or before the due date specified in section 139(1).

If in respect of such sum, tax has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in section 139(1), 30% of such sum shall be allowed as deduction in computing the income of the previous year in which such tax has been paid.

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such payee –

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed,

it would be deemed that the assessee has deducted and paid the tax on such sum.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the payee.

Since the date of furnishing the return of income by the payee is taken to be the date on which the payer has deducted tax at source and paid the same, 30% of such expenditure/payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(ia) in the year in which the said expenditure is incurred. However, 30% of such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the payee, since tax is deemed to have been deducted and paid by the payer in that year.

Example: *Tax on royalty paid to Mr. A, a resident, has been deducted during the previous year 2025-26, the same has to be paid by 31st July/ 31ts October 2026, as the case may be. Otherwise, 30% of royalty paid would be disallowed in computing the income for A.Y. 2026-27. If in respect of such royalty, tax deducted during the P.Y.2025-26 has been paid after 31st July/ 31st October, 2026, 30% of such royalty disallowed in A.Y. 2026-27, would be allowed as deduction in the year of payment, i.e. A.Y. 2027-28*

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ILLUSTRATION 12

Delta Ltd. credited the following amounts to the account of resident payees in the month of March, 2026 without deduction of tax at source. What would be the consequence of non-deduction of tax at source by Delta Ltd. on these amounts during the financial year 2025-26, assuming that the resident payees in all the cases mentioned below, have not paid the tax, if any, which was required to be deducted by Delta Ltd.?

	Particulars	*Amount (₹)*
(1)	*Salary to its employees (credited and paid in March, 2026)*	*13,00,000*
(2)	*Directors' remuneration (credited in March, 2026 and paid in April, 2026)*	*28,000*

Would your answer change if Delta Ltd. has deducted tax on directors' remuneration in April, 2026 at the time of payment and remitted the same in July, 2026?

SOLUTION

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

Therefore, non-deduction of tax at source on any sum paid by way of salary on which tax is deductible under section 192 or any sum credited or paid by way of directors' remuneration on which tax is deductible under section 194J, would attract disallowance@30% under section 40(a)(ia). Whereas in case of salary, tax has to be deducted under section 192 at the time of payment, in case of directors' remuneration, tax has to be deducted at the time of credit of such sum to the account of the payee or at the time of payment, whichever is earlier. Therefore, in both the cases i.e., salary and directors' remuneration, tax is deductible in the P.Y.2025-26, since salary was paid in that year and directors' remuneration was credited in that year. Therefore, the amount to be disallowed under section 40(a)(ia) while computing business income for A.Y.2026-27 is as follows –

	Particulars	Amount paid in ₹	Disallowance u/s 40(a)(ia)@ 30% (₹)
(1)	Salary [tax is deductible under section 192]	13,00,000	3,90,000
(2)	Directors' remuneration [tax is deductible under section 194J without any threshold limit]	28,000	8,400
Disallowance under section 40(a)(ia)			**3,98,400**

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If the tax is deducted on directors' remuneration in the next year i.e., P.Y.2026-27 at the time of payment and remitted to the Government, the amount of ₹ 8,400 would be allowed as deduction while computing the business income of A.Y.2027-28.

Disallowance of any sum paid to a resident at any time during the previous year without deduction of tax under section 40(a)(ia) [*Circular No.10/2013, dated 16.12.2013*]

There have been conflicting interpretations by judicial authorities regarding the applicability of provisions of section 40(a)(ia), with regard to the amount not deductible in computing the income chargeable under the head 'Profits and gains of business or profession'. Some court rulings have held that the provisions of disallowance under section 40(a)(ia) apply only to the amount which remained payable at the end of the relevant financial year and would not be invoked to disallow the amount which had actually been paid during the previous year without deduction of tax at source.

Departmental View: The CBDT's view is that the provisions of section 40(a)(ia) would cover not only the amounts which are payable as on 31st March of a previous year but also amounts which are payable at any time during the year. The statutory provisions are amply clear and in the context of section 40(a)(ia), the term "payable" would include "amounts which are paid during the previous year".

ILLUSTRATION 13

During the financial year 2025-26, the following payments/expenditure were made/incurred by Mr. Yuvan Raja, a resident individual (whose turnover during the year ended 31.3.2025 was ₹ 99 lakhs):

(i) Interest of ₹ 45,000 was paid to Rehman & Co., a resident partnership firm, without deduction of tax at source;

(ii) ₹ 15,00,000 was paid as salary to a resident individual without deduction of tax at source;

(iii) Commission of ₹ 26,000 was paid to Mr. Vidyasagar on 2.7.2025 without deduction of tax at source.

Briefly discuss whether any disallowance arises under the provisions of section 40(a)(ia) of the Income-tax Act, 1961 assuming that the payees in all the cases mentioned above, have not paid the tax, if any, which was required to be deducted by Mr. Raja?

SOLUTION

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

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(i) The obligation to deduct tax at source from interest paid to a resident arises under section 194A in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2024-25 exceeds ₹ 1 crore. Thus, in present case, since the turnover of the assessee is less than ₹ 100 lakhs, he is not liable to deduct tax at source. Hence, disallowance under section 40(a)(ia) is not attracted in this case.

(ii) The disallowance of 30% of the sums payable under section 40(a)(ia) would be attracted in respect of all sums on which tax is deductible under Chapter XVII-B. Section 192, which requires deduction of tax at source from salary paid, is covered under Chapter XVII-B. The obligation to deduct tax at source under section 192 arises, in the hands all assessee-employer even if the turnover amount does not exceed ₹ 1 crore in the immediately preceding previous year.

Therefore, in the present case, the disallowance under section 40(a)(ia) is attracted for failure to deduct tax at source under section 192 from salary payment. However, only 30% of the amount of salary paid without deduction of tax at source would be disallowed i.e. ₹ 4,50,000 (₹ 15 lakhs × 30%).

(iii) The obligation to deduct tax at source under section 194-H from commission paid in excess of ₹ 20,000 to a resident arises in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2024-25 exceeds ₹ 1 crore. Thus, in present case, since the turnover of the assessee is less than ₹ 1 crore, he is not liable to deduct tax at source under section 194H. Mr. Raja is not required to deduct tax at source u/s 194M also since the aggregate of such commission to Mr. Vidyasagar does not exceed ₹ 50 lakh during the P.Y. 2025-26. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

(3) Section 40(a)(ib)

Section 40(a)(ib) provides that where any consideration is paid or payable to a non-resident for a specified service on which equalisation levy is deductible, and such levy has not been deducted or after deduction, has not been paid on or before the due date under section 139(1), then, such expenses incurred by the assessee towards consideration for specified service shall not be allowed as deduction.

However, where in respect of such consideration, if the equalisation levy has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified under section 139(1), such sum shall be allowed as deduction in computing the income of the previous year in which such levy has been paid.

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(4) Section 40(a)(ii)

Any sum paid on account of rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or on the basis of any such profits and gains is not allowed as deduction from business income.

(a) Any sum paid outside India (on account of any rate or tax levied) which is eligible for tax relief under section 90 or deduction from the income-tax payable under section 91 is not allowable and is deemed to have never been allowable as a deduction under section 40(a).

(b) However, the tax payers will continue to be eligible for tax credit in respect of income-tax paid in a foreign country in accordance with the provisions of section 90 or section 91, as the case may be.

(c) Any sum paid outside India (on account of any rate or tax levied) and eligible for relief under section 90A will not be allowed as a deduction.

(d) The term "tax" would include and would be deemed to have always included any surcharge or cess, by whatever name called, on such tax. Hence, tax including surcharge and cess would be disallowed while computing business income.

(5) Section 40(a)(iib)

(i) any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge, etc., which is levied exclusively on, or

(ii) any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government (SG)

A State Government undertaking includes –

(a) A corporation established by or under any Act of the State Government;

(b) A company in which more than 50% of the paid up equity share capital is held by the State Government;

(c) A company in which more than 50% of the paid up equity share capital is held singly or jointly by (a) or (b);

(d) A company or corporation in which the State Government has the right to appoint the majority of directors or to control the management or policy decisions

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(e) 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.

(6) Section 40(a)(iii)

Any sum which is chargeable under the head 'Salaries' if it is payable outside India or to a non-resident and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B.

(7) Section 40(a)(iv)

Any contribution to a provident fund or the fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to make sure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head 'Salaries'.

(8) Section 40(a)(v)

Tax paid on perquisites on behalf of employees is not deductible - In case of an employee, deriving income in the nature of perquisites (other than monetary payments), the amount of tax on such income paid by his employer is exempt from tax in the hands of that employee.

Correspondingly, such payment is not allowed as deduction from the income of the employer. Thus, the payment of tax on perquisites by an employer on behalf of employee will be exempt from tax in the hands of employee but will not be allowable as deduction in the hands of the employer.

In the case of any firm assessable as such or a limited liability partnership (LLP) the following amounts shall not be deducted in computing the business income

Section 40(b)

(1) Remuneration to non-working partner - Any salary, bonus, commission, remuneration by whatever name called, to any partner who is not a working partner. (In the following discussion, the term 'remuneration' is applied to denote payments in the nature of salary, bonus, commission);

(2) Remuneration to a working partner not authorized by deed - Any remuneration paid to the working partner or interest to any partner which is not authorised by or which is inconsistent with the terms of the partnership deed

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(3) **Remuneration to a working partner or interest to a partner authorized by deed but relates to an earlier period -** It is possible that the current partnership deed may authorise payments of remuneration to any working partner or interest to any partner for a period which is prior to the date of the current partnership deed. The approval by the current partnership deed might have been necessitated due to the fact that such payment was not authorised by or was inconsistent with the earlier partnership deed. Such payments of remuneration or interest will also be disallowed. However, it should be noted that the current partnership deed cannot authorise any payment which relates to a period prior to the date of earlier partnership deed.

Next, by virtue of a further restriction contained in section 40(b)(iii), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not for any period prior thereto.

Example: If a firm incorporates the clause relating to payment of remuneration to the working partners, by executing an appropriate deed, say, on July 1, 2025 but effective from April 1, 2025 the firm would get deduction for the remuneration paid to its working partners from July 1, 2025 onwards, but not for the period from April 1 to June 30. It will not be possible to give retrospective effect to oral agreements entered into *vis-a-vis* such remuneration prior to putting the same in a written partnership deed.

(4) **Interest to any partner in excess of 12% p.a.-** Any interest payment authorised by the partnership deed falling after the date of such deed to the extent such interest exceeds 12% simple interest p.a.

(5) **Remuneration to a working partner in excess of prescribed limits -** Any remuneration paid to a working partner, authorised by a partnership deed and falling after the date of the deed in excess of the following limits:

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

(6) **Meaning of certain terms:**

Term	Meaning
Book Profit	The net profit as shown in the profit and loss account for the relevant previous year computed in accordance with the provisions for computing income from profits and gains [*Explanation 3* to section 40(b)].

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	The above amount should be increased by the remuneration paid or payable to all the partners of the firm if the same has been deducted while computing the net profit.
Working partner	An individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner [*Explanation 4* to section 40(b)]

ILLUSTRATION 14

A firm assessed as such has paid ₹ 8,50,000 as remuneration to its partners for the P.Y.2025-26, in accordance with its partnership deed, and it has a book profit of ₹ 10 lakh as computed under section 40(b). What is the remuneration allowable as deduction?

SOLUTION

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

Particulars	₹
On first ₹ 6 lakh of book profit [₹ 6,00,000 × 90%]	5,40,000
On balance ₹ 4 lakh of book profit [₹ 4,00,000 × 60%]	2,40,000
	7,80,000

The excess amount of ₹ 70,000 (i.e., ₹ 8,50,000 – ₹ 7,80,000) would be disallowed as per section 40(b)(v).

(7) *Explanations* to section 40(b)

(i) Where an individual is a partner in a firm in a representative capacity:

(a) interest paid by the firm to such individual otherwise than as partner in a representative capacity shall not be taken into account for the purposes of this clause.

(b) interest paid by the firm to such individual as partner in a representative capacity and interest paid by the firm to the person so represented shall be taken into account for the purposes of this clause [*Explanation 1* to section 40(b)]

(ii) Where an individual is a partner in a firm otherwise than in a representative capacity, interest paid to him by the firm shall not be taken into account if he receives the same on behalf of or for the benefit of any other person [*Explanation 2* to section 40(b)].

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Example: *Mr. A is a partner in ABC & Co. on behalf of Shah HUF. Interest to its partners @15% is authorised by ABC & Co. ABC & Co. pays ₹ 7 lakhs as interest to Mr. A out of which ₹ 4 lakhs on the funds advanced by Mr. A in his individual capacity and ₹ 3 lakhs on the funds advanced by him in his representative capacity on behalf of Shah HUF. The interest of ₹ 4 lakhs paid to Mr. A in his individual capacity is allowed as deduction subject to section 40A(2) and shall not be taken into account for purpose of section 40(b). Whereas the interest paid to Mr. A in his representative capacity would be allowed to the extent of ₹ 2.40 lakhs i.e., ₹ 3 lakhs/15% x 12%.*

ILLUSTRATION 15

Rao & Jain, a partnership firm consisting of two partners, reports a net profit of ₹ 17,00,000 before deduction of the following items:

(1) Salary of ₹ 40,000 each per month payable to two working partners of the firm (as authorized by the deed of partnership).

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

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

Compute:

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

(ii) Allowable working partner salary for the assessment year 2026-27 as per section 40(b).

SOLUTION

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

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

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

Particulars	₹	₹
Net Profit (before deduction of depreciation, salary and interest)		17,00,000
Less: Depreciation under section 32	1,50,000	
Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (₹ 5,00,000 × 12%)	60,000	2,10,000
Book Profit		**14,90,000**

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(ii) Salary actually paid to working partners = ₹ 40,000 × 2 × 12 = ₹ 9,60,000.

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

On the first ₹ 6,00,000 of book profit or in case of loss	₹ 3,00,000 or 90% of book profit, whichever is more
On the balance of book profit	60% of the balance book profit

Therefore, the maximum allowable working partners' salary for the A.Y. 2026-27 in this case would be:

Particulars	₹
On the first ₹ 6,00,000 of book profit [(₹ 3,00,000 or 90% of ₹ 6,00,000) whichever is more]	5,40,000
On the balance of book profit [60% of (₹ 14,90,000 - ₹ 6,00,000)]	5,34,000
Maximum allowable partners' salary	**10,74,000**

Hence, allowable working partners' salary for the A.Y. 2026-27 as per the provisions of section 40(b)(v) is ₹ 9,60,000.

In the case of Association of persons or body of individuals, following amounts shall not be deducted in computing the business income

Section 40(ba)

Any payment of interest, salary, commission, bonus or remuneration made by an association of persons or body of individuals to its members will also not be allowed as a deduction in computing the income of the association or body.

There are three Explanations to section 40(ba):

***Explanation 1* -** Where interest is paid by an AOP or BOI to a member who has paid interest to the AOP/BOI, the amount of interest to be disallowed under clause (ba) shall be limited to the net amount of interest paid by AOP/BOI to the partner.

***Explanation 2* -** Where an individual is a member in an AOP/BOI in a representative capacity, interest paid by AOP/BOI to such individual or by such individual to AOP/ BOI otherwise than as member in a representative capacity shall not be taken into account for the purposes of clause (ba). But interest paid to or received from each person in his representative capacity shall be taken into account.

***Explanation 3* -** Where an individual is a member in his individual capacity, interest paid to him in his representative capacity shall not be taken into account.

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3.8 EXPENSES OR PAYMENTS NOT DEDUCTIBLE IN CERTAIN CIRCUMSTANCES [SECTION 40A]

(1) Payments to relatives and associates

Section 40A(2) provides that where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a specified person *[See column (2) of Table below)* so much of the expenditure as is considered to be excessive or unreasonable shall be disallowed by the Assessing Officer. While doing so he shall have due regard to:

(a) the fair market value of the goods, service of facilities for which the payment is made; or

(b) the legitimate needs of the business or profession carried on by the assessee; or

(c) the benefit derived by or accruing to the assessee from such a payment.

Assessee	Specified Person
(1)	(2)
Individual	1. Any relative of the individual assessee 2. Any person who carries on a business or profession, if • the individual has a substantial interest in the business of that person **or** • any relative of the individual has a substantial interest in the business of that person
Company, Firm, HUF or AOP	1. Any director, partner of the firm or member of the family or association or any relative of such director, partner or member or 2. In case of a company assessee, any individual who has substantial interest in the business or profession of the company or any relative of such individual or 3. Any person who carries on a business or profession, in which the Company/ Firm/ HUF/ AOP or director of the company, partner of the firm or member of the family or association or any relative of such director, partner or member has substantial interest in the business of that person

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All assessees	The following are specified persons:	
	Person who has substantial interest in the assessee's business	**Other related persons of such person, who has a substantial interest in the assessee's business**
	Company/ AOP/ Firm/ HUF	• Any director of such company, partner of such firm or the member of such family or association **or** • Any relative of such director, partner **or** member **or** • Any other company carrying on business or profession in which the first mentioned company has a substantial interest
	A director, partner or member	• Company/ Firm/ AOP/ HUF of which he is a director, partner or member **or** • Any other director/ partner/ member of the such Company/ Firm/ AOP/ HUF **or** • Any relative of such director, partner **or** member
Relative in relation to an Individual means the spouse, brother or sister or any lineal ascendant or descendant of that individual [Section 2(41)].		
Substantial interest in a business or profession		
A person shall be deemed to have a substantial interest in a business or profession if - - in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of equity shares carrying not less than 20% of the voting power and - in any other case, such person is, at any time during the previous year, beneficially entitled to not less than 20% of the profits of such business or profession.		

(2) Payments in excess of ₹ 10,000 made otherwise than through prescribed modes

According to section 40A(3), where the assessee incurs any expenditure, in respect of which payment or aggregate of payments made to a person in a day otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft or use of electronic system through bank account or through such other prescribed electronic modes exceeds ₹ 10,000, such expenditure shall not be allowed as a deduction.

The prescribed electronic modes are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT

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(National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

The provision applies to all categories of expenditure involving payments for goods or services which are deductible in computing the taxable income.

Example:

If, in respect of an expenditure of ₹ 32,000 incurred by X Ltd., 4 cash payments of ₹ 8,000 are made on a particular day to one Mr. Y – one in the morning at 10 a.m., one at 12 noon, one at 3 p.m. and one at 6 p.m., the entire expenditure of ₹ 32,000 would be disallowed under section 40A(3), since the aggregate of cash payments made during a day to Mr. Y exceeds ₹ 10,000.

Payments in excess of ₹ 10,000 made otherwise than through prescribed modes deemed to be the income of the subsequent year, if expenditure has been allowed as deduction in any previous year on due basis:

In case of an assessee following mercantile system of accounting, if an expenditure has been allowed as deduction in any previous year on due basis, and payment has been made in a subsequent year otherwise than by account payee cheque or account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay, then the payment so made shall be deemed to be the income of the subsequent year if such payment or aggregate of payments made to a person in a day exceeds ₹ 10,000 [Section 40A(3A)].

Increase in limit of cash payment, where payment made to transport operator: This limit of ₹ 10,000 has been raised to ₹ 35,000 in case of payment made to transport operators for plying, hiring or leasing goods carriages. Therefore, payment or aggregate of payments up to ₹ 35,000 in a day can be made to a transport operator otherwise than by way of account payee cheque or account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay. In all other cases, the limit would continue to be ₹ 10,000.

Cases where disallowances would not be attracted:

(i) **Loan transactions:** It does not apply to loan transactions because advancing of loans or repayments of the principal amount of loan does not constitute an expenditure deductible in

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computing the taxable income. However, interest payments of amounts exceeding ₹ 10,000 at a time are required to be made by account payee cheques or drafts or electronic clearing system or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay as interest is a deductible expenditure.

(ii) **Payment made by commission agents:** This requirement does not apply to payment made by commission agents for goods received by them for sale on commission or consignment basis because such a payment is not an expenditure deductible in computing the taxable income of the commission agent.

For the same reason, this requirement does not apply to advance payment made by the commission agent to the party concerned against supply of goods.

However, where commission agent purchases goods on his own account but not on commission basis, the requirement will apply. The provisions regarding payments by account payee cheque or draft or electronic clearing system or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay apply equally to payments made for goods purchased on credit.

Cases and circumstances in which a payment or aggregate of payments exceeding ten thousand rupees may be made to a person in a day, otherwise than by an account payee cheque/ account payee bank draft/ use of ECS through a bank account or through such other prescribed electronic modes [Rule 6DD]:

As per this rule, no disallowance under section 40A(3) shall be made and no payment shall be deemed to be the profits and gains of business or profession under section 40A(3A) 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 or use of electronic clearing system through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay, exceeds ₹10,000 in the cases and circumstances specified hereunder, namely:

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(a) where the payment is made to

(i) the Reserve Bank of India or any banking company;

(ii) the State Bank of India or any subsidiary bank;

(iii) any co-operative bank or land mortgage bank;

(iv) any primary agricultural credit society or any primary credit society;

(v) the Life Insurance Corporation of India;

(b) where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;

(c) where the payment is made by

(i) any letter of credit arrangements through a bank;

(ii) a mail or telegraphic transfer through a bank;

(iii) a book adjustment from any account in a bank to any other account in that or any other bank;

(iv) a bill of exchange made payable only to a bank;

(d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

(e) where the payment is made for the purchase of -

(i) agricultural or forest produce; or

(ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or

(iii) fish or fish products; or

(iv) the products of horticulture or apiculture,

to the cultivator, grower or producer of such articles, produce or products;

Notes -

(i) The expression 'fish or fish products' (iii) above would include 'other marine products such as shrimp, prawn, cuttlefish, squid, crab, lobster etc.'.

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(ii) The 'producers' of fish or fish products for the purpose of Rule 6DD(e) would include, besides the fishermen, any headman of fishermen, who sorts the catch of fish brought by fishermen from the sea, at the sea shore itself and then sells the fish or fish products to traders, exporters etc.

However, the above exception will not be available on the payment for the purchase of fish or fish products from a person who is not proved to be a 'producer' of these goods and is only a trader, broker or any other middleman, by whatever name called.

(f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;

(g) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;

(h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed ₹ 50,000;

(i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee -

(i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and

(ii) does not maintain any account in any bank at such place or ship;

(j) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;

(k) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travelers cheques in the normal course of his business.

Note: Where any payment in respect of any expenditure is required to be made by an account payee cheque/ account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes in order that such expenditure may not be disallowed as a deduction under section 40A(3), then the payment may be made by such cheque or draft or electronic clearing system or through such other prescribed electronic modes.

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No person is allowed to raise, in any suit or other proceeding, a plea based on the ground that the payment was not made or tendered in cash or in any other manner.

This is notwithstanding anything contained in any other law for the time being in force or in any contract.

(3) Disallowance of provision for gratuity

Section 40A(7) provides that no deduction would be allowable to any taxpayer carrying on any business or profession in respect of any provision (whether called as provision or by any other names) made by him towards the payment of gratuity to his employers on their retirement or on the termination of their employment for any reason.

The reason for this disallowance is that, under section 36(1)(v), deduction is allowable in computing the profits and gains of the business or profession in respect of any sum paid by a taxpayer in his capacity as an employer in the form of contributions made by him to an approved gratuity fund created for the exclusive benefit of his employees under an irrevocable trust. Further, section 37(1) provides that any expenditure other than the expenditure of the nature described in sections 30 to 36 laid out or expended, wholly and exclusively for the purpose of the business or profession must be allowed as a deduction in computing the taxable income from business.

A reading of these two provisions clearly indicates that the intention of the legislature has always been that the deduction in respect of gratuity be allowable to the employer either in the year in which the gratuity is actually paid or in the year in which contributions to an approved gratuity fund are actually made by employer.

This provision, therefore, makes it clear that any amount claimed by the assessee towards provision for gratuity, by whatever name called would be disallowable in the assessment of employer even if the assessee follows the mercantile system of accounting.

However, no disallowance would be made as per section 40A(7) in the case where any provision is made by the employer for the purpose of payment of sum by way of contribution to an approved gratuity fund during the previous year or for the purpose of making payment of any gratuity that has become payable during the previous year by virtue of the employee's retirement, death, termination of service etc.

Further, where any provision for gratuity for any reason has been allowed as a deduction to 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 to gratuity to employee shall not be allowed as deduction to the assessee in the year in which it is paid.

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(4) Contributions by employers to funds, trust etc. [Sections 40A(9)]

This sub-section has been introduced to curb the growing practice amongst employers to claim deductions from taxable profits of the business of contributions made apparently to the welfare of employees from which, however, no genuine benefit flows to the employees.

Accordingly, no deduction will be allowed where the assessee pays in his capacity as an employer, any sum towards setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 or other institution for any purpose.

However, where such sum is paid in respect of funds covered by sections 36(1)(iv), 36(1)(iva) and 36(1)(v) or any other law, then the deduction will not be denied.

(5) Marked to market loss or other expected loss [Sections 40A(13)]

Section 40A(13) provides that no deduction or allowance in respect of any marked to market loss or other expected loss shall be allowed except as allowable under section 36(1)(xviii). 36(1)(xviii) provides that marked to market loss or other expected loss as computed in accordance with the ICDS notified under section 145(2), would be allowed as deduction. ICDS I provide that marked to market losses would not be allowed unless the same is in accordance with any other ICDS. Therefore, only marked to market losses specifically permitted under any other ICDS would be allowable as deduction under section 36. Other marked to market losses would not be allowed as deduction as per section 40A(13). This amendment was effective from A.Y. 2017-18.

3.9 PROFITS CHARGEABLE TO TAX [SECTION 41]

This section enumerates certain receipts which are deemed to be income under the head "business or profession." Such receipts would attract charge even if the business from which they arise had ceased to exist prior to the year in which the liability under this section arises. The particulars of such receipts are given below:

(1) Remission or cessation of trading liability [Section 41(1)]

Suppose an allowance or deduction has been made in any assessment year in respect of loss, expenditure or trading liability incurred by A. Subsequently, if A has obtained, whether in cash or in any manner whatsoever, any amount in respect of such loss or expenditure of some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by A, or the value of benefit accruing to him shall be taxed as income of that previous year. It does not matter whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not.

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It is possible that after the above allowance in respect of loss, expenditure, or trading liability has been given to A, he could have been succeeded in his business by another person. In such a case, the successor will be liable to be taxed in respect of any such benefit received by him during a subsequent previous year.

Successor in business:

(i) Where there has been an amalgamation of a company with another company, the successor will be the amalgamated company.

(ii) Where a firm carrying on a business or profession is succeeded by another firm the successor will be the other firm.

(iii) In any other case, where one person is succeeded by any other person in that business or profession the other person will be the successor.

(iv) In case of a demerger, the successor will be the resulting company.

Remission or cessation of a trading liability includes remission or cessation of liability by a unilateral act of the assessee by way of writing off such liability in his accounts.

(2) Balancing charge, sale of capital asset used for scientific research, recovery of a bad debt subsequently and withdrawal from reserves created [Section 41(2), (3), (4) & (4A)]

The provisions of section 41(2) relating to balancing charge, section 41(3) relating to sale of capital assets acquired for scientific research, section 41(4) dealing with recovery of bad debts and of section 41(4A) relating to withdrawal from special reserve created have been dealt with earlier under the respective items.

(3) Brought forward losses of defunct business [Section 41(5)]

In cases where a receipt is deemed to be profit of a business under section 41 relating to a business that had ceased to exist and there is an unabsorbed loss, not being a speculation loss, which arose in that business during the previous year in which it had ceased to exist, it would be set off against income that is chargeable under this section even after the expiry of 8 years.

3.10 OTHER PROVISIONS

(1) Special provisions for deduction in case of business for prospecting etc. for mineral oil [Section 42]

This section enables an assessee to claim an allowance which may on general principles be inadmissible, e.g., allowance in respect of expenditure which would be regarded as an accretion to capital on the ground that it brings into existence an asset of enduring benefit or to constitute initial

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expenditure incurred on the setting up of a profit-earning machinery in motion. It must further be noted that this concession can be availed of only in relation to contract or arrangements entered into by the Central Government for prospecting for, or the extraction or production of mineral oils.

(i) Allowable expenses

The allowance permissible under this section shall be in relation to

(a) the expenditure by way of infructuous or abortive exploration expenses in respect of an area surrendered prior to the beginning of commercial production by the assessee;

(b) after the beginning of commercial production, the expenditure incurred by the assessee, whether before or after such commercial production in respect of drilling or exploration activities or services or in respect of physical assets used in that connection; and

(c) to the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding years as may be specified in the agreement.

(ii) Amount of deduction

The sum of those allowances should be computed and deduction should be made in the manner specified in the agreement entered into by the Central Government with any person for the association or participation of the Central Government or any authorized person by it in such business for the prospecting or exploration of mineral oil.

It has been specifically provided that the other provisions of the Act are being deemed, for the purpose of this allowance, to have been modified to the extent necessary to give effect to the terms of the agreement. It may be noted that allowances in this regard are made in lieu of or in addition to the other allowances permissible under the Act, depending upon the terms of the agreement.

(iii) Taxability in case of transfer

	Transaction	Manner of deduction
(1)	Subject to the provisions of the agreement entered into by the Central Government, where the business of assessee consisting of the prospecting for or extraction or production of petroleum and natural gas is transferred or any interest therein is transferred, wholly or partly, in accordance with the aforesaid agreement,	
	Case 1: Where the proceeds of the transfer are less than the expenditure incurred remaining unallowed	The expenditure remaining unallowed **as reduced by** the proceeds of transfer shall be allowed in the previous year in which the business or interest has been transferred. Amount of deduction = Expenditure remain unallowed – Sale proceeds

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	Case 2: Where the proceeds of the transfer of whole or any part of the business or interest therein exceed the amount of expenditure remaining unallowed	The excess amount or expenditure allowed till date (i.e., difference between expenditure incurred in connection with the business or to obtain interest therein and the expenditure remaining unallowed), **whichever is less**, shall be chargeable to tax as profits and gains of business in the previous year in which the business or interest therein has been transferred.
		Taxable as profits and gains from business and profession = Sale proceeds – Expenditure remain unallowed **OR** Expenditure allowed till date } Whichever is less
		If the business or interest therein is transferred in a previous year in which the business is no longer in existence, the taxability would arise in the above manner as though the business is in existence in that previous year.
	Case 3: Where the proceeds of the transfer are not less than the amount of expenditure incurred remaining unallowed.	No deduction for such expenditure shall be allowed in the previous year in which business or interest therein is transferred or in respect of any subsequent previous year or years. Amount of deduction = NIL
	Case 4: Where transfer of the business or interest is not covered under Case 2 above	Deduction of unallowed expenditure **as reduced by** the proceeds of transfer from the expenditure remaining unallowed
		Allowable deduction = Unallowed expenditure – Sale proceeds
(2)	**Transfer of business in a scheme of amalgamation**	
	If the amalgamating company sells or transfers the business to the amalgamated company, being an Indian company under the scheme of amalgamation	The provisions of section 42 will apply to amalgamated company as they would have applied to amalgamating company as if the latter has not transferred the business or interest therein. The tax treatment in cases 1, 2, 3 & 4 given in (1) above will not apply to the amalgamating company.

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(3)	Transfer of business in a scheme of demerger	
	If the demerged company sells or transfers the business to the resulting company, being an Indian company under the scheme of demerger	The provisions of section 42 will apply to resulting company as they would have applied to demerged company as if the latter has not transferred the business or interest therein. The tax treatment in cases 1, 2, 3 & 4 given in (1) above will not apply to the demerged company.

Note: Mineral oil includes petroleum and natural gas.

(2) Changes in the rate of exchange of currency [Section 43A]

(i) The section provides that where an assessee has acquired any asset from a foreign country for the purpose of his business or profession, and due to a change thereafter in the exchange rate of the two currencies involved, there is an increase or decrease in the liability (expressed in Indian rupees) of the assessee **at the time of making the payment**, the following values may be changed accordingly with respect to the increase or decrease in such liability:

(a) the actual cost of the asset under section 43(1)

(b) the amount of capital expenditure incurred on scientific research under section 35(1)(iv)

(c) the amount of capital expenditure incurred by a company for promoting family planning amongst its employees under section 36(1)(ix)

(d) the cost of acquisition of a non-depreciable capital asset falling under section 48.

The amount arrived at after making the above adjustment shall be taken as the amount of capital expenditure or the cost of acquisition of the capital asset, as the case may be.

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

(iii) Where the assessee has entered into a contract with authorised dealer as defined in section 2 of the Foreign Exchange Management Act, 1999 for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, for adjustment under this section shall be computed with reference to the rate of exchange specified therein.

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(3) Taxation of foreign exchange fluctuation [Section 43AA]

(i) Section 43AA provides that, subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, which shall be computed in accordance with the notified ICDS i.e., ICDS VI: The effects of changes in foreign exchange rates.

(ii) Gain or loss arising on account of the effects of change in foreign exchange rates shall be in respect of all foreign currency transactions, including those relating to –

(a) monetary items and non-monetary items;

(b) translation of financial statements of foreign operations

(c) forward exchange contracts;

(d) foreign currency translation reserves.

(4) Certain Deductions to be made only on actual payment [Section 43B]

The following sums are allowed as deduction only in that previous year in which such sum is actually paid i.e., on actual payment basis.

(a) Any sum payable by way of **tax, duty, cess or fee,** by whatever name called, under any law for the time being in force, or

(b) Any sum payable by the assessee as an **employer** by way of **contribution to any provident fund or superannuation fund or gratuity fund** or any other fund for the welfare of employees, or

(c) **Bonus or Commission** for services rendered payable to employees, or

(d) Any sum payable by the assessee as **interest on any loan or borrowing** from any **public financial institution or a State Financial Corporation or a State Industrial Investment Corporation**, or

(da) Any sum payable by the assessee as **interest on any loan or borrowing from notified class of non-banking financial companies**, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or

(e) **Interest on any loan or advance from a scheduled bank or co-operative bank** other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or

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(f) Any sum paid by the assessee as an **employer in lieu of earned leave of his employee**, or

(g) Any sum payable by the assessee **to the Indian Railways for use of Railway assets**.

For the purpose of claiming deduction of the **sums referred to above in clauses (a) to (g)** in the relevant previous year in which the expenditure is incurred, the above sums have to be **paid by the assessee on or before the due date for furnishing the return of income under section 139(1)** in respect of the previous year in which the liability to pay such sum was incurred and the evidence of such payment is furnished by the assessee along with such return.

Conversion of interest into a loan or borrowing or debenture or any other instrument

Explanation 3C, 3CA & 3D clarifies that if any sum payable by the assessee as interest on any such loan or borrowing or advance referred to in (d), (da) and (e) above, is converted into a loan or borrowing or advance or debenture or any other instrument by which the liability to pay is deferred to a future date, the interest so converted and not "actually paid" shall not be deemed as actual payment, and hence would not be allowed as deduction. The clarificatory explanations only reiterate the rationale that conversion of interest into a loan or borrowing or advance or debenture or any other instrument by which the liability to pay is deferred to a future date does not amount to actual payment.

The manner in which the converted interest will be allowed as deduction has been clarified in *Circular No.7/2006 dated 17.7.2006*. The unpaid interest, whenever actually paid to the bank or financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid.

Meaning of Non-banking financial company:

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) such other non-banking institution or class of such institutions, as the bank may, specify with the previous approval of the Central Government and by notification in the Official Gazette.

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ILLUSTRATION 16

Hari, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Andhra Pradesh State Financial Corporation (APSFC) and Indian Bank and has not paid interest as detailed hereunder:

		₹
(i)	*Andhra Pradesh State Financial Corporation (P.Y. 2024-25 & 2025-26)*	*15,00,000*
(ii)	*Indian Bank (P.Y. 2025-26)*	*30,00,000*
		45,00,000

Both APSFC and Indian Bank, while restructuring the loan facilities of Hari during the year 2025-26, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2026, Hari paid 5 installments to APSFC and 3 installments to Indian Bank.

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

SOLUTION

According to section 43B, any interest payable on the term loans to specified financial institutions and any interest payable on any loans and advances to, *inter alia*, scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee. Where there is default in the payment of interest by the assessee, such unpaid interest may be converted into loan. Such conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest so converted as loan shall be allowed as deduction only in the year in which the converted loan is actually paid.

In the given case of Hari, the unpaid interest of ₹ 15,00,000 due to APSFC and of ₹ 30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of ₹ 45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y.2026-27 shall be calculated as follows:

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	Interest outstanding (₹)	Number of Instalments	Amount per instalment (₹)	Instalments paid	Interest allowable (₹)
APSFC	15 lakh	60	25,000	5	1,25,000
Indian Bank	30 lakh	60	50,000	3	1,50,000
Total amount eligible for deduction					**2,75,000**

Clarification on non-applicability of section 43B in respect of employee's Contribution to welfare funds [Explanation 5 to section 43B]

As per section 2(24)(x), any sum received by an assessee, being an employer from his employee as contribution to any provident fund or superannuation fund or any fund set up under Employee's State Insurance Act, 1948 or any other fund for the welfare of employees would be considered as the income of an employer.

The deduction in respect of above sum will be allowed to the assessee under section 36(1)(va) only if such sum is credited by the assessee to the employee's account in the relevant fund on or before the due date, being the date specified under the relevant Act, Rule, order or notification issued thereunder.

As per section 43B, any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees, would be allowable during any P.Y. if the same has been paid on or before the 'due date' applicable in his case for furnishing the return of income under section 139(1) in respect of that P.Y.

Explanation 5 clarifies that the provisions of section 43B regarding allowability of certain expenditure in a previous year only on actual payment basis (i.e., payment on or before the due date of filing of return of income for relevant assessment year), does not apply and would deemed never to be applied to employee's contribution received by employer towards any welfare fund. In effect, clause (b) of section 43B covers only employer's contribution to provident fund, superannuation fund, gratuity fund or any other fund for welfare of employees, for remittance of which extended time limit upto due date of filing return u/s 139(1) is available; however, it does not include within its scope, employees' contribution to such funds received by the employer, which has to be credited to the employee's account in the relevant fund on or before the due date specified under the relevant Act, Rule etc. Amount credited after the said due date but on or before the due date under section 139(1) would not be eligible for deduction.

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Section 43B [Clause (h)]

Any sum payable by the assessee to a micro or small enterprise beyond the time-limit specified in section 15 of the Micro, Small and Medium Enterprises Development Act, 2006 would be allowed as deduction only in that previous year in which such sum is actually paid.

Section 15 of the of the Micro, Small and Medium Enterprises Development Act, 2006 mandates payment of goods or services to supplier, being a micro or small enterprises by the buyer on or before the date agreed upon between them in writing i.e., as per the written agreement, which cannot be more than 45 days from the day of acceptance or the day of deemed acceptance of any goods or services by a buyer from a supplier. If there is no such written agreement, the payment shall be made before the appointed day i.e., within 15 days.

If the sum payable by the assessee to a micro or small enterprise is paid as per written agreement (maximum within 45 days) or within 15 days in case of no agreement, the deduction can be claimed on accrual basis if mercantile method of accounting is followed by the assessee.

However, if the sum payable by the assessee to a micro or small enterprise is not paid as per written agreement or within 15 days in case of no agreement, the deduction would be allowed in the previous year in which it is actually paid.

Example: *Mr. A has purchased goods of ₹ 10,000 from A & Co., a micro enterprise on 1.3.2026. As per the written agreement between them, the payment has to be made by 5.4.2026. Mr. A follows mercantile method of accounting.*

(i) If Mr. A paid the sum on 2.4.2026

Since Mr. A paid the sum on or before 5.4.2026, the deduction would be allowed in P.Y. 2025-26.

(ii) If Mr. A paid the sum on 20.4.2026

Since Mr. A paid the sum beyond the time limit, the deduction would be allowed in the year of actual payment i.e., P.Y. 2026-27.

Example: *Suppose Mr. Raju has purchased goods of ₹ 10,000 from A & Co., a medium enterprise on 1.3.2026. As per the written agreement between them, the payment has to be made by 5.4.2026, however Mr. Raju paid the sum on 10.4.2026. Mr. Raju follows mercantile method of accounting.*

In such case, since disallowance under section 43B(h) is not applicable on sum payable to medium enterprise, the deduction would be allowed in P.Y. 2025-26 on due basis.

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Meaning of Micro and Small enterprise

S. No.	Meaning		
(1)	**Micro Enterprise**		
	Investment in Plant and Machinery or Equipment ≤ ₹2.5 crore	**AND**	*Turnover ≤ ₹10 crore*
(2)	**Small Enterprise**		
	Investment in Plant and Machinery or Equipment ≤ ₹25 crore	**AND**	*Turnover ≤ ₹100 crore*

Any sum payable means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law.

(5) Special provision for computation of cost of acquisition of certain assets [Section 43C]

(i) Where an asset acquired under a scheme of amalgamation is sold by an amalgamated company as its stock-in-trade then in computing the profits and gains derived from sale of such stock-in-trade, the cost of acquisition of stock-in-trade to the amalgamated company shall be the cost of acquisition of the asset to the amalgamating company as increased by the cost, if any, of any improvement thereto and the expenditure incurred wholly and exclusively in connection with such a transfer.

(ii) The provisions of section 43C will thus apply to the following cases of revaluation:

(a) When the stock-in-trade of the amalgamating company is taken over at revalued price by the amalgamated company under the scheme of amalgamation.

(b) Where a capital asset of the amalgamating company is taken over as stock-in-trade by the amalgamated company after revaluation under the scheme of amalgamation.

(iii) The situation referred to at (b) above will in turn cover three situations:

(a) When the capital asset is converted to stock-in-trade by the amalgamating company with revaluation and the revalued asset is taken over by the amalgamated company under the scheme of amalgamation.

(b) Where the capital asset is taken over as stock-in-trade by the amalgamated company at revalued price at the time of amalgamation.

(c) Where the capital asset of the amalgamating company is taken over by the amalgamated company as a capital asset and has been converted into stock-in-trade and revalued.

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(iv) In a case referred to (c) above, where the revaluation and conversion of capital asset into stock-in-trade takes place in the hands of the amalgamated company, the provisions of section 45(2) will apply. In such a case, the provisions of section 43C will not apply. This has been done with a view to ensure that a tax payer does not face double taxation in respect of the same transaction. However, when the stock-in-trade referred to in item (ii)(a) as well as at (a) and (b) of (iii) above are sold, the provisions of section 43C will apply.

(v) A similar provision in section 43C has also been made to cover cases where the asset sold as stock-in-trade has been acquired by the assessee either by way of full or partial partition of HUF or under a gift or will or an irrevocable trust and such asset is sold as stock-in-trade.

(6) Stamp Duty Value of land and building to be taken as the full value of consideration in respect of transfer, even if the same are held by the transferor as stock-in-trade [Section 43CA]

(i) Section 43CA has been inserted as an anti-avoidance measure to provide that where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable (i.e., the stamp duty value) shall be deemed to be the full value of the consideration for the purposes of computing income under the head "Profits and gains of business of profession".

However, if the stamp duty value does not exceed 110% of the consideration received or accruing then, such consideration shall be deemed to be the full value of consideration for the purpose of computing profits and gains from transfer of such asset.

(ii) Further, where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer instead of on the date of registration for such transfer, provided at least a part of the consideration has been received by way of an account payee cheque/account payee bank draft or use of ECS through a bank account or through such other prescribed electronic modes on or before the date of the agreement.

The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

(iii) The Assessing Officer may refer the valuation of the asset to a valuation officer as defined in section 2(r) of the Wealth-tax Act, 1957 in the following cases -

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(1) Where the assessee claims before any Assessing Officer that the value adopted or assessed or assessable by the authority for payment of stamp duty exceeds the fair market value of the property as on the date of transfer and

(2) the value so adopted or assessed or assessable by such authority has not been disputed in any appeal or revision or no reference has been made before any other authority, court or High Court.

(iv) Where the value ascertained by the Valuation Officer exceeds the value adopted or assessed or assessable by the Stamp Valuation Authority, the value adopted or assessed or assessable shall be taken as the full value of the consideration received or accruing as a result of the transfer.

The term "assessable" covers transfers executed through power of attorney.

The term **'assessable'** has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

Date of transfer of land / building held as stock-in-trade	Actual consideration	Stamp duty value on the date of agreement	Stamp duty value on the date of registration	Full value of consideration	Remark
	₹ in lakhs				
Example:					
1/9/2025	100 (₹ 10 lakhs received by **A/c payee cheque** on 1/7/2025)	120 (1/7/2025)	210 (1/9/2025)	120	As part of the consideration is received by A/c payee cheque on the date of agreement, Stamp duty value (SDV) on the date of agreement to be adopted as full value of consideration, since the SDV exceeds 110% of consideration i.e., ₹ 110 lakhs.

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Example:					
1/9/2025	100 (₹ 10 lakhs received **by cash** on 1/7/2025)	109 (1/7/2025)	130 (1/9/2025)	130	SDV on the date of registration to be adopted as full value of consideration and such SDV exceeds 110% of consideration i.e.,₹ 110 lakhs. Since part of consideration is received by cash on the date of agreement, the SDV on the date of agreement cannot be considered vis-à-vis actual consideration.
Example:					
31/1/2026	100 (₹ 10 lakhs received by **A/c payee cheque** on 1/7/2025)	109 (1/7/2025)	130 (31/1/2026)	100	Actual sales consideration would be the full value of consideration, since SDV on the date of agreement does not exceed 110% of actual consideration. SDV on the date of agreement can be considered *vis-à-vis* actual consideration, since part of the consideration has been received by account payee cheque on the date of agreement.
Example:					
31/3/2026	100 (Full amount received in cash on the date of registration)	120 (1/5/2025)	130 (31/3/2026)	130	Stamp duty value of the date of registration would be the full value of consideration since the stamp duty value exceeds 110% of consideration i.e., ₹ 110 lakhs.

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(7) Income from construction and service contracts [Section 43CB]

The profits and gains arising from a construction contract or a service contract shall be computed on the basis of percentage of completion method (POCM) in accordance with the notified ICDS i.e., ICDS III: Construction Contracts.

However, the profits and gains arising from a service contract shall be computed on the basis of -

Method	Condition
Project completion method	If the duration of the contract is not more than 90 days
Straight line method	If the contract involves indeterminate number of acts over a specific period of time

For the purpose of percentage of completion method, project completion method or straight line method –

(i) the contract revenue shall include retention money;

(ii) the contract cost shall not be reduced by any incidental income in the nature of interest, dividends or capital gains.

(8) Special Provision in case of income of Public Financial Institutions [Section 43D]

In the case of

- a public financial institution or
- a scheduled bank or
- a co-operative bank other than primary agricultural credit society or a primary co-operative agricultural and rural development bank or
- a State financial corporation or
- a State industrial investment corporation or
- notified class of non-banking financial companies,

the income by way of interest on such categories of bad and doubtful debts, as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said institutions for that year or in the previous in which it is actually received by it, whichever is earlier.

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3.11 COMPULSORY MAINTENANCE OF ACCOUNTS [SECTION 44AA]

(1) **Maintain the books of account and other documents by notified profession [Section 44AA(1)]:** This section provides that every person carrying on the legal, medical, engineering or architectural profession or accountancy or technical consultancy or interior decoration or any other profession as has been notified by the CBDT in the official gazette must statutorily maintain such **books of accounts and other documents as may enable the assessing officer to compute his total income in accordance with the provisions of the Income-tax Act, 1961.**

Notified professions: The professions notified so far are as the profession of authorised representative; the profession of film artist (actor, camera man, director, music director, art director, dance director, editor, singer, lyricist, story writer, screen play writer, dialogue writer and dress designer); the profession of Company Secretary; and information technology professionals.

Prescribed books of accounts & other documents: The CBDT has been authorised, having due regard to the nature of the business or profession carried on by any class of persons, to **prescribe by rules the books of account and other documents** including inventories, wherever necessary, to be kept and maintained by the taxpayer, the particulars to be contained therein and the form and manner in which and **the place at which they must be kept and maintained**.

Rules pertaining to maintenance of books of accounts & other documents:

Rule 6F of the Income-tax Rules contains the details relating to the books of account and other documents to be maintained by certain professionals under section 44AA(1).

Prescribed class of persons: As per Rule 6F, every person carrying on legal, medical, engineering, or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist shall keep and maintain the books of account and other documents specified in Rule 6F(2) in the following cases :

– if his **gross receipts exceed ₹ 1,50,000 in all the 3 years immediately preceding the previous year**; or

– if, where the profession has been newly set up in the previous year, his **gross receipts are likely to exceed ₹ 1,50,000 in that year**.

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Note: Students may note that professionals whose gross receipts are less than the specified limits given above are also required to maintain books of account but these have not been specified in the Rule.

In other words, they are required to maintain (as per point (1) above) such books of account and other documents as may enable the Assessing Officer to compute the total income in accordance with the provisions of this Act.

Prescribed books of accounts and other documents [Sub-rule (2) of Rule 6F]: The following books of account and other documents are required to be maintained.

(i) a cash book;

(ii) a journal, if accounts are maintained on mercantile basis;

(iii) a ledger;

(iv) Carbon copies of bills and receipts issued by the person whether machine numbered or otherwise serially numbered, in relation to sums exceeding ₹ 25;

(v) Original bills and receipts issued to the person in respect of expenditure incurred by the person, or where such bills and receipts are not issued, payment vouchers prepared and signed by the person, provided the amount does not exceed ₹ 50. Where the cash book contains adequate particulars, the preparation and signing of payment vouchers is not required.

In case of a person carrying on medical profession, he will be required to maintain the following in addition to the list given above:

(i) a daily case register in Form 3C.

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

Place at which books to be kept and maintained: The books and documents shall be kept and maintained at the place where the person is carrying on the profession, or where there is more than one place, at the principal place of his profession. However, if he maintains separate set of books for each place of his profession, such books and documents may be kept and maintained at the respective places.

Period for which the books of account and other documents are required to be kept and maintained: The Central Board of Direct Taxes has also been empowered to

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prescribe, by rules, the period for which the books of account and other documents are required to be kept and maintained by the taxpayer.

Prescribed period: The above books of account and documents shall be kept and maintained for a minimum of 6 years from the end of the relevant assessment year.

ILLUSTRATION 17

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

	₹
Financial year 2022-23	*1,15,000*
Financial year 2023-24	*1,80,000*
Financial year 2024-25	*2,10,000*

What is his obligation regarding maintenance of books of accounts for Assessment Year 2026-27 under section 44AA of Income-tax Act, 1961?

SOLUTION

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

As per Rule 6F, a person carrying on a notified profession shall be required to maintain **specified books of accounts, only if**:

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

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

In the present case, Vinod is a person carrying on profession as film artist, which is a notified profession. Since his gross receipts have not exceeded ₹ 1,50,000 in financial year 2022-23, the requirement under section 44AA to compulsorily maintain the prescribed books of account is not applicable to him for A.Y. 2026-27.

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

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(2) Maintenance of books of account and other documents by persons carrying on business or profession [other than notified professions referred to in section 44AA(1)] [Section 44AA(2)]:

I. **In case of Individual or HUF:** An Individual or HUF carrying on any business or profession (other than notified professions specified in section 44AA(1)) must maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance the provisions of the Income-tax Act, 1961 in the following circumstances:

(i) **Existing business or profession:** In cases where the **income** from the existing business or profession **exceeds ₹ 2,50,000 or the total sales, turnover or gross receipts**, as the case may be, in the business or profession **exceed ₹ 25,00,000** in **any one of three years immediately preceding** the accounting year; or

(ii) **Newly set up business or profession:** In cases where the business or profession is newly set up in any previous year, if his **income** from business or profession **is likely to exceed ₹ 2,50,000** or his **total sales, turnover or gross receipts**, as the case may be, in the business or profession **are likely to exceed ₹ 25,00,000** during the previous year.

II. **Person (other than individual or HUF):** Every person (other than individual or HUF) carrying on any business or profession (other than the notified professions referred to in section 44AA(1)) must maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance the provisions of the Income-tax Act, 1961 in the following circumstances:

(i) **Existing business or profession:** In cases where the **income** from the business or profession **exceeds ₹ 1,20,000** or the **total sales, turnover or gross receipts**, as the case may be, in the business or profession **exceed ₹ 10,00,000 in any one of three years** immediately preceding the accounting year; or

(ii) **Newly set up business or profession:** In cases where the business or profession is newly set up in any previous year, if his income from business or profession is **likely to exceed ₹ 1,20,000** or his **total sales, turnover or gross receipts**, as the case may be, in the business or profession are **likely to exceed ₹ 10,00,000** during the previous year;

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III. **Showing lower income as compared to income computed on presumptive basis under section 44AE or (section 44BB or section 44BBB)**[13]: Where profits and gains from the business are calculated on a presumptive basis under section 44AE or section 44BB or section 44BBB and the assessee has claimed that his income is lower than the profits or gains so deemed to be the profits and gains of his business.

IV. **Where the provisions of section 44AD(4) are applicable in his case and his income exceeds the basic exemption limit in any previous year:** In cases, where an assessee not eligible to claim the benefit of the provisions of section 44AD(1) for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance with the provisions of 44AD(1) and his income exceeds the basic exemption limit during the previous year.

(3) **Penalty for failure to maintain books of account [Section 271A]:** If a person fails to keep and maintain any such books of account and other documents as required by section 44AA in respect of any previous year or to retain such books of account and other documents for the specified period, the Assessing Officer or the Joint Commissioner (Appeals) or the Commissioner (Appeals) may direct a penalty of ₹ 25,000 would be leviable under section 271A.

3.12 AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION [SECTION 44AB]

(1) **Requirement of Tax Audit:** It is obligatory for the persons mentioned in column (2) of the table below, carrying on business or profession, to get his accounts audited before the "specified date" by a Chartered Accountant, if the conditions mentioned in the corresponding row of column (3) are satisfied

	Persons	When tax audit is required?
(1)	(2)	(3)
I	**In case of a person carrying on business**	
(a)	In case of a person carrying on business	If his total sales, turnover or gross receipts in business > **₹ 1 crore** in the relevant PY

[13]Section 44BB and 44BBB will be discussed in Chapter 21: Non-resident taxation in Module 4 of the Study Material.

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		***Note** – The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44AD(1).*
	If in case of such person carrying on business - (i) Aggregate cash receipts in the relevant PY ≤ 5% of total receipts (including receipts for sales, turnover, gross receipts); and (ii) Aggregate cash payments in the relevant PY ≤ 5% of total payments (including amount incurred for expenditure)	If his total sales, turnover or gross receipts in business > **₹ 10 crore** in the relevant PY
	Note – For this purpose, the payment or receipt, as the case may be, by a cheque drawn on a bank or by a bank draft, which is not account payee, would be deemed to be the payment or receipt, as the case may be, in cash.	
(b)	In case of an assessee covered u/s 44AE i.e., an assessee engaged in the business of plying, hiring or leasing goods carriages who owns not more than 10 goods carriages at any time during the P.Y.	If such assessee claims that the profits and gains from business in the relevant P.Y. are lower than the profits and gains computed on a presumptive basis u/s 44AE [i.e., ₹ 1000 per ton of gross vehicle weight or unladen weight in case of each heavy goods vehicle and ₹ 7,500 for each vehicle, other than heavy goods vehicle, for every month or part of the month for which the vehicle is owned by the assessee].
(c)	In case of an eligible assessee carrying on business, whose total turnover, sales, gross receipts ≤ ₹ 200 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y. 2024-25)	If he declares profit for any of the five successive PYs (say, P.Y.2025-26) not in accordance with section 44AD (i.e., he declares profits lower than 8% or 6% of total turnover, sales or gross receipts, as the case may be, in that year), then, he cannot opt for section 44AD for five successive PYs after the year of such default (i.e., from P.Y.2026-27 to P.Y.2030-31). For the year of default (i.e., P.Y.2025-26) and five successive previous years (i.e., P.Y.2026-27 to P.Y.2030-31), he has to maintain books of account u/s 44AA and get them audited u/s 44AB, if his income exceeds the basic exemption limit.
	In case of an eligible assessee carrying on business, whose aggregate cash receipts in the relevant PY ≤ 5% of total turnover or gross receipts and whose total turnover, sales, gross receipts ≤ ₹ 300 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y. 2024-25)	

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II	In case of persons carrying on profession	
(a)	In case of a person carrying on profession	If his gross receipts in profession > ₹ 50 lakh in the relevant PY. ***Note** – The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44ADA(1).*
(b)	In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose gross receipts ≤ ₹ 50 lakhs	If such resident assessee claims that the profits and gains from such profession in the relevant PY are lower than the profits and gains computed on a presumptive basis u/s 44ADA (50% of gross receipts) and his income exceeds the basic exemption limit in that PY.
	In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose aggregate cash receipts in the relevant PY ≤ 5% of total gross receipts and whose gross receipts ≤ ₹ 75 lakhs	

(2) Audit Report: The persons mentioned above would have to furnish by the specified date a report of the audit in the prescribed forms. For this purpose, the Board has prescribed under Rule 6G, Forms 3CA/3CB/3CD containing forms of audit report and particulars to be furnished therewith. The audit report furnished may be revised by the person by getting revised report of audit from a chartered accountant, duly signed and verified by such chartered accountant, if there is payment by such person after furnishing of report which necessitates recalculation of disallowance under section 40 or section 43B. The said revised audit report has to be furnished before the end of the relevant assessment year for which the report pertains.

(3) Accounts audits under other statutes are considered: In cases where the accounts of a person are required to be audited by or under any other law before the specified date, it will be sufficient if the person gets his accounts audited under such other law before the specified date and also furnish by the said date the report of audit in the prescribed form in addition to the report of audit required under such other law.

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Thus, for example, the provision regarding compulsory audit does not imply a second or separate audit of accounts of companies whose accounts are already required to be audited under the Companies Act, 2013. The provision only requires that companies should get their accounts audited under the Companies Act, 2013 before the specified date and in addition to the report required to be given by the auditor under the Companies Act, 2013 furnish a report for tax purposes in the form to be prescribed in this behalf by the CBDT.

(4) **Specified date:** The expression **"specified date"** in relation to the accounts of the previous year or years relevant to any assessment year means the date one month prior to the due date for furnishing the return of income under section 139(1).

The due date for filing return of income in case of assessees (other than companies) who are required to get their accounts audited is 31st October of the relevant assessment year. Hence, the specified date for tax audit would be 30th September of the relevant assessment year.[14]

(5) **Non-applicability:** The requirement of audit under section 44AB does not apply to a person who derives income of the nature referred to in (sections 44B and 44BBA)[15].

(6) **Penal provision:** If any person fails to get his accounts audited in respect of any previous year or furnish the audit report by the specified date, penalty of lower of (a) and (b) mentioned below would be leviable on such person –

(a) ½% of total sales, turnover or gross receipts, as the case may be, in business or of the gross receipts in profession, in such previous year; or

(b) ₹ 1,50,000 [Section 271B].

3.13 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF BUSINESS ON PRESUMPTIVE BASIS [SECTION 44AD/ 44ADA/ 44AE]

	Particulars	Section 44AD	Section 44ADA	Section 44AE
(1)	**Eligible Assessee**	Resident individual, HUF or Partnership firm (but not LLP) engaged in eligible business and who has not claimed deduction	Resident individual or resident partnership firm (but not LLP) engaged in any profession specified u/s 4AA(1),	An assessee owning not more than 10 goods carriages at any time during the P.Y.

[14] In case of a person whose due date for filing return of income is 30th November of the relevant assessment year, the specified date for tax audit would be 31st October of the relevant assessment year.

[15] Section 44B and 44BBA will be discussed in Chapter 21: Non-resident taxation in Module 4 of the Study Material.

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		under section 10AA or Chapter VIA under "C – Deductions in respect of certain incomes" **Non-applicability of section 44AD in respect of the following persons**: - A person carrying on profession specified u/s 44AA(1); - A person earning income in the nature of commission or brokerage; - A person carrying on any agency business.	namely, legal, medical, engineering, architectural profession or profession of accountancy or technical consultancy or interior decoration or notified profession (authorized representative, film artist, company secretary, profession of information technology)	
(2)	**Eligible business/ profession**	Any business, other than business referred to in section 44AE, whose **total turnover/ gross receipts in the P.Y. ≤ ₹ 200 lakhs**	Any profession specified under section 44AA(1), whose **gross receipts ≤ ₹ 50 lakhs in the relevant P.Y.**	Business of plying, hiring or leasing goods carriages
		Any business, other than business referred to in section 44AE, whose **total turnover/gross receipts in the P.Y. ≤ ₹ 300 lakhs in the relevant P.Y., if aggregate cash receipts in the relevant PY ≤ 5% of total turnover or gross receipts.**	Any profession specified u/s 44AA(1), whose **gross receipts ≤ ₹ 50 lakhs in the relevant P.Y., if aggregate cash receipts in the relevant PY ≤ 5% of total gross receipts.**	

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		In effect, if the turnover of business is > ₹ 200 lakhs ≤ ₹ 300 lakhs, the benefit of section 44AD can be availed only if aggregate cash receipts in relevant P.Y. ≤ 5% of total turnover or gross receipts.	In effect, if the gross receipts from profession is > ₹ 50 lakhs ≤ ₹ 75 lakhs, the benefit of section 44ADA can be availed only if aggregate cash receipts in relevant P.Y. ≤ 5% of total gross receipts.	
		Note: *For this purpose, the receipt of amount or aggregate of amounts by a cheque drawn on a bank or by a bank draft, which is not account payee, would be deemed to be the receipt in cash.*		
(3)	**Presumptive income**	**8% of total turnover/ sales/gross receipts** or a sum higher than the aforesaid sum claimed to have been earned by the assessee. **6% of total turnover/ gross receipts** in respect of the amount of total turnover/ sales/ gross receipts received by A/c payee cheque/ bank draft/ ECS through a bank account or through such other prescribed electronic modes (credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay) **during the P.Y. or before due date of filing of return u/s 139(1)** in respect of that P.Y. (or) such higher sum	**50% of gross receipts of such profession** or a sum higher than the aforesaid sum claimed to have been earned by the assessee.	**For each heavy goods vehicle ₹ 1,000 per ton of gross vehicle weight** or unladen weight, as the case may be, for every month or part of a month; **For each vehicle, other than heavy goods vehicle: ₹ 7,500 per month or part of a month** during which such vehicle is owned by the assessee or an amount claimed to have been actually earned from such vehicle, whichever is higher.

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		claimed to have been earned by the assessee.		
(4)	**Non-allowability of deductions while computing presumptive income**	Deductions allowable under **sections 30 to 38** shall be **deemed to have been given full effect to** and no further deduction shall be allowed.		
		Even in case of a firm, salary and interest paid to partners is **not** deductible.	Even in case of a firm, salary and interest paid to partners is **not** deductible.	In case of a firm, **salary and interest paid to partners is deductible** subject to the conditions and limits specified in **section 40(b).**
(5)	**Written down value of asset**	WDV of any asset of an eligible business/profession shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed depreciation for each of the relevant assessment years.		
(6)	**Requirement of maintenance of books of account u/s 44AA and audit u/s 44AB**	If eligible assessee declares profits and gains in accordance with the provisions of section 44AD, he is **not** required to maintain books of account u/s 44AA or get them audited u/s 44AB. However, if after declaring profits on presumptive basis u/s 44AD, say, for A.Y.2026-27, non-declaration of profits on presumptive basis for any of the 5 successive A.Y.s thereafter (i.e., from A.Y.2027-28 to A.Y.2031-32), say, for A.Y. 2028-29, would disentitle the	If eligible assessee declares profits and gains in accordance with the provisions of section 44ADA, he is **not** required to maintain books of account u/s 44AA or get them audited u/s 44AB. However, if the assessee **claims his profits to be lower** than the profits computed by applying the presumptive rate, he has to maintain books of account and other documents **u/s 44AA(1)** and get his **accounts audited u/s 44AB, if his total income >**	If eligible assessee declares profits and gains in accordance with the provisions of section 44AE, he is **not** required to maintain books of account u/s 44AA or get them audited u/s 44AB. However, if the assessee **claims his profits to be lower** than the profits computed by applying the presumptive rate, he has to **maintain books of account u/s 44AA(2)** and get

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		assessee from claiming profits on presumptive basis for five successive AYs subsequent to the AY relevant to the PY of such non-declaration (i.e., from A.Y.2029-30 to A.Y. 2033-34). In such a case, the assessee would have to **maintain books of account and other documents u/s 44AA(2)** and get his accounts audited u/s **44AB**, **if his total income exceeds the basic exemption limit in those years**.	**basic exemption limit for that year**.	his **accounts audited u/s 44AB.**
(7)	**Advance tax obligation**	The eligible assessee opting for section 44AD is required to pay advance tax by **15th March of the financial year (F.Y.)**.	The eligible assessee opting for section 44ADA is required to pay advance tax by **15th March** of the F.Y.	The eligible assessee has to pay advance tax in four installments **[See Chapter 13 in Module 3 for details].**

Meaning of certain terms for the purpose of section 44AE:

S.No	Term	Meaning
(1)	**Heavy goods vehicle**	any goods carriage, the gross vehicle weight of which exceeds 12,000 kilograms.
(2)	**Gross vehicle weight**	total weight of the vehicle and load certified and registered by the registering authority as permissible for that vehicle.
(3)	**Unladen weight**	the weight of a vehicle or trailer including all equipment ordinarily used with the vehicle or trailer when working but excluding the weight of driver or attendant and where alternative parts or bodies are used the unladen weight of the vehicle means the weight of the vehicle with the heaviest such alternative body or part

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The CBDT clarified that in respect of a "heavy goods vehicle" i.e. any goods carriage vehicle whose gross vehicle weight exceeds 12.000 kilograms, the profits and gains from each goods carriage would be at the rate of ₹ 1,000 per ton of gross vehicle weight for every month or part of the month.

However, in respect of a tractor or a road-roller. where the gross vehicle weight is not applicable, and unladen weight exceeds 12,000 Kilograms. the profits and gains from each goods carriage shall be at the rate of ₹ 1,000 per ton of unladen weight for every month or part of the month [Clarification dated 14.8.2019].

Example:

Let us consider the following particulars relating to a resident individual, Mr. A, being an eligible assessee carrying on retail trade business whose total turnover do not exceed ₹ 2 crore in any of the previous years relevant to A.Y.2026-27 to A.Y.2028-29

Particulars	A.Y.2026-27	A.Y.2027-28	A.Y.2028-29
Total turnover (₹)	1,80,00,000	1,90,00,000	2,00,00,000
Amount received through prescribed electronic modes on or before 31st October of the A.Y.	1,60,00,000	1,45,00,000	1,80,00,000
Income offered for taxation (₹)	11,20,000	12,30,000	10,00,000
% of gross receipts	6% on ₹ 1.60 crore and 8% on ₹ 20 lakhs	6% on ₹ 1.45 crore and 8% on ₹ 45 lakhs	5% on ₹ 2 crore
Offered income as per presumptive taxation scheme u/s 44AD	Yes	Yes	No

In the above case, Mr. A, an eligible assessee, opts for presumptive taxation under section 44AD for A.Y.2026-27 and A.Y.2027-28 and offers income of ₹ 11.20 lakhs and ₹ 12.30 lakhs on gross receipts of ₹ 1.80 crore and ₹ 1.90 crore, respectively.

However, for A.Y.2028-29, he offers income of only ₹ 10 lakhs on turnover of ₹ 2 crores, which amounts to 5% of his gross receipts. He needs to maintain books of account under section 44AA and gets the same audited under section 44AB. Since he has not offered income in accordance with the provisions of section 44AD(1) for five consecutive assessment years, after A.Y. 2026-27, he will not be eligible to claim the benefit of section 44AD for next five assessment years succeeding A.Y.2028-29 i.e., from A.Y.2029-30 to 2033-34.

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ILLUSTRATION 18

Mr. Praveen engaged in retail trade, reports a turnover of ₹ 2,98,50,000 for the financial year 2025-26. Amount received in cash during the P.Y. 2025-26 is ₹ 14,00,000 and balance through prescribed electronic modes on or before 31st July 2026. His income from the said business as per books of account is ₹ 15,00,000 computed as per the provisions of Chapter IV-D "Profits and gains from business or Profession" of the Income-tax Act, 1961. Retail trade is the only source of income for Mr. Praveen. A.Y. 2025-26 was the first year for which he declared his business income in accordance with the provisions of presumptive taxation u/s 44AD.

(i) Is Mr. Praveen also eligible for presumptive determination of his income chargeable to tax for the assessment year 2026-27?

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

(iii) In case Mr. Praveen wants to declare profits as per books of account from retail trade, what are his obligations under the Income-tax Act, 1961?

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

SOLUTION

(i) Yes. Since his cash receipts during the P.Y. does not 5% of the total turnover (14,00,000/2,98,50,000 x 100) and his total turnover for the F.Y.2025-26 is below ₹ 300 lakhs, he is eligible for presumptive taxation scheme under section 44AD in respect of his retail trade business.

(ii) His income from retail trade, applying the presumptive tax provisions under section 44AD, would be ₹ 18,19,000 (₹ 1,12,000, being 8% of ₹ 14,00,000 + ₹ 17,07,000, being 6% of ₹ 2,84,50,000).

(iii) Mr. Praveen had declared profit for the previous year 2024-25 in accordance with the presumptive provisions and if he wants to declare profits as per books of account which is lower than the presumptive income for any of the five consecutive assessment years i.e., A.Y. 2026-27 to A.Y. 2030-31, he would not be eligible to claim the benefit of presumptive taxation for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance the presumptive provisions i.e. if he declares profits lower than the presumptive income in say P.Y. 2025-26 relevant to A.Y.2026-27, then, he would not be eligible to claim the benefit of presumptive taxation for A.Y. 2027-28 to A.Y. 2031-32.

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Consequently, Mr. Praveen is required to maintain the books of accounts and get them audited under section 44AB, since his income exceeds the basic exemption limit.

(iv) In case he declares presumptive income under section 44AD, the due date would be 31st July, 2026.

In case he declares profits as per books of account which is lower than the presumptive income, he is required to get his books of account audited, in which case the due date for filing of return of income would be 31st October, 2026.

ILLUSTRATION 19

Mr. X commenced the business of operating goods vehicles on 1.4.2025. He purchased the following vehicles during the P.Y.2025-26. Compute his income under section 44AE for A.Y.2026-27.

	Gross Vehicle Weight (in kilograms)	Number	Date of purchase
(1)	7,000	2	10.04.2025
(2)	6,500	1	15.03.2026
(3)	10,000	3	16.07.2025
(4)	11,000	1	02.01.2026
(5)	15,000	2	29.08.2025
(6)	15,000	1	23.02.2026

Would your answer change if the two goods vehicles purchased in April, 2025 were put to use only in July, 2025?

SOLUTION

Since Mr. X does not own more than 10 vehicles at any time during the previous year 2025-26, he is eligible to opt for presumptive taxation scheme under section 44AE. ₹ 1,000 per ton of gross vehicle weight or unladen weight per month or part of the month for each heavy goods vehicle and ₹ 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by him would be deemed as his profits and gains from such goods carriage.

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Heavy goods vehicle means any goods carriage, the gross vehicle weight of which exceeds 12,000 kg.

(1)	(2)	(3)	(4)
Number of Vehicles	Date of purchase	No. of months for which vehicle is owned	No. of months × No. of vehicles [(1) × (3)]
Heavy goods vehicle			
2	29.08.2025	8	16
1	23.02.2026	2	2
			18
Goods vehicle other than heavy goods vehicle			
2	10.4.2025	12	24
1	15.3.2026	1	1
3	16.7.2025	9	27
1	02.1.2026	3	3
			55

The presumptive income of Mr. X under section 44AE for A.Y.2026-27 would be -

₹ 6,82,500, i.e., 55 × ₹ 7,500, being for other than heavy goods vehicle + 18 x ₹ 1,000 x 15 ton being for heavy goods vehicle.

The answer would remain the same even if the two vehicles purchased in April, 2025 were put to use only in July, 2025, since the presumptive income has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.

3.14 METHOD OF COMPUTING DEDUCTION IN THE CASE OF BUSINESS REORGANISATION OF CO-OPERATIVE BANKS [SECTION 44DB]

(1) This section provides the manner in which the deduction under the following sections are to be allowed in a case where business reorganisation of a co-operative bank has taken place during the financial year –

(i) Section 32 (Depreciation);

(ii) Section 35D (Amortisation of certain preliminary expenses);

(iii) Section 35DD (Amortisation of expenses in case of amalgamation or demerger);

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(iv) Section 35DDA (Amortisation of expenditure incurred under voluntary retirement scheme).

(2) Quantum of Deduction to predecessor co-operative bank: The amount of deduction allowable to the predecessor co-operative bank under the above-mentioned sections has to be determined in accordance with the following formula-

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

A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the 1st day of the financial year and ending on the day immediately preceding the date of business reorganisation; and

C= the total number of days in the financial year in which the business reorganisation has taken place.

(3) Quantum of Deduction to successor co-operative bank *or* to the converted banking company: The amount of deduction allowable to the successor co-operative bank or to the converted banking company under the above-mentioned sections has to be determined in accordance with the formula -

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

A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the date of business reorganisation and ending on the last day of the financial year; and

C = the total number of days in the financial year in which the business reorganisation has taken place.

Example:

Let us take a case where the deduction allowable under section 32 to the predecessor co-operative bank is, say, ₹ 1,20,000 and the business re-organisation took place on 1.11.2025. Then, the deduction allowable to the predecessor co-operative bank under section 32 would be ₹ 70,356 i.e., ₹ 1,20,000 x 214/365. The deduction allowable to the successor co-operative bank or to the converted banking company would be ₹ 49,644 i.e., ₹ 1,20,000 x 151/365.

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(4) **Manner for computing deduction:** In a case where an undertaking of the predecessor co-operative bank entitled to the deduction under sections 35D, 35DD or 35DDA is transferred before the expiry of the period specified therein to a successor co-operative bank or to a converted banking company on account of business reorganisation, the provisions of section 35D, section 35DD or section 35DDA shall apply to the successor co-operative bank or to converted banking company in the financial years subsequent to the year of business reorganisation as they would have applied to the predecessor co-operative bank, as if the business reorganisation had not taken place.

(5) **Meaning of certain terms:**

Term	Meaning
Business reorganisation	The reorganisation of business involving the amalgamation or demerger of a co-operative bank or conversion of a primary co-operative bank.
Conversion	Transition of a primary co-operative bank to a banking company under the scheme of the RBI as notified vide its circular no. DCBR. CO. LS. PCB. Cir. No. 5/07.01.000/2018-19, dated 27.09.2018.
Converted banking company	A banking company formed as a result of conversion from primary co-operative bank.
Co-operative bank	The meaning assigned to it in clause (cci) of section 5 of the Banking Regulation Act, 1949 i.e., a primary co-operative bank or Central Co-operative bank or a State co-operative bank.
Banking company	The meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949 i.e., any company which transacts the business of banking in India.
Predecessor co-operative bank	The amalgamating co-operative bank or the demerged co-operative bank or primary co-operative bank which has been succeeded as a result of conversion, as the case may be.
Primary co-operative bank	The meaning assigned to it in clause (ccv) of section 5 of the Banking Regulation Act, 1949 i.e., a co-operative society, other than a primary agricultural credit society – (i) the primary object or principal business of which is the transaction of banking business; (ii) the paid-up share capital and reserves of which are not less than ₹ 1 lakh; and (iii) The bye-laws of which do not permit admission of any other co-operative society as a member. However, it shall not

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	apply to the admission of a co-operative bank as a member by reason of such co-operative bank subscribing to the share capital of such co-operative society out of funds provided by the State Government for this purpose.
Successor co-operative bank	the amalgamated co-operative bank or the resulting bank, as the case may be.
Amalgamated co-operative bank	(1) a co-operative bank with which one or more amalgamating co-operative banks merge; or (2) a co-operative bank formed as a result of merger of two or more amalgamating co-operative banks.
Amalgamating co-operative bank	(1) a co-operative bank which merges with another co-operative bank; or (2) every co-operative bank merging to form a new co-operative bank.
Amalgamation	the merger of an amalgamating co-operative bank or banks with an amalgamated co-operative bank, in such a manner that – (1) all the assets and liabilities of the amalgamating co-operative bank or banks immediately before the merger (other than the assets transferred, by sale or distribution on winding up, to the amalgamated co-operative bank) become the assets and liabilities of the amalgamated co-operative bank; (2) the members holding 75% or more voting rights in the amalgamating co-operative bank become members of the amalgamated co-operative bank; and (3) the shareholders holding 75% or more in value of the shares in the amalgamating co-operative bank (other than the shares held by the amalgamated co-operative bank or its nominee or its subsidiary, immediately before the merger) become shareholders of the amalgamated co-operative bank.
Demerger	The transfer by a demerged co-operative bank of one or more of its undertakings to any resulting co-operative bank, in such manner that- (1) all the assets and liabilities of the undertaking or undertakings immediately before the transfer become the assets and liabilities of the resulting co-operative bank; (2) the assets and the liabilities are transferred to the resulting co-operative bank at values (other than change in the value of assets consequent to their revaluation) appearing in its books of account immediately before the transfer;

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	(3) the resulting co-operative bank issues, in consideration of the transfer, its membership to the members of the demerged co-operative bank on a proportionate basis; (4) the shareholders holding 75% or more in value of the shares in the demerged co-operative bank (other than shares already held by the resulting bank or its nominee or its subsidiary immediately before the transfer), become shareholders of the resulting co-operative bank, otherwise than as a result of the acquisition of the assets of the demerged co-operative bank or any undertaking thereof by the resulting co-operative bank; (5) the transfer of the undertaking is on a going concern basis; and (6) the transfer is in accordance with the conditions specified by the Central Government, by notification in the Official Gazette, having regard to the necessity to ensure that the transfer is for genuine business purposes.
Demerged co-operative bank	the co-operative bank whose undertaking is transferred, pursuant to a demerger, to a resulting bank.
Resulting co-operative bank	(1) one or more co-operative banks to which the undertaking of the demerged co-operative bank is transferred in a demerger; or (2) any co-operative bank formed as a result of demerger.

ILLUSTRATION 20

Alpha Co-operative Bank amalgamated with Beta Co-operative Bank on 1.12.2025. The depreciation for the year ended 31.3.2026 calculated as per Income-tax Rules, 1962, allowable to Alpha Co-operative Bank had the amalgamation had not taken place amounts to ₹ 2,40,000. Compute the deduction on account of depreciation allowable in the hands of Alpha Co-operative Bank and Beta Co-operative Bank for A.Y. 2026-27.

SOLUTION

(i) The amount of deduction allowable to the amalgamating co-operative bank (i.e. Alpha Co-operative bank, in this case) under section 32 has to be determined in accordance with the following formula -

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

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A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.

B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e., 1.4.2025, in this case) and ending on the day immediately preceding the date of business reorganization (i.e., 30.11.2025, in this case); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e., 365 days).

(ii) The amount of deduction allowable to the amalgamated co-operative bank (i.e. Beta Co-operative bank, in this case) under section 32 has to be determined in accordance with the formula -

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

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.

B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.12.2025, in this case) and ending on the last day of the financial year (i.e. 31.3.2026); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).

(iii) In this case, the deduction that would have been allowable under section 32 to Alpha co-operative bank had the business reorganization had not taken place is ₹ 2,40,000 and the business re-organisation took place on 1.12.2025. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be ₹1,60,438 i.e., ₹ 2,40,000 x 244/365. The deduction allowable to Beta co-operative bank would be ₹ 79,562 i.e., ₹ 2,40,000 x 121/365.

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3.15 COMPUTATION OF BUSINESS INCOME IN CASES WHERE INCOME IS PARTLY AGRICULTURAL AND PARTLY BUSINESS IN NATURE

(1) Income from the manufacture of rubber [Rule 7A]

(i) Income derived from the sale of centrifuged latex or cenex or latex based crepes or brown crepes or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller **in India** shall be computed as if it were income derived from business, and 35% of such income shall be deemed to be income liable to tax.

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

(2) Income from the manufacture of coffee [Rule 7B]

(i) Income derived from the sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and 25% of such income shall be deemed to be income liable to tax.

(ii) Income derived from the sale of coffee grown cured, roasted and grounded by the seller in India, with or without mixing of chicory or other flavouring ingredients, shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

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

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(3) Income from the manufacture of tea [Rule 8]

(i) Income derived from the sale of tea grown and manufactured by the seller in India shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

(ii) In computing such income, an allowance shall be made in respect of the cost of planting bushes in replacement of bushes that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provision of section 10(30), is not includible in the total income.

Taxability in case of composite income: A Summary

Rule	Nature of composite income	Business income (Taxable)	Agricultural Income (Exempt)
7A	Income from sale of rubber products derived from rubber plants grown by the seller in India	35%	65%
7B	Income from sale of coffee		
	- grown and cured by the seller in India	25%	75%
	- grown, cured, roasted and grounded by the seller in India	40%	60%
8	Income from sale of tea grown and manufactured by the seller in India	40%	60%

ILLUSTRATION 21

Miss Vivitha, a resident and ordinarily resident in India, has derived the following income from various operations (relating to plantations and estates owned by her) during the year ended 31-3-2026:

S. No.	*Particulars*	*₹*
(i)	*Income from sale of centrifuged latex processed from rubber plants grown in Darjeeling.*	*3,00,000*
(ii)	*Income from sale of coffee grown and cured in Yercaud, Tamil Nadu.*	*1,00,000*
(iii)	*Income from sale of coffee grown, cured, roasted and grounded, in Colombo. Sale consideration was received at Chennai.*	*2,50,000*

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(iv)	*Income from sale of tea grown and manufactured in Shimla.*	*4,00,000*
(v)	*Income from sapling and seedling grown in a nursery at Cochin. Basic operations were not carried out by her on land.*	*80,000*

You are required to compute the business income and agricultural income of Miss Vivitha for the assessment year 2026-27.

SOLUTION

Computation of business income and agricultural income of Ms. Vivitha for the A.Y.2026-27

Sr. No.	Source of income	Gross (₹)	Business income		Agricultural income
			%	₹	₹
(i)	Sale of centrifuged latex from rubber plants grown in India.	3,00,000	35%	1,05,000	1,95,000
(ii)	Sale of coffee grown and cured in India.	1,00,000	25%	25,000	75,000
(iii)	Sale of coffee grown, cured, roasted and grounded outside India. **(See Note 1 below)**	2,50,000	100%	2,50,000	-
(iv)	Sale of tea grown and manufactured in India	4,00,000	40%	1,60,000	2,40,000
(v)	Saplings and seedlings grown in nursery in India **(See Note 2 below)**	80,000		Nil	80,000
	Total			**5,40,000**	**5,90,000**

Notes:

1. Where income is derived from sale of coffee grown, cured, roasted and grounded by the seller in India, 40% of such income is taken as business income and the balance as agricultural income. However, in this question, these operations are done in Colombo, Sri Lanka. Hence, there is no question of such apportionment and the whole income is taxable as business income. Receipt of sale proceeds in India does not make this agricultural income. In the case of an assessee, being a resident and ordinarily resident, the income arising outside India is also chargeable to tax.

2. *Explanation 3* to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income whether or not the basic operations were carried out on land.

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SIGNIFICANT SELECT CASES

S. No.	Case Law	
1.	***Frontier Information Tech Ltd. v DCIT (ITA 239/2008, Judgment, Telangana High Court)***	
	Issue	**Facts, Analysis and Decision**
	Whether conversion of interest due on loan into equity of the company amounts to actual payment of the interest and is to be allowed as deduction as per section 43B of the Act?	**Facts of the Case:** The assessee-company, a developer of software, had converted the interest due of ₹ 75.75 lakhs to Andhra Pradesh Industrial Development Corporation Limited, being a State industrial investment corporation and interest of ₹ 39.94 lakhs to Andhra Pradesh State Financial Corporation into equity shares. The Assessing Officer held that actual payment of the amount was sine qua non for allowing deduction under section 43B. It was further held that conversion of outstanding interest liability into loan i.e., funding interest or into equity did not amount to actual payment. Accordingly, the amount was disallowed under section 43B on the ground that the same was not actually paid. **Analysis and Decision:** The High Court held that as the liability of the assessee to pay interest ceased to exist on issue of shares, the same would tantamount to actual payment within the meaning of section 43B. The assessee, therefore, is entitled to claim the benefit of deduction under section 43B.
2.	***Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673 (SC);*** ***Rayala Corporation (P) Ltd. v. Asstt. CIT (2016) 386 ITR 500 (SC); and*** ***Raj Dadarkar and Associates v. ACIT (2017) 394 ITR 592 (SC)***	
	Issue	**Analysis & Decision**
	Would rental income from the business of leasing out properties be taxable under the head "Income from house property" or "Profits and gains from business or profession"?	In *Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673*, the Supreme Court observed that holding of the properties and earning income by letting out of these properties is the main objective of the company. Further, in the return of income filed by the company and accepted by the Assessing Officer, the entire income of the company comprised of income from letting out of

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		such properties. The Supreme Court, accordingly, held that such income was taxable as business income. Likewise, in *Rayala Corporation (P) Ltd. v. Asst. CIT (2016) 386 ITR 500*, the Supreme Court noted that the assessee was engaged only in the business of renting its properties and earning rental income therefrom and accordingly, held that such income was taxable as business income. However, in *Raj Dadarkar and Associates v. ACIT (2017) 394 ITR 592*, on account of lack of sufficient material to prove that substantial income of the assessee was from letting out of property, the Supreme Court held that the rental income has to be assessed as "Income from house property". ***Note:*** *The Finance (No. 2) Act, 2024 inserted an Explanation 3 to section 28 and clarified that the income from* ***letting out of a residential house or a part of the house*** *by the owner would be chargeable to tax under the head "Income from house property" and will no longer be considered under the head* ***"Profits and gains of business or profession" even though the main business of the assessee is to let out the residential house properties.*** *Accordingly, the rationale of the above rulings hold good only in respect of letting out of commercial properties.*
3.	***CIT v. K and Co. (2014) 364 ITR 93 (Del)***	
	Issue	**Analysis & Decision**
	Whether interest income on margin money deposited with bank for obtaining bank guarantee to carry on business, taxable the head 'Profits and Gains from Business or Profession' or under the head 'Income from other sources?	The interest income from the deposits made by the assessee is inextricably linked to the business of the assessee and such income, therefore, cannot be treated as income under the head 'Income from other sources'. The margin money requirement was an essential element for obtaining the bank guarantee. If the assessee had not furnished bank guarantee, it would not have got the contract. Therefore, the interest income received on funds kept as margin money for obtaining the bank guarantee would be taxable under the head "Profits and gains of business or profession".

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4.	*I.C.D.S. Ltd. v. CIT (2013) 350 ITR 527 (SC)*	
	Issue	**Analysis & Decision**
	Can depreciation on leased vehicles be denied to the lessor on the ground that the vehicles are registered in the name of the lessee and that the lessor is not the actual user of the vehicles?	Section 32 imposes a twin requirement of "ownership" and "usage for business" as conditions for claim of depreciation thereunder. As far as usage of the asset is concerned, the section requires that the asset must be used in the course of business. It does not mandate actual usage by the assessee itself. **In this case, the assessee did use the vehicles in the course of its leasing business. Hence, this requirement of section 32 has been fulfilled, notwithstanding the fact that the assessee was not the actual user of the vehicles.** As long as the assessee-lessor has a right to retain the legal title against the rest of the world, he would be the owner of the asset in the eyes of law. In this regard, the following provisions of the lease agreement are noteworthy – • The assessee is the exclusive owner of the vehicle at all points of time; • The assessee is empowered to repossess the vehicle, in case the lessee committed a default; • At the end of the lease period, the lessee was obliged to return the vehicle to the assessee; • The assessee had a right of inspection of the vehicle at all times. The proof of ownership lies in the lease agreement itself, which clearly points in favour of the assessee. **The assessee-lessor was, therefore, entitled to claim depreciation in respect of vehicles leased out since it has satisfied both the requirements of section 32, namely, ownership of the vehicles and its usage in the course of business.**

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5.	***CIT v. BSES Yamuna Powers Ltd (2013) 358 ITR 47 (Delhi)*** ***CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 0049 (Delhi)*** ***Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)***	
	Issue	**Analysis & Decision**
	What is the eligible rate of depreciation in respect of computer accessories, peripherals and UPS under the Income-tax Act, 1961?	**Computer accessories and peripherals such as printers, scanners and server etc. form an integral part of the computer system and they cannot be used without the computer**. Since they are part of the computer system, **they would be eligible for depreciation at the higher rate of 40% applicable to computers including computer software**. **Depreciation on UPS is allowable@40%**, being the eligible rate of depreciation on computers including computer software, and not at the general rate of 15% applicable to plant and machinery.
	Can EPABX and mobile phones be treated as computers to be entitled to higher depreciation?	**EPABX and mobile phones are <u>not</u> computers and therefore, are not entitled to higher depreciation@40%.**
6.	***CIT v. Ceebros Hotels Private Limited [2018] 409 ITR 423 (Mad)***	
	Issue	**Analysis & Decision**
	Can an assessee setting up a hotel claim deduction under section 35AD for the relevant previous year, on the basis that it had commenced its operations and made an application for three-star category classification in beginning of the said previous year, even though the same was granted by the authority only in the next year due to the requirement of completion of inspection?	As the application for three star category classification was granted with no discrepancy during inspection, the assessee could not be penalised for the delay on the part of the concerned authority (the Hotel and Restaurant Approval and Classification Committee, in the instant case) to complete inspection before the end of the financial year. Under section 35AD, deduction is available from the previous year in which the assessee commences operation of the specified business i.e., hotel business, in this case. Section 35AD does not mandate that the date of the certificate has to be with effect from a particular date. Thus, the assessee is entitled to claim the deduction under section 35AD for the relevant previous year, since the provision which was

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		introduced to encourage the establishment of hotels of a particular category is a beneficial provision, and hence, should be read and interpreted liberally.
7.	***Berger Paints India Ltd v. CIT (2017) 393 ITR 113 (SC)***	
	Issue	**Analysis & Decision**
	Whether "premium" on subscribed share capital is "capital employed in the business of the company" u/s 35D to be eligible for a deduction?	Share premium collected by the assessee on its subscribed issued share capital could not be part of "capital employed in the business of the company" for the purpose of section 35D(3)(b). If it were the intention of the legislature to treat share premium as being "capital employed in the business of the company", it would have been explicitly mentioned. Moreover, Sl. No. IV(i) in Form MGT- 7 read with section 92 of the Companies Act, 2013 dealing with capital structure of the company provides the break-up of "issued share capital" and "subscribed share capital" which does not include share premium at the time of subscription. **Hence, in the absence of the reference in section 35D, share premium is not a part of the capital employed**. Also, section 52 of the Companies Act, 2013 requires a company to transfer the premium amount to be kept in a separate account called "securities premium account". **The assessee is, therefore, not entitled to claim deduction u/s 35D in relation to the premium amount received from shareholders at the time of share subscription.**
8.	***Shasun Chemicals & Drugs Ltd v. CIT (2016) 388 ITR 1 (SC)***	
	Issue	**Analysis & Decision**
	In a case where payment of bonus due to employees is paid to a trust and such amount is subsequently paid to the employees before the stipulated due date, would the same be allowable u/s 36(1)(ii) while computing business income?	**The embargo contained in section 43B(b) or section 40A(9) does not come in the way of the assessee's claim, since the bonus was ultimately paid to the employees before the due date as per the statutory requirement. Therefore, the payment in respect of bonus is allowable as deduction.**

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9.	***CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 49 (Delhi)***	
	Issue	**Analysis & Decision**
	What is the nature of expenditure incurred on glow-sign boards displayed at dealer outlets - capital or revenue?	The expenditure on glow sign boards displayed at dealer outlets is revenue in nature due to the following reasons- (i) The expenditure incurred by the assessee on glow sign boards does not bring into existence an asset or advantage for the enduring benefit of the business, which is attributable to the capital. (ii) The glow sign board is not an asset of permanent nature. It has a short life. (iii) The materials used in the glow sign boards decay with the effect of weather. Therefore, it requires frequent replacement. Consequently, the assessee has to incur expenditure on glow sign boards regularly in almost each year. (iv) The assessee incurred expenditure on the glow sign boards with the object of facilitating the business operation and not with the object of acquiring asset of enduring nature.
10.	***CIT v. ITC Hotels Ltd. (2011) 334 ITR 109 (Kar.)***	
	Issue	**Decision**
	Would the expenditure incurred on issue and collection of convertible debentures be treated as revenue expenditure or capital expenditure?	The expenditure incurred on the issue and collection of debentures would be treated as revenue expenditure even in case of convertible debentures, i.e., the debentures which had to be converted into shares at a later date.
11.	***CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594 (Delhi)***	
	Issue	**Analysis & Decision**
	Would expenditure incurred on feasibility study conducted for examining proposals for technological advancement relating to the existing business be classified as a revenue	Since the feasibility studies were conducted by the assessee for the existing business with a common administration and common fund and the studies were abandoned without creating a new asset, the expenses were of revenue nature.

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	expenditure, where the project was abandoned without creating a new asset?	
12.	***National Co-operative Development Corporation v. CIT (2020) 427 ITR 288 (SC)***	
	Issue	**Analysis & Decision**
	Is source of funds from which expenditure is incurred for the purpose of business relevant for the purpose of allowability of deduction u/s 37(1)?	In case of an assessee carrying on business, it is relevant to see whether an outlay constitutes an expenditure "for the purpose of business" as used in section 37(1), for the purpose of claiming deduction thereunder. **The source of funds from which the expenditure is made is <u>not</u> relevant.** Every application of income towards the business objective of the assessee is a business expenditure. There can be an amount treated as a capital receipt while the same amount expended may be a revenue expenditure.
13.	***CIT v. Kap Scan and Diagnostic Centre P. Ltd. (2012) 344 ITR 476 (P&H)***	
	Issue	**Analysis & Decision**
	Can the commission paid to doctors by a diagnostic centre for referring patients for diagnosis be allowed as a business expenditure u/s 37 or would it be treated as illegal and against public policy to attract disallowance?	As per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, no physician shall give, solicit, receive, or offer to give, solicit or receive, any gift, gratuity, commission or bonus in consideration of a return for referring any patient for medical treatment. The demanding as well as paying of such commission is bad in law. It is not a fair practice and is opposed to public policy and should be discouraged. Thus, **the commission paid to doctors for referring patients for diagnosis is not allowable as business expenditure.**
14.	***Shanti Bhushan v. CIT (2011) 336 ITR 26 (Delhi)***	
	Issue	**Analysis & Decision**
	Can the expenditure incurred on heart surgery of an assessee, being a lawyer by profession, be allowed as business expenditure u/s 31, by treating it as current repairs considering heart as	Though the definition of "plant" as per the provisions of section 43(3) is inclusive in nature, such plant must have been used as a business tool which is not true in case of heart. Therefore, the **heart cannot be said to be plant for the business or profession of the assessee.**

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	plant and machinery, or u/s 37, by treating it as expenditure incurred wholly and exclusively for the purpose of business or profession?	**Therefore, the expenditure on heart surgery is not allowable as repairs to plant u/s 31.** Also, **there is no direct nexus between the expenses incurred by the assessee on the heart surgery and his efficiency in the professional field. Therefore, the claim for allowing the said expenditure u/s 37 is also not tenable.** Hence, the heart surgery expenses shall **not** be allowed as a business expenditure of the assessee under the Income-tax Act, 1961.
15.	***CIT v. Neelavathi & Others (2010) 322 ITR 643 (Karn)***	
	Issue	**Analysis & Decision**
	Can payment to police personnel and gundas to keep away from the cinema theatres run by the assessee be allowed as deduction?	Any payment made to the police illegally amounts to bribe and such illegal gratification cannot be considered as an allowable deduction. Similarly, any payment to a gunda as a precautionary measure so that he shall not cause any disturbance in the theatre run by the assessee is an illegal payment for which no deduction is allowable under the Act.
16.	***Millennia Developers (P) Ltd. v. DCIT (2010) 322 ITR 401 (Karn.)***	
	Issue	**Analysis & Decision**
	Is the amount paid by a construction company as regularization fee for violating building bye-laws allowable as deduction?	The assessee, a private limited company carrying on business activity as a developer and builder, claimed the amount paid by way of regularization fee for the deviations made while constructing a structure and for violating the plan sanctioned in terms of the building bye-laws, approved by the municipal authorities as per the provisions of the Karnataka Municipal Corporations Act, 1976. As per the provisions of the Karnataka Municipal Corporations Act, 1976, **the amount paid to compound an offence is obviously a penalty and hence, does not qualify for deduction u/s 37**. Merely describing the payment as a compounding fee would not alter the character of the payment.

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17.	***CIT v. Maruti Suzuki India Limited (2018) 407 ITR 165 (Del)***	
	Issue	**Analysis & Decision**
	Can payments made by an assessee to a non-resident agent who does not have any income assessable in India be disallowed u/s 40(a)(i) for non-deduction of tax at source on the ground that no application was made by the assessee u/s 195(2) for making deduction of tax at source at Nil rate?	The non-resident agent who operated outside India did not have any income arising in India. Accordingly, **the commission earned by a non-resident agent who was in the business of selling Indian goods abroad, did not accrue or arise in India, and hence, no tax was deductible on such commission payment to a non-resident agent.** Since the assessee has made payment to a non-resident agent and such income is not chargeable to tax in India, section 40(a)(i) could not be invoked to disallow deduction of such payment for non-deduction of tax at source while computing the business income of the assessee.
18.	***CIT v. Great City Manufacturing Co. (2013) 351 ITR 156 (All)***	
	Issue	**Analysis & Decision**
	Can remuneration paid to working partners as per the partnership deed be considered as unreasonable and excessive for attracting disallowance u/s 40A(2)(a), even though the same is within the statutory limit prescribed u/s 40(b)(v)?	**Section 40(b)(v) prescribes the limit of remuneration to working partners, and deduction is allowable up to such limit while computing the business income. If the remuneration paid is within the ceiling limit provided u/s 40(b)(v), then, recourse to provisions of section 40A(2)(a) cannot be taken**. The Assessing Officer is only required to ensure that the remuneration is paid to the working partners mentioned in the partnership deed, the terms and conditions of the partnership deed provide for payment of remuneration to the working partners and the remuneration is within the limits prescribed u/s 40(b)(v). If these conditions are complied with, then, the Assessing Officer cannot disallow any part of the remuneration on the ground that it is excessive by invoking the provisions of section 40A(2)(a).

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TEST YOUR KNOWLEDGE

Questions

1. *Examine critically the following cases in the context of provisions contained in the Income-tax Act, 1961 relevant for Assessment Year 2026-27. Support the answers with relevant case laws and workings.*

   (a) *Mr. Janak is proprietor of M/s. Yash Texnit which is engaged in garment manufacturing business. The entire block of Plant & Machinery chargeable to depreciation @ 15%, has 20 different machinery items as at 31-03-2026. One of the machineries used for packing had become obsolete and was discarded by Mr. Janak in July 25.*

   Assessee filed its return for A.Y. 2026-27 claiming total depreciation of ₹ 40 lakhs which includes ₹ 4 lakhs being the depreciation claimed on the machinery item discarded by Mr. Janak. The A.O. disallowed the claim of depreciation of ₹ 4 lakhs during the course of scrutiny assessment.

   Comment on the validity of action taken by A.O.

   (b) *X. Ltd. issued debentures in the previous year 2025-26, which were to be matured at the end of 5 years. The debenture holder was given an option of one time upfront payment of ₹ 60 per debenture on account of interest which was to be immediately paid by the company. As per the option exercised by the debenture holders, company paid interest upfront to them in the first year itself and the same was claimed as deduction in the return of the company. But in the accounts, the interest expenditure was shown as deferred expenditure to be written off over a period of 5 years. During the course of assessment, the Assessing Officer spread the upfront interest paid over a period of five year term of debentures and allowed only one-fifth of the amount in the previous year 2025-26. Examine the correctness of the action of Assessing Officer.*

2. *Compute the quantum of depreciation available under section 32 of the Income-tax Act, 1961 in respect of the following items of Plant and Machinery purchased by PQR Textile Ltd., by paying through account payee cheque, which is engaged in the manufacture of textile fabrics, for the year ended 31-3-2026. Assume company does not opt for the provisions of section 115BAA:*

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	(₹ in crores)
New machinery installed on 1-5-2025	84
New Windmill purchased and installed on 18-6-2025	22
Lorries for transporting goods to sales depots (purchased and put to use in July, 2025)	3
Items purchased after 30th November 2025:	
Fork-lift-trucks, used inside factory	4
Computers installed in office premises	1
Computers installed in factory	2
New imported machinery	12

The new imported machinery arrived at Chennai port on 30-03-2026 and was installed on 3-4-2026. All other items were installed during the year ended 31-3-2026.

The company was newly started during the year.

Also, compute the WDV of the various blocks of assets as on 1.4.2026 after charging depreciation for P.Y. 2025-26.

3. (A) *Examine the taxability and/ or allowability of the following receipts or expenditures under the provisions of the Income-tax Act, 1961, for the assessment year 2026-27:*

   (i) *Secret commission was paid during the previous year 2025-26.*

   (ii) *P Ltd. paid dollars equivalent to ₹ 50 lakhs as sales commission for the year ended 31.03.2026, without deducting tax at source, to Mr. Rodrigues, a citizen of UK and non-resident who acted as agent for booking orders, from various customers who are outside India.*

   (B) *Can the following transactions be covered under section 43B for disallowance?*

   (i) *A bank guarantee given by a company towards disputed tax liabilities.*

   (ii) *Interest payable to Goods and Services Tax Department but not paid before the due date specified in section 139(1).*

4. *ILT Limited is engaged in manufacturing of pipes and tubes. The profit and loss account of the company for the year ended 31st March, 2026 shows a net profit of ₹ 405 lakhs. The following information and particulars are furnished to you. You are required to compute total income of the company for Assessment Year 2026-27 indicating reasons for treatment of each item, assuming that the company has not opted for special provisions under section 115BAA or 115BAB.*

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(i) *A group free air ticket was provided by a supplier for reaching a certain volume of purchase during the financial year 2025-26. The same is encashed by the company for ₹ 10 lakhs in April 2025 and credited to General Reserve Account.*

(ii) *A regular supplier of raw materials agreed for settlement of ₹ 8 lakhs instead of ₹ 10 lakhs for poor quality of material supplied during the previous year which was not given effect in the running account of the supplier.*

(iii) *Andhra Bank sanctioned and disbursed a term loan in the financial year 2022-23 for a sum of ₹ 50 lakhs. Interest of ₹ 8 lakhs was in arrears. The bank has converted the arrear interest into a new loan repayable in 10 equal instalments. During the year, the company has paid 2 instalments and the amount so paid has been reduced from Funded Interest in the Balance Sheet.*

(iv) *The company remitted ₹ 5 lakhs as interest to a company incorporated in USA on a loan taken 2 years ago. Tax deducted under section 195 from such interest has been deposited by the company on 15th July, 2026. The said interest was debited to profit and loss account.*

(v) *Sandeep, a sales executive stationed at HO at Delhi, was on official tour in Bangalore from 31st May, 2025 to 18th June, 2025 and 28th September, 2025 to 15th October, 2025 for the business development. The company has paid Sandeep's salary in cash, from its local office at Bangalore for the month of May, 2025 (payable on 1st June) and September 2025 (payable on 1st October), amounting to ₹ 45,000 and ₹ 47,000 respectively (net of TDS and other deduction), as Sandeep has no bank account at Bangalore. These were included in the amount of "salary" debited to Profit and Loss Account.*

(vi) *The company has contributed ₹ 50,000 by account payee cheque to an electoral trust and the same stands included under the head "General Expenses".*

5. *G Ltd., a company in which public are substantially interest, is engaged in the business of growing and manufacturing tea in India. For the previous year ended 31.03.2025, its composite business profits before allowing deduction u/s 33AB is ₹ 60,00,000. On 01.09.2025, it deposited a sum of ₹ 11,00,000 in the Tea Development Account. During the previous year 2023-24, G Ltd. had incurred a business loss of ₹ 14,00,000 which has been carried forward. On 25.01.2026, it withdrew ₹ 10 lakhs, from deposit account which is utilized as under:*

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₹ 6,00,000 for purchase on non-depreciable asset as per the scheme specified.

₹ 3,00,000 for purchase of machinery to be installed in the office premises.

₹ 1,00,000 was spent for the purpose of scheme on 5.4.2026.

(i) You are required to determine business income of G Ltd. and the tax consequences that may arise from the above transactions in the A.Y. 2026-27.

(ii) What will be the consequence if the asset which was purchased for ₹ 6,00,000 is sold for ₹ 8,00,000 in April, 2026.

6. *The trading and profit and loss account of Pingu Trading Pvt. Ltd. having business of agricultural produce, consumer items and other products for the year ended 31.03.2026 is as under:*

Trading Account

Particulars	₹	Particulars	₹
Opening Stock	3,75,000	Sales	1,55,50,000
Purchases	1,25,75,000	Closing Stock	4,50,000
Freight & Cartage	1,26,000		
Gross profit	29,24,000		
	1,60,00,000		**1,60,00,000**

Profit and Loss Account

Particulars	₹	Particulars	₹
Bonus to staff	47,500	Gross profit	29,24,000
Rent of premises	53,500	Income-tax refund	20,000
Advertisement	5,000	Warehousing charges	15,00,000
Bad Debts	75,000		
Interest on loans	1,67,500		
Depreciation	71,500		
Goods and Services tax demand paid	1,08,350		
Miscellaneous expenses	5,25,650		
Net profit of the year	33,90,000		
	44,44,000		**44,44,000**

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On scrutiny of records, the following further information and details were extracted/ gathered:

(i) There was a survey under section 133A on the business premises on 31.3.2026 in which it was revealed that the value of closing stocks of 31.3.2025 was ₹ 8,75,000 and a sale of ₹ 75,000 made on 13.3.2026 was not recorded in the books. The value of closing stocks after considering these facts and on the basis of inventory prepared by the department as on 31.3.2026 worked out at ₹ 12,50,000, which was accepted to be correct and not disputed.

(ii) Income-tax refund includes amount of ₹ 4,570 of interest allowed thereon.

(iii) Bonus to staff includes an amount of ₹ 7,500 paid in the month of December 2025, which was provided in the books on 31.03.2025.

(iv) Rent of premises includes an amount of ₹ 5,500 incurred on repairs. The assessee was under no obligation to incur such expenses as per rent agreement.

(v) Advertisement expenses include an amount of ₹ 2,500 paid for advertisement published in the souvenir issued by a political party. The payment is made by way of an account payee cheque.

(vi) Miscellaneous expenses include:

(a) amount of ₹ 15,000 paid towards penalty for non-fulfillment of delivery conditions of a contract of sale for the reasons beyond control,

(b) amount of ₹ 1,00,000 paid to the wife of a director, who is working as junior lawyer for taking an opinion on a disputed matter. The junior advocate of High Courts normally charge only ₹ 25,000 for the same opinion,

(c) amount of ₹ 1,00,000 paid to an Electoral Trust by cheque.

(vii) Goods and Services Tax demand paid includes an amount of ₹ 5,300 charged as penalty for delayed filing of returns and ₹ 12,750 towards interest for delay in deposit of tax.

(viii) The company had made an investment of ₹ 25 lakhs on the construction of a warehouse in rural area for the purpose of storage of agricultural produce. This was made available for use from 15.09.2025 and the income from this activity is credited in the Profit and Loss account under the head "Warehousing charges".

(ix) Depreciation under the Income-tax Act, 1961 works out at ₹ 65,000.

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(x) Interest on loans includes an amount of ₹ 80,000 paid to Mr. X, a resident, on which tax was not deducted.

Compute the income chargeable to tax for assessment year 2026-27 of Pingu Trading Pvt. Ltd, ignoring MAT and provisions of section 115BAA. Support your answer with working notes.

7. (a) A Ltd. paid IDBI (a public financial institution) a lump sum pre-payment premium of ₹ 1.2 lakhs on 7.4.2025 for restructuring its debts and reducing its rate of interest. It claimed the entire sum as business expenditure for the P.Y.2025-26. The Assessing Officer, however, held that the pre-payment premium should be amortised over a period of 10 years (being the tenure of the restructured loan), and thus, allowed only 10% of the pre-payment premium in the P.Y.2025-26. Discuss, with reasons, whether the contention of A Ltd. is correct or that of the Assessing Officer.

(b) Explain the tax treatment of emergency spares (of plant and machinery) acquired during the year which, even though kept ready for use, have not actually been used during the relevant previous year.

8. "Easy Call Ltd.", to provide telecom services in Mumbai, obtained a licence on 1.4.2023 for a period of 10 years ending on 31.3.2033 against a fee of ₹ 27 lakhs to be paid in 3 installments of ₹ 9 lakhs each by April, 2023, April, 2024 and April, 2025, respectively. The company has commenced business on 1.4.2024.

Explain, how the payment made for licence fee shall be dealt with under the Income-tax Act, 1961 and the amount, if any, deductible for A.Y. 2026-27.

9. Alpha Ltd., a manufacturing company, has disclosed a net profit of ₹ 12.50 lakhs for the year ended 31st March, 2026. You are required to compute the taxable income (ignore the provisions of section 115BAA) of the company for the Assessment year 2026-27, after considering the following information, duly explaining the reasons for each item of adjustment:

(i) Advertisement expenditure debited to profit and loss account includes the sum of ₹ 60,000 paid in cash to the sister concern of a director, the market value of which is ₹ 52,000.

(ii) Repairs of plant and machinery debited to profit and loss account includes ₹ 1.80 lakhs towards replacement of worn out parts of machineries. Such expenditure does not increase the future benefit from the asset beyond its previously assessed standard of performance.

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(iii) A sum of ₹ 6,000 on account of liability foregone by a creditor has been taken to general reserve. The original purchases was debited to the Profit & Loss Account in the A.Y.2021-22.

(iv) Sale proceeds of import entitlements amounting to ₹ 1 lakh has been credited to Profit & Loss Account, which the company claims as capital receipt not chargeable to income-tax.

(v) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority:

(a) Research equipments purchased ₹ 1,50,000.

(b) Remuneration paid to scientists ₹ 50,000.

The total amount of ₹ 2,00,000 is debited to the profit and loss account.

10. (i) A corporation was set up by the State Government transferring all the buses owned by it for a consideration of ₹ 75 lakhs, which was discharged by the Corporation by issue of equity shares. The Corporation in its assessment claimed depreciation. Can the depreciation be denied in the Corporation's hands on the ground that there was no registration of the buses in favour of the Corporation?

(ii) Ravi succeeded to his father's business in the year 2023. In the previous year ended 31.3.2026, Ravi has written off the balance in the name of 'Y' which relates to supply made by his father, when he carried on business. Ravi desires to know whether the write off could be eligible for deduction.

Answers

1. (a) The issue under consideration is whether disallowance of depreciation made by the Assessing Officer with regard to the discarded asset, in arriving at the written down value of the block of assets, is justified.

One of the conditions for claim of depreciation under section 32 is that the eligible asset must have been put to use for the purpose of business or profession.

The other aspect to considered is whether merely discarding an obsolete machinery, which is physically available, will attract the expression "moneys payable" appearing in section 43(6), so as to deduct its value from the written down value of the block.

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The facts in the present case are similar to facts in the case of *CIT v. Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297*, wherein the Delhi High Court observed that the expression "used for the purposes of the business" in section 32 when used with respect to discarded machinery would mean the use in the business, not only in the relevant financial year/previous year, but also in the earlier financial years.

The discarded machinery may not be actually used in the relevant previous year but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year. Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it was used in the earlier previous years for the business.

For the purpose of section 43(6), "moneys payable" means the sale price, in case of sale, or the insurance, salvage or compensation moneys payable in respect of the asset. In this case, the machinery has not been sold as machinery or scrap or disposed off, and it continues to exist. Hence, there is no "moneys payable" in this case, which alone is deductible while computing the WDV of the block to which it belongs.

Applying the rationale of the above case, the action of the Assessing Officer in disallowing ₹ 4 lakhs, being the depreciation claim attributable to discarded machinery, on the ground that the same was not put to use in the relevant previous year, is invalid, since the said machinery was put to use in the earlier previous years.

(b) The issue under consideration is whether, in a case where debentures are issued with maturity at the end of five years, and the debenture holders are given an option of upfront payment of interest in the first year itself, can the entire upfront interest paid, be claimed as deduction by the company in the first year or should the same be deferred over a period of five years; and would the treatment of such interest as deferred revenue expenditure in the books of account have any impact on the tax treatment.

The facts of the case are similar to the facts in *Taparia Tools Ltd. v. JCIT (2015) 372 ITR 605*, wherein the above issue came up before the Supreme Court. In that case, it was observed that under section 36(1)(iii), the amount of interest paid in respect of capital borrowed for the purposes of business or profession, is allowable as deduction.

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The moment the option for upfront payment was exercised by the subscriber, the liability of X Ltd. to make the payment in that year had arisen. Not only had the liability arisen in the previous year in question, it was even quantified and discharged as well in that very year.

As per the rationale of the Supreme Court ruling in *Taparia Tools Ltd.'s* case, when the deduction of entire upfront payment of interest is allowable as per the Income-tax Act, 1961, the fact that a different treatment was given in the books of account could not be a factor which would bar the company from claiming the entire expenditure as a deduction.

Accordingly, the action of the Assessing Officer in spreading the upfront interest paid over the five year term of debentures and restricting the deduction in the P.Y.2025-26 to one-fifth of the upfront interest paid is **not** correct. The company is eligible to claim the entire amount of interest paid upfront as deduction under section 36(1)(iii) in the P.Y.2025-26.

2. Computation of depreciation allowance under section 32 for the A.Y. 2026-27

Particulars	Normal Depreciation [u/s 32(1)(ii)]	Additional Depreciation [u/s 32(1)(iia)]
	(₹ in crores)	
(A) Plant and Machinery (15% block) (Put to use for 180 days or more)		
- New machinery installed on 01.05.2025	84.00	84.00
- Lorries for transporting goods to depots	3.00	-
	87.00	84.00
Normal Depreciation @15% & additional deprecation @20%	**13.05**	**16.80**
(B) Plant and Machinery (15% block) (Put to use for less than 180 days – hence, depreciation is restricted to 7.5%, being 50% of 15%)		
- Fork-lift trucks, used inside a factory	4.00	4.00
Normal Depreciation @ 7.5% & additional depreciation @10%	**0.30**	**0.40**

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(C) Plant and Machinery (40% block) (Put to use for less than 180 days, hence depreciation restricted to 20%, i.e., 50% of 40%)		
- Computers installed in office premises	1.00	-
- Computers installed in factory	2.00	2.00
	3.00	**2.00**
Normal depreciation @20% & additional depreciation@10%	**0.60**	**0.20**
(D) Plant and Machinery (40% block) (Put to use for 180 days or more) *(See Note 1)*		
- New windmill purchased and installed on 18.06.2025	22.00	22.00
Normal Depreciation @ 40% & additional depreciation @ 20%	**8.80**	**4.40**
Total depreciation and additional depreciation		
- Plant and Machinery (15% block) (A +B)	13.35	17.20
- Plant and Machinery (40% block) (C + D)	9.40	4.60
Depreciation available under section 32 = ₹ 44.55 crores		

Computation of Written Down Value (WDV)
after charging depreciation for P.Y. 2025-26

Particulars		Plant & Machinery	
		15%	40%
		(₹ in crores)	
WDV as on 01.04.2025 (The company was started during the year – as given in question)		Nil	Nil
Add: Plant and Machinery acquired during the year			
- New Machinery installed on 01.05.2025	84.00		
- Lorries for transporting goods to sales depots	3.00		
- Fork-lift trucks, used inside factory	4.00		

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- New imported machinery	12.00	103.00	-
- New Windmill purchased and installed on 18.6.2025		-	22.00
- Computers installed in office premises		-	1.00
- Computers installed in factory		-	2.00
		103.00	**25.00**
Less: Asset sold during the year		Nil	Nil
WDV as on 31.3.2026 (before charging depreciation)		**103.00**	**25.00**
Less: Depreciation for the P.Y.2025-26			
- Normal depreciation		13.35	9.40
- Additional depreciation		17.20	4.60
WDV as on 1.4.2026 (after charging depreciation for P.Y. 2025-26)		**72.45**	**11.00**

Notes:

(1) Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014 would be eligible for depreciation @ 40%.

(2) New imported machinery was not installed during the previous year 2025-26. Hence, it would not be eligible for additional depreciation for A.Y. 2026-27. It would also not be eligible for normal depreciation for A.Y 2026-27, since it was not put to use in the P.Y.2025-26 being the year of acquisition.

(3) It may be noted that investment in the following plant and machinery would not be eligible for additional depreciation under section 32(1)(iia):

(a) Lorries for transporting goods to sales depots, being vehicles/road transport vehicles; and

(b) Computers installed in office premises.

(4) As per section 2(28) of the Motor Vehicles Act, 1988, the definition of a "vehicle" excludes, *inter alia*, a vehicle of special type adopted for use only in a factory or in any enclosed premises. Therefore, fork-lift trucks used inside the factory would not fall within the definition of "vehicle". Hence, it is eligible for additional deprecation under section 32(1)(iia).

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3. **(A)** **(i)** Secret commission is one of the forms of commission payment generally made by business organizations. Secret commission is a payment for obtaining business orders or contracts from parties and /or customers and paid to employees and / or officials of those parties and / or customers or companies from whom business orders are obtained by the assessee.

Explanation 1 below section 37(1) of Income-tax Act, 1961 provides that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law, shall not be deemed to have been incurred for the purpose of business and no deduction or allowance shall be made in respect of such expenditure. In view of the *Explanation*, any expenditure incurred for a purpose which is an offence and prohibited by law cannot be allowed as expenditure. Therefore, since secret commission payment is a payment for an offence prohibited by law, the same cannot be allowed as deduction.

(ii) A foreign agent of an Indian exporter operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for booking orders by non-resident who remains outside India is not subject to tax in India, disallowance under section 40(a)(i) is not attracted in respect of payment of commission to such non-resident outside India even though tax has not been deducted at source. Thus, the amount of ₹ 50 lakhs remitted to Mr. Rodrigues outside India in foreign currency towards commission would not attract disallowance under section 40(a)(i) for non-deduction of tax at source.

(B) **(i)** For claiming deduction of any expense enumerated under section 43B, the requirement is, the actual payment and not deemed payment. Furnishing of bank guarantee cannot be equated with actual payment. Actual payment requires that money must flow from the assessee to the public exchequer as specified in section 43B. Therefore, deduction of an expense covered under section 43B cannot be claimed by merely furnishing a bank guarantee *[CIT v. McDowell & Co Ltd (2009) 314 ITR 167 (SC)]*

(ii) Interest payable to Goods and Services Tax department is part of Goods and Services Tax.

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Therefore, interest payable to Goods and Services Tax department, which is not paid before the "due date" of filing of return of income, would attract disallowance under section 43B [*Mewar Motors v. CIT (2003) 260 ITR 218 (Raj)*]

4. Computation of total income of ILT Ltd. for the A.Y.2026-27

Particulars	₹ (in lakhs)	
Profits and gains from business or profession		
Net profit as per profit and loss account		405.00
***Add:* Items debited to profit and loss account, but to be disallowed and items not considered in accounts but to be taxed**		
Value of group free air ticket provided by a supplier is taxable as business income under section 28(iv), as the value of any benefit, whether convertible into money or not, arising from business is taxable as business income.	10	
Amount waived by the supplier of raw materials is a deemed income under section 41(1), as the expenditure was allowed as deduction in the last year and there is a benefit by way of remission or cessation of a trading liability. The fact that effect was not given in the running account of supplier is not relevant.	2	
Interest payable outside India to a foreign company is allowable **[See Note 1 below]**	-	
Salary paid to employee Sandeep is eligible for deduction. Disallowance under section 40A(3) will not apply **[See Note 2 below]**	-	
Contribution to electoral trust is not an allowable expenditure while computing business income. Hence, the same has to be added back, since it is included in general expenses.	0.50	12.50
		417.50
***Less:* Amount of deduction allowable**		
Under section 43B, interest on loan due to any scheduled bank, etc. is allowed as deduction, if such interest is actually paid irrespective of the method of accounting followed by the assessee.		

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Conversion of arrear interest into a fresh loan by a bank cannot be considered as actual payment of interest. However, the amount of funded interest (i.e., converted loan) actually paid is allowable as deduction. Hence, ₹ 1,60,000, being two instalments of ₹ 80,000 each, actually paid is deductible.		1.60
Business Income		**415.90**
Gross total income		**415.90**
***Less:* Deduction under Chapter VI-A**		
Deduction under section 80GGB in respect of contribution by the assessee company to an electoral trust.		0.50
Total Income		**415.40**

Notes:

1. Since tax has been deducted on interest payable outside India to a foreign company during the previous year 2025-26 and the same has been deposited before the due date of filing return of income under section 139(1), disallowance under section 40(a)(i) is not attracted. Since the interest has already been debited to profit and loss account, no further adjustment is required.

2. In respect of payment of salary to sales executive in cash, no disallowance under section 40A(3) is to be made as the payments fall within the scope of Rule 6DD(i). Salary paid to him in cash is allowable as the executive was temporarily posted for a continuous period of more than 15 days in Bangalore which is not the place of his normal duty. Further tax was deducted from such salary under section 192 and he does not maintain any bank account in Bangalore. No disallowance under section 40A(3) is attracted in respect of such salary.

5. (i) Computation of Business Income of G Ltd. and tax consequences for the A.Y. 2026-27

Particulars	₹
₹ 10,00,000 being the amount withdrawn from Tea Development Account has to be utilized in the prescribed manner, otherwise, the withdrawn amount would be chargeable to tax as business income. In the given case, the taxability of withdrawal amount based on their utilization is as follows:	
- ₹ 6,00,000, out of the amount withdrawn from the deposit account, utilised for purchase of non-depreciable asset as per the specified scheme.	Not taxable

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	[As per section 33AB(6), no deduction would be allowed under section 33AB since amount is spent out of ₹ 11 lakh deposited in Tea Development Account, which has already been allowed as deduction in A.Y.2025-26 **(See Working Note below)**].	
-	₹ 3,00,000, being the amount utilized for purchase of machinery to be installed in the office premises is not a permissible utilization. Hence, the amount would be deemed as profits and gains of business of the previous year 2025-26 as per section 33AB(4).	3,00,000
-	₹ 1,00,000 was spent for the purpose of scheme on 05.04.2026. As per section 33AB(7), this amount would be taxable since the same is not utilized during the same previous year (i.e., P.Y. 2025-26) in which the amount is withdrawn from the deposit account.	1,00,000
When any part of withdrawal amount becomes taxable, the agricultural and non-agricultural portions of income must be segregated. Accordingly, ₹ 1,60,000, being 40% of ₹ 4,00,000 (₹ 3,00,000 + ₹ 1,00,000) would be chargeable to tax as business income and the balance ₹ 2,40,000, being 60% of ₹ 4,00,000 would be agricultural income exempt from tax.		

Working Note:

Computation of Business Income of G Ltd. for the A.Y. 2025-26

Particulars	₹
Composite business profits before allowing deduction under section 33AB	60,00,000
Less: Deduction under section 33AB(1) would be the lower of:	
- Amount deposited in Tea Development Account on or before 30.9.2025 [i.e., ₹ 11,00,000]	
- 40% of profits of such business [i.e., ₹ 24,00,000, being 40% of ₹ 60,00,000]	11,00,000
	49,00,000
Less: 60% of ₹ 49,00,000, being agricultural income **[as per Rule 8]**	29,40,000
Business income	19,60,000
Less: Brought forward business loss of A.Y.2024-25 set-off as per section 72	14,00,000
Business income chargeable to tax	5,60,000

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(ii) Consequences, if asset purchased out of deposit account is sold during the previous year 2026-27

As per section 33AB(8), if the asset is sold before the expiry of eight years from the end of the previous year in which it was acquired, then, the cost of such asset shall be deemed to be the profits and gains from business or profession of the previous year in which asset is sold.

Therefore, ₹ 6,00,000 would be deemed to be the business income (composite) for the A.Y.2027-28. However, since the full cost of the asset was deducted in the assessment year 2025-26 (being part of ₹ 11 lakh deposited in Tea Development Account) before segregation of agricultural income and non-agricultural income, the agricultural and non-agricultural portions of income should be segregated in the year in which such amount becomes taxable on account of sale of asset before the expiry of eight years. Therefore, ₹ 3,60,000, being 60% of ₹ 6,00,000 would represent agricultural income. The balance ₹ 2,40,000 being 40% of ₹ 6,00,000 would be chargeable to tax as business income.

Moreover, the difference between the sale consideration and purchase price of the asset would be chargeable to tax as "Short term capital gains", which is computed as follows:

Sales consideration	8,00,000
Less: Cost of acquisition	6,00,000
Short term capital gain	**2,00,000**

6. Computation of Income of Pingu Trading Pvt. Ltd. chargeable to tax for the A.Y.2026-27

Particulars		₹
Net profit as per profit and loss account		33,90,000
Less:	Income-tax refund credited in the profit and loss account, out of which interest is to be considered separately under the head "Income from other sources"	20,000
		33,70,000
Add:	**Expenses either not allowable or to be considered separately but charged in the profit & loss account**	
	- Repair expenses on rented premises where assessee is under no obligation to incur such expenses are not	-

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	allowable as per section 30(a)(i). However, if such expenses are required for carrying on the business efficiently, the same are allowable under section 37. In this case, assuming that such expenses are required for carrying on business efficiently, the same are allowable under section 37.	
	- Advertisement in the souvenir of political party not allowable as per section 37(2B) **(See Note 2)**	2,500
	- Payment made to the wife of a director examined as per section 40A(2) and the excess payment made to be disallowed **(See Note 4)**	75,000
	- Payment made to electoral trust by cheque **(See Note 5)**	1,00,000
	- Penalty levied by the Goods and Services tax department for delayed filing of returns not allowable as being paid for infraction of law **(See Note 6)**	5,300
	- Depreciation as per books	71,500
	- 30% of interest paid on loan paid to Mr. X, a resident, without deduction of tax at source not allowable as per section 40(a)(ia)	24,000
		36,48,300
Less:	Depreciation allowable as per Income-tax Act, 1961	65,000
		35,83,300
Less:	Income from specified business (warehousing charges) credited to profit and loss account, to be considered separately **(See Note 7)**	15,00,000
Income from business (other than specified business)		**20,83,300**
Add: Difference in the value of stocks detected on survey under section 133A on 31.03.2026 chargeable as income **(See Note 8)**		3,75,000
		24,58,300
Computation of income/ loss from specified business (See Note 7)		
Income from specified business	₹ 15,00,000	
Less: Deduction under section 35AD @ 100% of ₹ 25 lakhs	₹ 25,00,000	
Loss from specified business to be carried forward as per section 73A	**(₹ 10,00,000)**	
Income from Other Sources		
Interest on income-tax refund		4,570
Gross Total Income		**24,62,870**

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***Less:* Deduction under section 80GGB**		
Contribution to political party **(See Note 2)**	₹ 2,500	
Contribution to an Electoral trust **(See Note 5)**	₹ 1,00,000	1,02,500
Total Income		**23,60,370**

Notes:

(1) Bonus for the previous year 2024-25 paid after the due date for filing return for that year would have been disallowed under section 43B for the P.Y.2024-25. However, when the same has been paid in December 2025, it should be allowed as deduction in the P.Y.2025-26 (A.Y.2026-27). Since it is already included in the figure of bonus to staff debited to profit and loss account of this year, no further adjustment is required.

(2) The amount of ₹ 2,500 paid for advertisement in the souvenir issued by a political party attracts disallowance under section 37(2B). However, such expenditure falls within the meaning assigned to "contribute" under section 293A of the Companies Act, 1956, and is hence, eligible for deduction under section 80GGB. Any contribution to the political party or electoral trust made by way of cash is not allowed as deduction under section 80GGB. Since in the present case, the payment to the political party is made by way of an account payee cheque, it is allowed as deduction under section 80GGB.

(3) The penalty of ₹ 15,000 paid for non-fulfilment of delivery conditions of a contract for reasons beyond control is not for the breach of law but was paid for breach of contractual obligations and therefore, is an allowable expense.

(4) It has been assumed that ₹ 25,000 is the reasonable payment for the wife of Director, working as a junior lawyer, since junior advocates of High Courts normally charge only ₹ 25,000 for the same opinion and therefore, the balance ₹ 75,000 has been disallowed.

(5) Payment to an electoral trust qualifies for deduction under section 80GGB since the payment is made by way of a cheque. However, since the amount has been debited to profit and loss account, the same has to be added back for computing business income.

(6) The interest of ₹ 12,750 paid on the delayed deposit of goods and services tax is for breach of contract and hence, is allowable as deduction. However, penalty of ₹ 5,300 for delay in filing of returns is not allowable since it is for breach of law.

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(7) Deduction @ 100% of the capital expenditure is available under section 35AD in respect of specified business of setting up and operating a warehouse facility for storage of agricultural produce which commences operation on or after 1.04.2012. It is presumed that ₹ 25 lakhs does not include expenditure on acquisition of any land.

The loss from specified business under section 35AD (warehousing) should be segregated from the income from other businesses, since, as per section 73A(1), any loss computed in respect of any specified business referred to in section 35AD shall not be set off except against profits and gains, if any, of any other specified business.

In view of the provisions of section 73A(1), the loss of ₹ 10 lakhs from the specified business cannot be set-off against income from other businesses. Such loss has to be carried forward to be set-off against profit from specified business in the next assessment year. The return should be filed on or before the due date under section 139(1) for carry forward of such losses.

(8) The business premises were surveyed and differences in the figures of opening and closing stocks and sales were found which have not been disputed and accepted by the assessee. Therefore, the trading account for the year is to be re-cast to arrive at the correct amount of the gross profit/ net profit for the purpose of return of income to be filed for the previous year ended on 31.3.2026.

Revised Trading Account

Particular	₹	Particular	₹
Opening Stock	8,75,000	Sales (₹ 1,55,50,000 + ₹ 75,000)	**1,56,25,000**
Purchases	1,25,75,000	Closing Stock	**12,50,000**
Freight and Cartage	1,26,000		
Gross Profit	32,99,000		
	1,68,75,000		1,68,75,000

The difference of gross profit of ₹ 32,99,000 - ₹ 29,24,000 = ₹ 3,75,000 is to be added as income of the business for the year as undisclosed income[16].

7. **(a)** This issue came up before the Delhi High Court in *CIT v. Gujarat Guardian Ltd (2009) 177 Taxman 434*.The Court observed that the assessee company's claim for deduction has to be allowed in one lump sum keeping in view the provisions of

[16] No loss (whether brought forward or otherwise) or unabsorbed depreciation under section 32(2) can be set-off against undisclosed income.

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section 43B(d), which provide that any sum payable by the assessee as interest on any loan or borrowing from any financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the periods, in which the liability to pay such sum is incurred by the assessee according to the method of accounting regularly followed by the assessee. The High Court concurred with the Tribunal's view supporting the assessee that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable. Since there was no dispute that the pre-payment premium was nothing but interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, in terms of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the payment has actually been made.

Therefore, applying the ratio of the above case, the contention of A Ltd. is correct and not that of the Assessing Officer.

Note *– Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A) defines interest to include, inter alia, any other charge in respect of the moneys borrowed or debt incurred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –*

(i) pre-payment premium represents interest as per section 2(28A);

(ii) such interest is deductible as business expenditure as per section 36(1)(iii);

(iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).

(b) As per ICDS V on Tangible Fixed Assets, machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised. Where the spares are capitalised as per the above requirement, the issue as to provision of depreciation arises – whether depreciation can be provided where such spares are kept ready for use or is it necessary that they are actually put to use. This issue was dealt with by the Delhi High Court in *CIT v. Insilco Ltd (2010) 320 ITR 322*. The Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and

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form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note *– One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is "kept ready for use". For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term "use" embraces both active use and passive use for business purposes.*

8. The payment made for acquiring the licence to operate telecom services in Mumbai shall be subject to deduction as per the scheme in section 35ABB. As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services shall be allowed as deduction in equal instalments during the number of years for which the license is in force.

If the payment is made before the commencement of business: The deduction shall be allowed beginning with the year of commencement of business.

In any other case: It will be allowed commencing from the year of payment. Deduction shall be allowed up to the year in which the license shall cease to be in force.

The amount of deduction available for A.Y. 2026-27 is worked out below:-

(1)	(2)	(3)	(4) = (3)/(2)
Previous year of payment	**Unexpired period of license**	**Instalment paid (₹)**	**Deduction in respect of each instalment (₹)**
2023-24	9 years	9,00,000	1,00,000
2024-25	9 years	9,00,000	1,00,000
2025-26	8 years	9,00,000	1,12,500
		27,00,000	**3,12,500**

The deduction under section 35ABB from assessment year 2026-27 shall be ₹ 3,12,500.

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9. Computation of taxable income of Alpha Ltd. for the A.Y.2026-27

Particulars	₹
Net profit as per profit and loss account	12,50,000
***Add:* Items debited to profit and loss A/c but not deductible or income to be taxed**	
1. **Payment of advertisement expenditure of ₹60,000**	
(i) ₹ 8,000, being the excess payment to a relative disallowed under section 40A(2)	8,000
(ii) As the payment is made in cash and since the remaining amount of ₹ 52,000 exceeds ₹ 10,000, 100% shall be disallowed under section 40A(3)	52,000
2. Under section 31, expenditure relatable to current repairs regarding plant, machinery or furniture is allowed as deduction. The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or substantial part of the entire machinery [*CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)].* Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs. Hence, no adjustment is required. Further, as per ICDS V on Tangible Fixed Assets, only an expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance has to be added to the actual cost.	
3. Liability foregone by creditor chargeable as business income but not credited to profit and loss account [taxable under section 41(1)]	6,000
4. Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iiia). As the amount has already been credited to profit and loss account, no further adjustment is necessary.	-
5. Expenditure on in-house research and development is entitled to a weighted deduction of 100% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1). As the amount has already been debited to profit and loss account, no further adjustment is necessary	-
Taxable Income	**13,16,000**

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10. **(i)** The decision of the Supreme Court in *Mysore Minerals Ltd v. CIT (1999) 239 ITR 775* is relevant in the context of the facts stated. The term "asset used" in section 32 must be assigned a wider meaning and anyone in possession of property in his own title, exercising dominion over the property, to the exclusion of others and having the right to use and enjoy it, must be taken to be the owner.

Registration of the buses is only a formality to perfect the title and does not bar enjoyment. The Corporation cannot, therefore, be denied depreciation on the buses. A similar decision was also taken in *CIT v. J & K Tourism Development Corporation (2001) 248 ITR 94 (J&K).*

(ii) The deduction of bad debt is allowed if it is written off in the books of account of the assessee. In this case, Ravi has succeeded to the business carried on by his father. Under clause (vii) of section 36(1) the amount has been written off in the books of account as irrecoverable is eligible for deduction provided the debt has been taken into account in computing the income of the business in an earlier previous year [vide section 36(2)].

Therefore, Ravi is eligible for deduction in respect of the amount due in the name of Y which is written off in the books of account as bad debt, even though the debt represents the amount due for the supplies made by previous owner viz. deceased father of Ravi.[*CIT v. T. Veerabhadra Rao, K. Koteswara Rao and Co (1985) 155 ITR 152 (SC)].*

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CHAPTER 4

CAPITAL GAINS

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** the scope of income chargeable under this head;
- **examine** the provisions of section 2(42A), relating to period of holding, for classification of a capital asset as short-term capital asset and long-term capital asset;
- **analyse and apply** the provisions of section 47 to determine whether a particular transaction would be considered/not be considered as transfer for the purpose of capital gains taxation;
- **determine** the cost of acquisition/ improvement for the purpose of computing the capital gains;
- **compute** capital gains on transfer of depreciable assets;
- **compute** capital gains in case of market linked debenture and other specified securities;
- **compute** capital gains in case of slump sale;
- **determine** the quantum of exemption available on investment of capital gains/ net consideration arising on transfer of certain assets and appreciate the conditions to be satisfied to avail such exemption;
- **compute** the capital gains chargeable to tax applying the charging and deeming provisions and giving effect to the exemptions available in respect of capital gains;
- **identify** the cases where an Assessing Officer can make a reference to the Valuation Officer;
- **appreciate** the concessional tax treatment available for short-term capital gains and for long term capital gains on transfer of listed equity shares/ units of an equity oriented fund/ units of a business trust;
- **compute** the tax liability applying the special rates of tax on long-term capital gains and short-term capital gains arising on transfer of listed equity shares/ units of an equity oriented fund and the normal rates of tax on capital gains arising on transfer of other short-term capital assets and other long-term capital assets.

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4.1 INTRODUCTION

Section 45 provides that any profits or gains arising from the **transfer** of a **capital asset** effected in the previous year will be chargeable to income-tax under the head 'Capital Gains'. Such capital gains will be deemed to be the income of the previous year in which the transfer took place. In this charging section, two terms are important. One is "capital asset" and the other is "transfer".

Hence, in this chapter on capital gains, we begin our discussion with the definition of "capital asset" and "transfer". Thereafter, we will proceed to discuss the various circumstances under which capital gains tax is levied. There are certain transactions which are not to be regarded as transfer for the purposes of capital gains. These transactions have also been discussed in this chapter. There is a separate method of computation of capital gains in respect of depreciable assets. Also, there are exemptions in cases where capital gains/net sales consideration are invested in specified assets. All these aspects are being discussed in this chapter.

4.2 CAPITAL ASSET

Definition: According to section 2(14), a capital asset means –

(a) property of any kind held by an assessee, whether or not connected with his business or profession;

(b) *any securities held by*

- *a Foreign Institutional Investor which has invested in such securities in accordance with the SEBI regulations; or*
- *an investment fund specified in section 115UB which has invested such securities in accordance with the provisions of the regulations made under the SEBI Act, 1992 or under the IFSC Authority Act, 2019*.

(c) *any unit linked insurance policy (ULIP) to which exemption under section 10(10D) does not apply.*

However, it **does not include**—

(i) **Stock-in trade:** Any stock-in-trade [other than securities referred to in (b) above], consumable stores or raw materials held for the purpose of the business or profession of the assessee;

Whether a particular asset is stock-in-trade or capital asset does not depend upon the nature of the item, but the manner in which the same is held. The item would be

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stock-in-trade in the hands of the assessee who deals or trades in that item; however, the same item would be capital asset for the assessee who holds it as an investment.

Example: *A dealer in real estate holds a piece of land as stock-in-trade. But the same will be capital asset for an assessee who holds it as an investment.*

The exclusion of stock-in-trade from the definition of capital asset is only in respect of sub-clause (a) above and not sub-clause (b). This implies that even if the nature of such security in the hands of the Foreign Portfolio Investor is stock in trade, the same would be treated as a capital asset and the profit on transfer would be taxable as capital gains.

Further, the Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that the income arising from transfer of such security by a Foreign Portfolio Investor (FPI) would be in the nature of capital gain, irrespective of the presence or otherwise in India, of the Fund manager managing the investments of the assessee.

(ii) **Personal effects:** Personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him.

EXCLUSIONS:

(a) jewellery;

(b) archaeological collections;

(c) drawings;

(d) paintings;

(e) sculptures; or

(f) any work of art.

Definition of Jewellery - Jewellery is a capital asset and the profits or gains arising from the transfer of jewellery held for personal use are chargeable to tax under the head "capital gains". For this purpose, the expression 'jewellery' includes the following:

(i) Ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones and whether or not worked or sewn into any wearing apparel;

(ii) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

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(iii) **Rural agricultural land** in India i.e., agricultural land in India which is not situated in any specified area.

As per the definition that only rural agricultural lands in India are excluded from the purview of the term 'capital asset'. Hence urban agricultural lands constitute capital assets. Accordingly, the agricultural land described in (a) and (b) below, being land situated within the specified urban limits, would fall within the definition of "capital asset", and transfer of such land would attract capital gains tax -

(a) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand, or

(b) agricultural land situated in any area within such distance, measured aerially, in relation to the range of population as shown hereunder -

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

Example

	Area	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.	Is the land situated in this area a capital asset?
(i)	A	1 km	9,000	No
(ii)	B	1.5 kms	12,000	Yes
(iii)	C	2 kms	11,00,000	Yes

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

Explanation regarding gains arising on the transfer of urban agricultural land - *Explanation 1* to section 2(1A) clarifies that capital gains arising from transfer of any agricultural land situated in any non-rural area (as explained above) will not constitute agricultural revenue within the meaning of section 2(1A).

In other words, the capital gains arising from the transfer of such urban agricultural lands would not be treated as agricultural income for the purpose of exemption under section 10(1). Hence, such gains would be exigible to tax under section 45.

(iv) **Specified Gold Bonds:** 6½% Gold Bonds, 1977, or 7% Gold Bonds, 1980, or National Defence Gold Bonds, 1980, issued by the Central Government;

(v) **Special Bearer Bonds, 1991** issued by the Central Government;

(vi) **Gold Deposit Bonds** issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetisation Scheme, 2015 and Gold Monetisation Scheme, 2018 notified by the Central Government.

Note – 'Property' includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

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4.3 SHORT TERM AND LONG TERM CAPITAL ASSETS

- **Definition –** As per section 2(42A), short-term capital asset means a capital asset held by an assessee **for not more than 24 months** immediately preceding the date of its transfer.

  As per section 2(29A), long-term capital asset means a capital asset which is not a short-term capital asset.

  Accordingly, based on the period of holding capital assets would be classified as short-term or long-term capital asset as follows:

Capital Asset	STCG, if held for	LTCG, if held for
• Security listed in a recognized stock exchange including listed units of a business trust • Unit of equity-oriented fund/unit of UTI • Zero Coupon bond	**≤ 12 months** immediately preceding the date of its transfer	**> 12 months** immediately preceding the date of its transfer
• Other capital assets	**≤ 24 months** immediately preceding the date of its transfer	**> 24 months** immediately preceding the date of its transfer

Note – *As per section 50AA, capital gains arising from transfer of the following assets would always be capital gains arising from transfer of short-term capital assets irrespective of the period of holding of such assets -*

- *units of a specified mutual fund acquired on or after 1.4.2023,*
- *market linked debentures,*
- *unlisted bond and unlisted debenture.*

Meaning of certain terms:

Term	Meaning
Equity oriented fund [Clause (a) of *Explanation* to section 112A]	A fund set up under a scheme of a mutual fund specified under section 10(23D) or under a scheme of an insurance company unit linked insurance policies which are not exempt under section 10(10D) and (i) in a case where the fund invested in the units of another fund which is traded on a recognised stock exchange – I. a minimum of 90% of the total proceeds of such fund is invested in the units of such other fund; and

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	II. such other fund also invests a minimum of 90% of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and (ii) in any other case, a minimum of 65% of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange. However, the percentage of equity shareholding or unit held in respect of the fund, as the case may be, shall be computed with reference to the annual average of the monthly averages of the opening and closing figures. In case of a scheme of an insurance company comprising ULIPs to which exemption u/s 10(10D) does not apply, the minimum requirement of 90% or 65%, as the case may be, mentioned in (i) and (ii) above, is required to be satisfied throughout the term of such insurance policy.
Zero Coupon Bond [Section 2(48)]	A bond - issued by any infrastructure capital company or infrastructure capital fund or infrastructure debt fund notified by the Central Government under section 10(47) or a public sector company or a scheduled bank on or after 1st June, 2005, - in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and - which the Central Government may notify in this behalf.

Note: The income from transfer of a Zero coupon bond (not being held as stock-in-trade) is to be treated as capital gains. Section 2(47)(iva) provides that maturity or redemption of a Zero coupon bond shall be treated as a transfer for the purposes of capital gains tax.

The definitions of the terms "infrastructure capital company" and "infrastructure capital fund" have already been discussed in Chapter 3 – "Profits and gains from business and profession".

Applicability of tax on capital gains in the hands of the unit holders where the term of the units of Mutual Funds under the Fixed Maturity Plans has been extended *[Circular No. 6/2015, dated 09-04-2015]*

Fixed Maturity Plans (FMPs) are closed ended funds having a fixed maturity date wherein the duration of investment is decided upfront.

Some Asset Management Companies (AMCs) administering mutual funds have offered extension of the duration of the FMPs by providing to the investor an option of roll-over of FMPs in accordance with the provisions of Regulation 33(4) of the SEBI (Mutual Funds) Regulation, 1996.

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The CBDT has, vide this Circular, clarified that the roll over in accordance with the aforesaid regulation will not amount to transfer as the scheme remains the same.

Accordingly, no capital gains will arise at the time of exercise of the option by the investor to continue in the same scheme. The capital gains will, however, arise at the time of redemption of the units or opting out of the scheme, as the case may be.

- **Determination of period of holding [Clause (i) of *Explanation 1* to section 2(42A)]:** In determining period of holding of any capital asset by the assessee in the circumstances stated in column (1), the period shall be determined by considering the period specified in Column (2).

Determination of period of holding

S. No.	Circumstances (Column 1)	Period to be reckoned/included/excluded, as the case may be (Column 2)
1	Where **shares held in a company in liquidation**	The period subsequent to the date of liquidation of company shall be **excluded**.
2	Where **asset becomes the property of an assessee by virtue of section 49(1)**	The period for which the capital asset was held by the previous owner shall be **included**.
3	Where **inventory of business is converted** into or treated **as a capital asset** by the assessee	Period from the date of conversion or treatment as a capital asset shall be **considered**.
4	Where **share(s) in the Indian company (amalgamated company)**, becomes the property of an assessee in lieu of share(s) held by him in the amalgamating company at the time of transfer referred under section 47(vii).	The period for which the share(s) was held by the assessee in the amalgamating company shall be **included**.
5	Where the **share or any other security is subscribed** by the assessee **on the basis of right to subscribe** to any share or security or by the person in whose favour such right is renounced by the assessee	Period from the date of allotment of such share or security shall be **reckoned**.
6	Where the **right to subscribe** to any share or security, which is renounced in favour of any other person	Period from the date of offer of such right by the company or institution shall be **reckoned**.

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7	Where any **financial asset is allotted** without any payment and on the basis of holding of any other financial asset	Period from the date of allotment of such financial asset shall be **reckoned**.
8	Where **share(s) in the Indian company** being a resulting company becomes the property of an assessee in consideration of **demerger.**	The period for which the share(s) were held by the assessee in demerged company shall be **included**.
9	Where **trading or clearing rights of a recognised stock exchange** in India is acquired by a person pursuant to demutualisation or corporation of a recognised stock exchange in India as referred to in section 47(xiii)	The period for which the person was a member of the recognised stock exchange immediately prior to such demutualisation or corporatisation shall be **included**.
10	Where equity share(s) **in a company allotted** pursuant to demutualisation or corporation of a recognised stock exchange in India as referred to in section 47(xiii)	The period for which the person was a member of the recognised stock exchange immediately prior to such demutualisation or corporatisation shall be **included**.
11	Where **unit of a business trust**, allotted pursuant to transfer of share(s) as referred to in section 47(xvii)	The holding period for which the share(s) held by the assessee shall be **included**.
12	Where **unit(s)** becomes the property of the assessee in consideration of **transfer of unit(s) in the consolidated scheme of the mutual fund** referred to in section 47(xviii)	The period for which the unit(s) in the consolidating scheme of the mutual fund were held by the assessee shall be **included**.
13	Where **share(s) of a company is acquired by the non-resident** assessee on redemption of **Global Depository Receipts** referred to in section 115AC(1)(b) held by such assessee	Period from the date on which a request for such redemption was made shall be **reckoned**.
14	Where **equity share** in a company becomes the property of the assessee by way of **conversion of preference shares into equity shares** referred under section 47(xb)	The period for which the preference shares were held by the assessee shall be **included**.
15	Where **unit(s)** becomes the property of the assessee in consideration of **transfer of unit(s) in the consolidated plan of a mutual fund scheme** as referred to in section 47(xix)	The period for which the unit(s) in the consolidating plan of a mutual fund scheme was held by the assessee shall be **included**.

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16	In case of a unit or units in a segregated portfolio referred under section 49(2AG)	Period for which the original unit or units in the main portfolio were held by the assessee shall also be **reckoned**.
17	(i) Electronic Gold Receipt [EGR] issued by a Vault Manager in respect of gold deposited as referred to in section 47(viid) [**Conversion of gold into EGR** not regarded as transfer by virtue of section 47(viid)]	The period for which such gold was held by the assessee prior to conversion into the Electronic Gold Receipt
	(ii) Gold released in respect of an Electronic Gold Receipt as referred to in section 47(viid) [**Conversion of EGR into Gold** not regarded as transfer by virtue of section 47(viid)]	The period for which such Electronic Gold Receipt was held by the assessee prior to its conversion into gold.
18	Where any **specified security or sweat equity shares allotted** or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employees)	Period from the date of allotment or transfer of such specified security or sweat equity shares shall be **reckoned**.
	"Specified security" means the securities as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956 and, where employees' stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme. **"Sweat equity shares"** means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.	

- **Period of holding in respect of other capital assets [Clause (ii) of *Explanation 1* to section 2(42A)] -** The period for which any capital asset is held by the assessee shall be determined in accordance with any rules made by the CBDT in this behalf.

  Accordingly, the CBDT has inserted Rule 8AA in the Income-tax Rules, 1962 to provide for method of determination of period of holding of capital assets, other than the capital assets mentioned in clause (i) of *Explanation 1* to section 2(42A).

  - In the case of a capital asset, **being a share or debenture of a company**, which **becomes the property** of the assessee in the circumstances mentioned **in section 47(x),** there shall be **included the period** for which the bond, debenture, debenture-

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stock or deposit certificate, as the case may be, was held by the assessee **prior to the conversion.**

Note: *Section 47(x) provides that 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 shall not be regarded as transfer for the purposes of levy of capital gains tax.*

- In case of a capital asset which became the property of the Indian subsidiary company in consequence to conversion of a branch of a foreign company referred to in section 115JG(1), the period for which the asset was held by the said branch of the foreign company and by the previous owner, if any, who has acquired the capital asset by a mode of acquisition referred to in clause (i)/(ii)/(iii)/(iv) of section 49(1) or section 115JG(1) shall be included. Section 115JG has been discussed in detail in Chapter 21: Non-resident Taxation in Module 4.

- In case of the amount which is chargeable to tax as income of specified entity under section 45(4) under the head - "Capital gains", the amount or a part of it shall be deemed to be from transfer of short-term capital asset or long term capital asset, as the case may be, mentioned in column (2), if it is attributed to capital asset mentioned in the corresponding row in column (3) –

	Deemed capital gains from transfer of capital asset	**Type of capital asset of specified entity**
	(2)	**(3)**
1.	Capital gains from transfer of a short term capital asset	(a) capital asset which is short term capital asset at the time of taxation of amount under section 45(4); or (b) capital asset forming part of block of asset; or (c) capital asset being self-generated asset and self-generated goodwill as defined in section 45(4)
2.	Capital gains from transfer of a long term capital asset	Capital asset which is not covered in 1. above and is long term capital asset at the time of taxation of amount under section 45(4).

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4.4 TRANSFER: WHAT IT MEANS? [SECTION 2(47)]

The Act contains an inclusive definition of the term 'transfer'. Accordingly, transfer in relation to a capital asset includes the following types of transactions:—

(i) the sale, exchange or relinquishment of the asset; or

(ii) the extinguishment of any rights therein; or

(iii) the compulsory acquisition thereof under any law; or

> ***Example:*** *Acquisition of industrial undertaking under the Industries (Development and Regulation) Act, 1951.*

(iv) the owner of a capital asset may convert/treated the same into/as the stock-in-trade of a business carried on by him. Such conversion/treatment is treated as transfer; or

> ***Example:*** *Where an investor in shares starts a business of dealing in shares and treats existing investments as stock-in-trade of the newly set up business, such conversion shall be regarded as transfer for the purpose of capital gains.*

(v) the maturity or redemption of a zero coupon bond; or

(vi) possession of an immovable property in consideration of part-performance of a contract referred to in section 53A of the Transfer of Property Act, 1882.

> ***Example:*** *A enters into an agreement for the sale of his house. The purchaser gives the entire sale consideration to A. A hands over complete rights of possession to the purchaser since he has received the entire sale consideration though house is not yet registered in the name of the buyer. Under the Income-tax Act, the above transaction is considered as transfer.*

(vii) transactions which have the effect of transferring or enabling the enjoyment of an immovable property.

> ***Example:*** *A person may become a member of a co-operative society, company or other association of persons which may be building houses/ flats. When he pays an agreed amount, the society etc. hands over possession of the house to the person concerned. No conveyance deed is registered. For the purpose of income-tax, the above transaction is a transfer.*

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Note – Section 2(47) provides an inclusive definition of "transfer", in relation to a capital asset. *Explanation 2* to section 2(47) clarifies that 'transfer' includes and shall be deemed to have always included –

(1) disposing of or parting with an asset or any interest therein, or	-	directly or indirectly,
	-	absolutely or conditionally,
(2) creating any interest in any asset in any manner whatsoever	-	voluntarily or involuntarily

by way of an agreement (whether entered into in India or outside India) or otherwise.

The above transactions would be deemed as a transfer notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

4.5 SCOPE AND YEAR OF CHARGEABILITY [SECTION 45]

(1) General Provision [Section 45(1)]

Any profits or gains arising from the transfer of a capital asset effected in the previous year (other than exemptions covered under this chapter) shall be chargeable to income-tax under this head **in the previous year in which the transfer took place.**

Year of chargeability - Capital gains are chargeable as the income of the previous year in which the sale or transfer takes place. In other words, for determining the year of chargeability, the relevant date of transfer is not the date of the agreement to sell, but the actual date of sale *i.e.,* the date on which the effect of transfer of title to the property as contemplated by the parties has taken place [*Alapati Venkataramiah v. CIT [1965] 57 ITR 185 (SC)]*.

However, as already noted, Income-tax Act has recognised certain transactions as transfer in spite of the fact that conveyance deed might not have been executed and registered.

(2) Insurance receipts [Section 45(1A)]

Where any person receives any money or other assets under any insurance from an insurer on account of damage to or destruction of any capital asset, as a result of -

- flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or
- riot or civil disturbance; or

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- accidental fire or explosion; or
- action by an enemy or action taken in combating an enemy (whether with or without declaration of war),

then, any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of **such person for the previous year in which such money or other asset was received.**

Full value of consideration: In order to compute capital gains, the value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital assets.

(3) Unit Linked Insurance Policy Receipts [Section 45(1B)]

Where any person receives, at any time during any previous year, any amount, including the amount allocated by way of bonus, on such policy under a unit linked insurance policy (ULIP), ***to which exemption under section 10(10D) does not apply***, then, any profits or gains arising from receipt of such amount by such person 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 amount was received.

Exemption under section 10(10D)

Any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy would not be included in the total income of a person.

The following table summarizes the exemption available under section 10(10D) *vis-a-vis* the date of issue of such policies and the corresponding condition to be satisfied for exemption -

	Exemption u/s 10(10D)
In respect of policies issued before 1.4.2003	Any sum received under a LIP including the sum allocated by way of bonus is exempt.
In respect of policies issued between 1.4.2003 and 31.3.2012	Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 20% of "actual capital sum assured".

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In respect of policies issued on or after 1.4.2012 but before 1.4.2013		Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 10% of actual capital sum assured.
In respect of policies issued on or after 1.4.2013	**(a)**	**Where the insurance is on the life of a person with disability or severe disability as referred to in section 80U or a person suffering from disease or ailment as specified under section 80DDB.**
		Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 15% of "actual capital sum assured"
	(b)	**Where the insurance is on the life of any person, other than mentioned in (a) above**
		Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 10% of "actual capital sum assured".
In respect of ULIP issued on or after 1.2.2021		Any sum received under a ULIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 10% or 15%, as the case may be, of "actual capital sum assured. Further, exemption would also not be available with respect to ULIP issued on or after 1.2.2021, if the amount of premium payable exceeds ₹ 2,50,000 for any of the previous years during the term of such ULIP. ***The condition of payment of premium of ₹ 2,50,000 would not be applicable in case of any sum received, under a Life Insurance policy issued by the IFSC Insurance Office, including the sum allocated by way of bonus on such policy.***
		In a case where premium is payable by a person for more than one ULIP issued on or after 1.2.2021 and the aggregate of premium payable on such ULIPs exceed ₹ 2,50,000 for any of the previous years during the term of any such ULIPs, exemption would be available in respect of any of those ULIPs, at the option of the assessee, whose aggregate premium payable does not exceed ₹ 2,50,000 for any of the previous years during their term.
		Meaning of ULIP - ULIP means a life insurance policy which has components of both investment and insurance and is linked to a unit defined under IRDA (ULIP) Regulations, 2019 issued by IRDA under the Insurance Act, 1938 and the IRDA Act, 1999.

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In respect of life insurance policies issued on or after 1.4.2023	Any sum received under a LIP including the sum allocated by way of bonus is exempt. However, exemption would not be available if the premium payable for any of the years during the term of the policy exceeds 10% or 15%, as the case may be, of "actual capital sum assured. Further, exemption would also not be available if the amount of premium payable exceeds ₹ 5,00,000 for any of the previous years during the term of such policy. ***The condition of payment of premium of ₹ 5,00,000 would not be applicable in case of any sum received, under a Life Insurance policy issued by the IFSC Insurance Office, including the sum allocated by way of bonus on such policy.***
	In a case where premium is payable by a person for more than one LIP (other than ULIP) issued on or after 1.4.2023 and the aggregate of premium payable on such policies exceed ₹ 5,00,000 for any of the previous years during the term of any such policy(ies), exemption would be available in respect of any of those LIPs (other than ULIP), at the option of the assessee, whose aggregate premium payable does not exceed ₹ 5,00,000 for any of the previous years during their term.
Any sum is received on the death of a person is exempt irrespective of the annual premium payable on the ULIP/LIP. The condition of payment of premium of 10% or 15% or 20% or ₹ 2,50,000 or ₹ 5,00,000 would not be applicable.	

Exemption is not available in respect of amount received from an insurance policy taken for disabled person under section 80DD: Any sum received under section 80DD(3) shall not be exempt under section 10(10D). Accordingly, if the dependent disabled, in respect of whom an individual or the member of the HUF has paid or deposited any amount in any scheme of LIC or any other insurer, predeceases the individual or the member of the HUF, the amount so paid or deposited shall be deemed to be the income of the assessee of the previous year in which such amount is received. Such amount would not be exempt u/s 10(10D).

Exemption is not available in respect of the sum received under a Keyman insurance policy: Any sum received under a Keyman insurance policy shall also not be exempt.

Explanation 1 to section 10(10D) defines "Keyman insurance policy" as a life insurance policy taken by one person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person. The term includes within its scope a keyman insurance policy which has been assigned to any person during its term, with or without consideration. Therefore, such policies shall continue to be treated as a keyman insurance policy even after the same is assigned to the

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keyman. Consequently, the sum received by the keyman on such policies, being "keyman insurance policies", would not be exempt u/s 10(10D).

Unit Linked Insurance Policies

Guidelines by CBDT: In case any difficulty arises in giving effect to the provisions of this clause, the CBDT may issue guidelines for the purpose of removing the difficulty with the previous approval of the Central Government.

Accordingly, the CBDT has, with the approval of the Central Government, vide Circular No. 2/2022, dated 19.01.2022, issued the following guidelines in respect of ULIPs –

Situation 1: No sum including any sum allocated by way of bonus (such sum hereinafter referred as "consideration") is received by the assessee on any ULIPs which are issued on or after 1.2.2021 (such ULIPs hereinafter referred as "eligible ULIPs") during any previous year preceding the current previous year or consideration has been received on such eligible ULIPs in an earlier previous year but has not been claimed exempt. In such a situation, the exemption u/s 10(10D) would be determined as under:

I. Where the assessee has received consideration, during the current P.Y., under one eligible ULIP only

Circumstance	Eligibility for exemption u/s 10(10D)
If the amount of premium payable on such eligible ULIP does not exceed ₹ 2,50,000 for any of the PYs during the term of such eligible ULIP and annual premium does not exceed 10% of actual capital sum assured	Such consideration would be eligible for exemption u/s 10(10D). **[Refer Example 1 given below]**
If the amount of premium payable on such eligible ULIP > ₹ 2,50,000 for any of the PYs during the term of such eligible ULIP	Such consideration would **not** be eligible for exemption u/s 10(10D). **[Refer Example 2 given below]**

Example 1:

ULIP	A
Date of issue	1.4.2021
Annual premium	2,50,000
Sum assured	25,00,000
Consideration received as on 01.11.2031 on maturity	32,00,000
Note – The assessee did not receive any consideration under any other eligible ULIPs in earlier P.Y. preceding the P.Y.2031-32.	

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Eligibility for exemption u/s 10(10D) - The consideration received would be exempt u/s 10(10D) in A.Y. 2032-33, since the annual premium payable on the policy does not exceed ₹ 2,50,000 and also does not exceed 10% of actual capital sum assured.

Example 2:

ULIP	A
Date of issue	1.4.2021
Annual premium	5,00,000
Sum assured	50,00,000
Consideration received as on 01.11.2031 on maturity	60,00,000
Note – The assessee did not receive any consideration under any other eligible ULIPs in earlier P.Y. preceding the P.Y.2031-32.	

Eligibility for exemption u/s 10(10D) - The consideration received would **not** be exempt u/s 10(10D) in A.Y. 2032-33 since the annual premium payable on the eligible ULIP exceeds ₹ 2,50,000.

II. Where the assessee has received consideration, during the current P.Y., under more than one eligible ULIP

Circumstance	Eligibility for exemption u/s 10(10D)
If the aggregate of the amount of premium payable on such eligible ULIPs does not exceed ₹ 2,50,000 for any of the PYs during the term of such eligible ULIPs and the annual premium ≤ 10% of actual capital sum assured	Such consideration would be eligible for exemption under u/s 10(10D). **[Refer Example 3 given below]**
If the aggregate of the amount of premium payable on such eligible ULIPs > ₹ 2,50,000 for any of the PYs during the term of such eligible ULIP	Consideration in respect of any of those eligible ULIPs whose aggregate amount of premium payable does not exceed ₹ 2,50,000 for any of the PYs during their term would be eligible for exemption u/s 10(10D), provided their annual premium ≤ 10% of actual capital sum assured. **[Refer Examples 4 and 5 given below]**

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Example 3:

ULIP	A	B
Date of issue	1.4.2021	1.4.2021
Annual premium	1,00,000	1,50,000
Sum assured	10,00,000	15,00,000
Consideration received as on 01.11.2031 on maturity	12,00,000	18,00,000
Note – The assessee did not receive any consideration under any other eligible ULIPs in earlier P.Y. preceding the P.Y.2031-32.		

Eligibility for exemption u/s 10(10D) – In this case, the aggregate of the annual premium payable for ULIP "A" and ULIP "B" does not exceed ₹ 2,50,000 during the term of these policies.

Further, annual premium payable in respect of ULIP "A" and ULIP "B" does not exceed 10% of actual capital sum assured. Therefore, the consideration received under ULIP "A" and "B" would be exempt u/s 10(10D) in A.Y. 2032-33

Example 4:

ULIP	A	B	C
Date of issue	1.4.2021	1.4.2021	1.4.2021
Annual premium	1,00,000	1,50,000	3,00,000
Sum assured	10,00,000	15,00,000	30,00,000
Consideration received as on 01.11.2031 on maturity	12,00,000	18,00,000	34,00,000
Note – The assessee did not receive any consideration under any other eligible ULIPs in earlier P.Y. preceding the P.Y.2031-32.			

Eligibility for exemption u/s 10(10D) – In this case, the aggregate of the annual premium payable for ULIP "A", ULIP "B" and ULIP "C" exceeds ₹ 2,50,000 during the term of these policies.

However, the consideration received under ULIPs "A" and "B" would be exempt u/s 10(10D) in A.Y. 2032-33, since aggregate of annual premium payable for these two policies does not exceed ₹ 2,50,000 for any previous year during the term of these two policies and also does not exceed 10% of actual capital sum assured.

Consequently, the consideration received under ULIP "C" alone would **not** be exempt u/s 10(10D) in A.Y. 2032-33.

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Example 5:

ULIP	X	A	B	C
Date of issue	1.4.2020	1.4.2021	1.4.2021	1.4.2021
Annual premium	2,50,000	1,00,000	1,50,000	3,00,000
Sum assured	25,00,000	10,00,000	15,00,000	30,00,000
Consideration received as on 01.11.2030 on maturity	30,00,000			
Consideration received as on 01.11.2031 on maturity		12,00,000	18,00,000	34,00,000
Note – The assessee did not receive any consideration under any other eligible ULIPs in earlier P.Y. preceding the P.Y.2031-32.				

Eligibility for exemption u/s 10(10D) - The consideration received under ULIP "X" would be exempt u/s 10(10D) in A.Y. 2031-32 since annual premium does not exceed 10% of the actual capital sum assured. Moreover, as the policy has been issued before 1.2.2021, limit of ₹ 2,50,000 of amount of premium payable is not applicable.

The aggregate of annual premium payable for ULIP "A", ULIP "B" and ULIP "C" (being ULIPs issued on or after 1.2.2021) exceeds ₹ 2,50,000 during the term of these policies.

However, the consideration received under ULIPs "A" and "B" would be exempt u/s 10(10D) in A.Y. 2032-33, since aggregate of annual premium payable for these two policies does not exceed ₹ 2,50,000 for any previous year during the term of these two policies and annual premium payable in respect of these policies does not exceed 10% of actual capital sum assured.

Consequently, the consideration received under ULIP "C" alone would not be exempt u/s 10(10D) in A.Y. 2032-33.

Situation 2: Consideration has been received by the assessee under any one or more eligible ULIPs during any P.Y. preceding the current P.Y. and it has been claimed to be exempt u/s 10(10D). Such eligible ULIPs are referred as "Earlier Exempt Eligible ULIPs (EEE ULIPs)" in this paragraph and corresponding examples and reference to eligible ULIPs shall not include EEE ULIPs. The exemption u/s 10(10D) would be determined as under:

I. <u>Where the assessee has received consideration, during the current P.Y., under one eligible ULIP only</u>

Circumstance	Eligibility for exemption u/s 10(10D)
If aggregate amount of premium payable on such eligible ULIP and EEE ULIPs does not exceed ₹ 2,50,000 for any of	Consideration under such eligible ULIP would be eligible for exemption u/s 10(10D). **[Refer Example 6]**

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the PYs during the term of such eligible ULIP and annual premium in respect of eligible ULIP does not exceed 10% of actual capital sum assured.	
If aggregate amount of premium payable on such eligible ULIP and EEE ULIPs > ₹ 2,50,000 for any of the PYs during the term of such eligible ULIP	Consideration under such eligible ULIP would **not** be eligible for exemption u/s 10(10D). **[Refer Example 7]**

Example 6:

ULIP	X	A
Date of issue	1.4.2021	1.4.2022
Annual premium	2,00,000	50,000
Sum assured	20,00,000	5,00,000
Consideration received as on 01.11.2031 on maturity	25,00,000	
Consideration received as on 01.11.2032 on maturity		6,00,000
Note – The assessee did not receive any consideration under any other eligible ULIPs in earlier P.Y. preceding the P.Y.2032-33, except ULIP X in P.Y. 2031-32.		

Eligibility for exemption u/s 10(10D) – The consideration under ULIP "X" would be exempt u/s 10(10D) in A.Y. 2032-33, since the annual premium does not exceed ₹ 2,50,000 and also does not exceed 10% of actual capital sum assured.

The consideration received under ULIP "A" will also be exempt u/s 10(10D) in A.Y. 2033-34 since aggregate of the annual premium payable for ULIP "A" and ULIP "X" does not exceed ₹ 2,50,000 for the P.Ys. 2022-23 to 2031-32 and the annual premium of ULIP "A" does not exceed 10% of actual capital sum assured.

Example 7:

ULIP	X	A
Date of issue	1.4.2021	1.4.2022
Annual premium	2,00,000	1,00,000
Sum assured	20,00,000	10,00,000
Consideration received as on 01.11.2031 on maturity	25,00,000	
Consideration received as on 01.11.2032 on maturity		12,00,000
Note – The assessee did not receive any consideration under any other eligible ULIPs in earlier P.Y. preceding the P.Y.2032-33, except ULIP X in P.Y. 2031-32.		

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Eligibility for exemption u/s 10(10D) – The consideration under ULIP "X" would be exempt u/s 10(10D) in A.Y. 2032-33, since the annual premium does not exceed ₹ 2,50,000 and also does not exceed 10% of actual capital sum assured.

The consideration received under ULIP "A" will **not** be exempt u/s 10(10D) in A.Y. 2033-34 since aggregate of the annual premium payable for ULIP "A" and ULIP "X" (both ULIPs issued on or after 1.2.2021) exceeds ₹ 2,50,000.

II. Where the assessee has received consideration, during the current P.Y., under more than one eligible ULIP

Circumstance	Eligibility for exemption u/s 10(10D)
If aggregate of the amount of premium payable on such eligible ULIPs and EEE ULIPs does not exceed ₹ 2,50,000 for any of the PYs during the term of such eligible ULIPs and annual premium in respect of eligible ULIPs also does not exceed 10% of actual capital sum assured.	Consideration received would be eligible for exemption under u/s 10(10D).
If aggregate of the amount of premium payable on such eligible ULIPs and EEE ULIPs > ₹ 2,50,000 for any of the PYs during the term of such eligible ULIPs	Consideration in respect of any of those eligible ULIPs (whose aggregate amount of premium along with the aggregate amount of premium of EEE ULIPs does not exceed ₹ 2,50,000 for any of the PYs during their term) would be eligible for exemption u/s 10(10D). **[Refer Examples 8, 9 and 10 given below]**

Example 8:

ULIP	X	A	B	C
Date of issue	1.4.2021	1.4.2022	1.4.2022	1.4.2022
Annual premium	2,00,000	1,00,000	1,50,000	3,00,000
Sum assured	20,00,000	10,00,000	15,00,000	30,00,000
Consideration received as on 01.11.2031 on maturity	25,00,000			
Consideration received as on 01.11.2032 on maturity		12,00,000	18,00,000	34,00,000
Note – The assessee did not receive any consideration under any other eligible ULIPs in earlier P.Y. preceding the P.Y.2032-33, except ULIP X in P.Y. 2031-32.				

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Eligibility for exemption u/s 10(10D) - The consideration under ULIP "X" would be exempt u/s 10(10D) in A.Y. 2032-33, since the annual premium does not exceed ₹ 2,50,000 and also does not exceed 10% of actual capital sum assured.

In this case, the aggregate of the annual premium payable for ULIP "A", ULIP "B" and ULIP "C" along with the premium for ULIP "X" exceeds ₹ 2,50,000 during the term of these policies. Hence, the consideration received under ULIPs "A", "B" and "C" will **not** be exempt u/s 10(10D) in A.Y. 2033-34.

Alternative treatment: If the consideration under ULIP "X" was not claimed to be exempt u/s 10(10D) in A.Y. 2032-33 by the assessee, then, the consideration received under ULIP "A" and ULIP "B" would be exempt u/s 10(10D) in A.Y.2033-34 since the aggregate of the annual premium payable for the ULIPs "A" and "B" together did not exceed ₹ 2,50,000 for any of the previous years during the term of these two policies.

Example 9:

ULIP	X	A	B	C
Date of issue	1.4.2021	1.4.2022	1.4.2022	1.4.2022
Annual premium	1,00,000	1,00,000	1,50,000	3,00,000
Sum assured	10,00,000	10,00,000	15,00,000	30,00,000
Consideration received as on 01.11.2031 on maturity	12,00,000			
Consideration received as on 01.11.2032 on maturity		12,00,000	18,00,000	34,00,000
Note – The assessee did not receive any consideration under any other eligible ULIPs in earlier P.Y. preceding the P.Y.2032-33, except ULIP X in P.Y. 2031-32.				

Eligibility for exemption u/s 10(10D) - The consideration under ULIP "X" would be exempt u/s 10(10D) in A.Y. 2032-33, since the annual premium does not exceed ₹ 2,50,000 and also does not exceed 10% of actual capital sum assured.

In this case, the aggregate of the annual premium payable for ULIP "A", ULIP "B" and ULIP "C" along with the premium for ULIP "X" exceeds ₹ 2,50,000 during the term of these policies.

However, the consideration received under ULIPs "A" or "B" (any one) can be claimed as exempt u/s 10(10D) in A.Y. 2033-34.

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If the consideration received under ULIP "A" claimed to be exempt as aggregate of the annual premium payable for ULIP "X" and "A" did not exceed ₹ 2,50,000 for any of the PYs., the consideration received under ULIP "B" would not be exempt.

If the consideration received under ULIP "B" claimed to be exempt as aggregate of the annual premium payable for ULIP "X" and "B" did not exceed ₹ 2,50,000 for any of the PYs., the consideration received under ULIP "A" would not be exempt. Exemption for consideration received under ULIP "B" is preferred as it is more beneficial to the assessee.

Alternative treatment: If the consideration under ULIP "X" was not claimed to be exempt u/s 10(10D) in A.Y. 2032-33 by the assessee, then the consideration received under ULIP "A" and ULIP "B" would be exempt u/s 10(10D) in A.Y. 2033-34 since the aggregate of the annual premium payable for the ULIPs "A" and "B" together did not exceed ₹ 2,50,000 for any of the previous years during the term of these two policies.

It may be noted that in every case, the consideration received for ULIP "C" would not be exempt u/s 10(10D).

Example 10:

ULIP	X	Y	A	B	C
Date of issue	1.4.2021	1.4.2021	1.4.2022	1.4.2022	1.4.2022
Annual premium	1,00,000	1,00,000	1,00,000	1,50,000	3,00,000
Sum assured	10,00,000	10,00,000	10,00,000	15,00,000	30,00,000
Consideration received on surrender as on 1.7.2025	6,00,000				
Consideration received as on 01.11.2031 on maturity		12,00,000			
Consideration received as on 01.11.2032 on maturity			12,00,000	18,00,000	34,00,000
Note – The assessee did not receive any consideration under any other eligible ULIPs in earlier P.Y. preceding the P.Y.2032-33, except ULIP "X" and "Y".					

Eligibility for exemption u/s 10(10D) - The consideration under ULIP "X" would be exempt u/s 10(10D) in A.Y.2026-27, since the annual premium does not exceed ₹ 2,50,000 and also does not exceed 10% of actual capital sum assured.

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The consideration received under ULIP "Y" would be exempt u/s 10(10D) in A.Y. 2032-33, since the aggregate of annual premium payable for ULIP "X" and "Y" does not exceed ₹ 2,50,000 and annual premium payable for ULIP "Y" does not exceed 10% of actual capital sum assured.

The consideration received under ULIPs "A", ULIP "B" and ULIP "C" would not be exempt u/s 10(10D) in A.Y. 2033-34, since aggregate of annual premium payable for these three policies and ULIP "X" and "Y" exceeds ₹ 2,50,000.

Alternative treatment: If the consideration on surrender under ULIP "X" was not claimed to be exempt u/s 10(10D) in A.Y. 2026-27 by the assessee, then the consideration received under ULIP "Y" would be exempt and the consideration received under ULIP "A" **or** ULIP "B" (any one) can be exempt u/s 10(10D) in A.Y. 2033-34. If the consideration received under ULIP "A" claimed to be exempt, as aggregate of the annual premium payable for ULIP "Y" and "A" did not exceed ₹ 2,50,000 for any of the PYs., the consideration received under ULIP "B" would not be exempt.

If the consideration received under ULIP "B" is claimed to be exempt as aggregate of the annual premium payable for ULIP "Y" and "B" did not exceed ₹ 2,50,000 for any of the PYs., the consideration received under ULIP "A" would not be exempt. Exemption for consideration received under ULIP "B" is preferred as it is more beneficial to the assessee.

If the consideration on surrender of ULIP "X" and on maturity of ULIP "Y" were not claimed to be exempt under section 10(10D) in A.Y.2026-27 and A.Y.2032-33, respectively, then consideration received under both ULIP "A" and ULIP "B" would be exempt in A.Y.2033-34 (being ULIPs issued on or after 1.2.2021, whose aggregate consideration does not exceed ₹ 2,50,000).

It may be noted that, in every case, consideration received under ULIP "C" would not be exempt under section 10(10D).

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Summary

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Any ULIP which is not exempt under section 10(10D) will be a capital asset and taxable under section 45(1B).

Rule 8AD prescribes the following manner to compute capital gains on receipt of amount under such ULIPs. Where any person receives at any time during any previous year any amount under such ULIP, including the amount allocated by way of bonus on such policy, then, —

	Situation	Capital gains arising from receipt of amount during the previous year in which such amount is received
(i)	Where the amount is received for the first time under such ULIP during the previous year,	**A-B,** where **A** = the amount received for the first time under such ULIP during the previous year, including the amount allocated by way of bonus on such policy; and **B** = the aggregate of the premium paid during the term of such ULIP till the date of receipt of the amount as referred to in "A"
(ii)	Where the amount is received under such ULIP during the previous year, at any time after the receipt of the amount as referred to in (i)	**C-D,** where **C** = the amount received under such ULIP during the previous year, at any time after the receipt of the amount as referred to in (i) above, including the amount allocated by way of bonus on such policy. **Note** - The amount which has already been considered for calculation of taxable amount during the earlier previous year(s) would not be included in "C". **D** = the aggregate of the premium paid during the term of such ULIP till the date of receipt of the amount as referred to in "C" as reduced by "B" i.e., the premium that has already been considered for calculation of taxable amount during the earlier previous year(s).

The capital gains as computed in above would be deemed to be the capital gains arising from the transfer of a unit of an equity-oriented fund set up under a scheme of an insurance company comprising unit linked insurance policies.

(4) Conversion or treatment of a capital asset as stock-in-trade [Section 45(2)]

A person who is the owner of a capital asset may convert the same or treat it as stock-in-trade of the business carried on by him. As noted above, the conversion/treatment is a transfer.

As per section 45(2), notwithstanding anything contained in section 45(1), being the charging section, the profits or gains arising from the above conversion or treatment will be chargeable to income-tax as **his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him.**

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Full value of consideration: In order to compute the capital gains, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received as a result of the transfer of the capital asset.

Note – Both Capital Gains and Business income are chargeable to tax in the year in which stock-in-trade is sold or otherwise transferred.

ILLUSTRATION 1

X converts his capital asset (acquired on June 10, 2006 for ₹ 60,000) into stock-in-trade on March 10, 2025. The fair market value on the date of the above conversion was ₹ 5,50,000. He subsequently sells the stock-in-trade so converted for ₹ 6,00,000 on June 10, 2025. Examine the tax implication.

Cost Inflation Index - F.Y. 2006-07: 122; F.Y. 2024-25: 363; F.Y. 2025-26: 376.

SOLUTION

Since the capital asset is converted into stock-in-trade during the previous year relevant to the A.Y. 2025-26, it will be a transfer under section 2(47) during the P.Y.2024-25. However, the profits or gains arising from the above conversion will be chargeable to tax during the A.Y. 2026-27, since the stock-in-trade has been sold only on June 10, 2025. For this purpose, the fair market value on the date of such conversion (i.e. 10th March, 2025) will be the full value of consideration.

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The capital gains will be computed after deducting the cost of acquisition from the full value of consideration since the transfer (i.e., conversion of capital asset into stock in trade) took place during the P.Y. 2024-25. Indexation benefit will not be available since transfer took place on or after 23.7.2024. ₹ 4,90,000 (i.e., ₹ 5,50,000 – ₹ 60,000) will be treated as long-term capital gains chargeable to tax during the A.Y.2026-27. During the same assessment year, ₹ 50,000 (₹ 6,00,000 - ₹ 5,50,000) will be chargeable to tax as business profits.

(5) Transfer of beneficial interest in securities [Section 45(2A)]

As per section 45(2A), where any person has had at any time during the previous year any beneficial interest in any securities, then, any profits or gains arising from the transfer made by the depository or participant of such beneficial interest in respect of securities shall be chargeable to tax as the income of the beneficial owner of the previous year in which such transfer took place and shall not be regarded as income of the depository who is deemed to be the registered owner of the securities by virtue of section 10(1) of the Depositories Act, 1996.

Full value of consideration and period of holding: For the purposes of section 48 and proviso to section 2(42A), the cost of acquisition and the period of holding of securities shall be determined on the basis of the first-in-first-out (FIFO) method.

When the securities are transacted through stock exchanges, it is the established procedure that the brokers first enter into contracts for purchase/ sale of securities and thereafter, follow it up with delivery of shares, accompanied by transfer deeds duly signed by the registered holders.

- The seller is entitled to receive the consideration agreed to as on the date of contract.
- Thus, it is the date of broker's note that should be treated as the date of transfer in case of sale transactions of securities provided such transactions are followed up by delivery of shares and also the transfer deeds.
- Similarly, in respect of the purchasers of the securities, the holding period shall be reckoned to take place directly between the parties and not through stock exchanges.
- The date of contract of sale as declared by the parties shall be treated as the date of transfer provided it is followed up by actual delivery of shares and the transfer deeds.

Where securities are acquired in several lots at different points of time, the First-In-First-Out (FIFO) method shall be adopted to reckon the period of the holding of the security, in cases where the dates of purchase and sale could not be correlated through specific numbers of the scrips.

In other words, the assets acquired last will be taken to be remaining with the assessee while assets acquired first will be treated as sold. Indexation, wherever applicable, for long-term assets will be regulated on the basis of the holding period determined in this manner - *CBDT Circular No. 704, dated 28.4.1995.*

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Meaning of certain terms:

Term	Meaning
Beneficial owner	A person whose name is recorded as such with a depository.
Depository	A company formed and registered under the Companies Act, 1956[1] and which has been granted a certificate of registration under section 12(1A) of the SEBI Act, 1992.
Security	Such security as may be specified by SEBI.

(6) Introduction of capital asset as capital contribution [Section 45(3)]

Where a person transfers a capital asset to a firm, AOP or BOI in which he is already a partner/ member or is to become a partner/ member by way of capital contribution or otherwise, the profits or gains arising from such transfer will be **chargeable to tax as income of the previous year in which such transfer takes place.**

Full value of consideration: For this purpose, the full value of the consideration will be deemed to be the amount recorded in the books of account of the firm, AOP or BOI as the value of the capital asset.

(7) Tax implications on receipt of money or capital asset or stock-in trade by a partner or a member on dissolution or reconstitution of firm/AOPs/BOIs [Section 9B and 45(4)]

Tax implications on receipt of capital assets or stock in trade or both on dissolution or reconstitution of firm/AOP or BOI [Section 9B]

(i) Deemed transfer in the hands of specified entity - Where a **specified person (partner of a firm/member of AoP/BoI) receives** during the previous year **any capital asset or stock in trade or both** from a specified entity (firm/AoP/BoI, as the case may be) in connection with the **dissolution or reconstruction** of such specified entity, then **such specified entity** would be **deemed to have transferred** such capital asset or stock in trade or both, as the case may be, to the specified person **in the year in which such capital asset or stock in trade or both** are received by the specified person.

(ii) Year of taxability – Any profits and gains from such deemed transfer of capital asset or stock in trade or both, as the case may be, by the specified entity shall be deemed to be the **income of such specified entity of the previous year in which such capital asset or stock in trade or both were received by the specified person.**

[1] Now Companies Act, 2013

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(iii) Head of income – Any profit and gains from such deemed transfer of capital asset would be chargeable to income-tax as income of such specified entity under the head "Capital gains". Any profits and gains from such deemed transfer of stock in trade would be chargeable to tax under the head "Profits and gains from business or profession", in accordance with the provisions of this Act.

(iv) Full value of consideration - In order to compute the capital gains, the **fair market value of the capital asset or stock in trade or both** on the date of its receipt by the specified person shall be **deemed to be the full value of the consideration** received or accruing as a result of such deemed transfer of the capital asset or stock in trade or both by the specified entity.

Tax implications on receipt of money or capital assets or both on reconstitution of firm/AOP or BOI [Section 45(4)]

(i) Deemed income in the hands of specified entity – Where a specified person receives during the previous year **any money or capital asset or both** from a specified entity in connection with the **reconstitution of such specified entity**, then any profits or gains arising from such receipt by the specified person shall be chargeable to income-tax as income of such specified entity under the head "Capital gains".

(ii) Year of taxability – Such profits and gains shall be deemed to be the **income of specified entity of the previous year in which such money or capital asset or both were received by the specified person.**

(iii) Computation of such profits and gains from such receipt – Notwithstanding anything to the contrary contained in this Act, such profits or gains shall be determined in accordance with the following formula –

$$A^{**} = B + C - D$$

A = Income chargeable to income-tax u/s 45(4) as income of the specified entity under the head "Capital gains"

B = Value of any money received by the specified person from the specified entity on the date of such receipt;

C = The amount of fair market value of the capital asset received by the specified person from the specified entity on the date of such receipt; and

D = The amount of balance in the capital account (represented in any manner) of the specified person in the books of account of the specified entity at the time of its reconstitution.

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Balance in the capital account of the specified person in the books of account of the specified entity is to be calculated without taking into account the increase in the capital account of the specified person due to the following

- revaluation of any asset or
- self-generated goodwill or
- any other self-generated asset.

"self-generated goodwill" and "self-generated asset" mean goodwill or asset, as the case may be, which has been acquired without incurring any cost for purchase or which has been generated during the course of the business or profession.

** If the value of "A" in the above formula **is negative**, its value shall be **deemed to be zero.**

(iv) Taxability u/s 45(4) is in addition to taxability under section 9B – When a capital asset is received by a specified person from a specified entity in connection with the reconstitution of such specified entity, the provisions of this section shall operate in addition to the provisions of section 9B and the taxation under section 9B shall be worked out independently.

(v) Definition of certain terms commonly used under both section 9B and 45(4):

Terms	Meaning
Specified person	a person, who is a partner of a firm or member of AOPs or BOIs (not being a company or a co-operative society) in any previous year.
Specified entity	a firm or other AOPs or BOIs (not being a company or a co-operative society)
Reconstitution of the specified entity	Where (a) one or more of its partners or members, as the case may be, of such specified entity **ceases** to be partners or members; **or** (b) one or more new partners or members, as the case may be, are **admitted** in such specified entity in such circumstances that **one or more of the persons who were partners or members,** as the case may be, of the specified entity, before the change, **continue as partner or partners or member or members after the change; or** (c) **all the partners or members**, as the case may be, of such specified entity **continue with a change in their respective share or in the shares of some of them**

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Note: The case of dissolution of specified entity which is dealt in section 9B is not covered under section 45(4). The taxability of receipt of money by a partner of a firm/ member of AoP/BoI on reconstitution of firm/AoP/BoI, as the case may be, is dealt with only in section 45(4) and not in section 9B. The taxability of receipt of stock-in-trade by a partner of a firm/member of AoP/BoI on reconstitution is dealt with in section 9B. Therefore, it is only receipt of capital asset by a partner of a firm/member of an AoP/BoI on reconstitution of the firm/AoP/BoI which is taxable under section 9B and under section 45(4).

(vi) Type of capital gain from capital asset received by specified person from specified entity in connection with its reconstitution [Section 2(42A) Rule 8AA]: In case of the amount which is chargeable to tax as income of specified entity under section 45(4) under the head - "Capital gains", the amount or a part of it shall be deemed to be from transfer of short-term capital asset or long term capital asset, as the case may be, mentioned in column (2), if it is attributed to capital asset mentioned in the corresponding row in column (3) -

	Deemed capital gains from transfer of capital asset	Type of capital asset of specified entity
	(2)	(3)
1.	Capital gains from transfer of a short term capital asset	(a) capital asset which is short term capital asset at the time of taxation of amount under section 45(4); or (b) capital asset forming part of block of asset; or (c) capital asset being self-generated asset and self-generated goodwill as defined in section 45(4)
2.	Capital gains from transfer of a long term capital asset	Capital asset which is not covered in 1. above and is long term capital asset at the time of taxation of amount under section 45(4).

(vii) Attribution of capital gains: For the purpose of section 48(iii), where the amount is chargeable to income-tax as income of specified entity under section 45(4), the specified entity shall attribute such amount to capital asset remaining with the specified entity in the prescribed manner:

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Accordingly, Rule 8AB provides that the specified entity shall attribute such amount to capital asset remaining with the specified entity in the following manner:

S. No.	Particulars	Attribution to the capital assets remaining with the specified entity
Where the aggregate of the value of money and the fair market value of the capital asset received by the specified person from the specified entity, in excess of the balance in his capital account, chargeable to tax under section 45(4) -		
(i)	relates to revaluation of any capital asset or valuation of self-generated asset or self-generated goodwill, of the specified entity. The revaluation should be based on a valuation report obtained from a registered valuer.	the amount charged u/s 45(4) x $\frac{\text{increase in, or recognition of, value of that asset because of revaluation or valuation}}{\text{aggregate of increase in, or recognition of, value of all assets because of the revaluation or valuation}}$
(ii)	does not relate to revaluation of any capital asset or valuation of self generated asset or self-generated goodwill, of the specified entity	the amount charged to tax under section 45(4) shall not be attributed to any capital asset
(iii)	relate only to the capital asset received by the specified person from the specified entity	the amount charged to tax under section 45(4) shall not be attributed to any capital asset

The specified entity shall furnish the details of amount attributed to capital asset remaining with the specified entity in Form No. 5C.

Form No. 5C shall be furnished on or before the due date referred to in *Explanation 2* below section 139(1) for the assessment year in which the amount is chargeable to tax under section 45(4).

It is clarified that revaluation of an asset or valuation of self-generated asset or self-generated goodwill does not entitle the specified entity for the depreciation on the increase in value of that

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asset on account of its revaluation or recognition of the value of self-generated asset or self-generated goodwill due to its valuation.

(viii) Power of CBDT to issue guidelines [Section 9B(4) and 9B(5)] - If any difficulty arises in giving effect to the provisions of section 9B and section 45(4), the CBDT may issue guidelines for the purpose of removing the difficulty with the approval of the Central Government.

Every guideline issued by the CBDT shall be laid before each House of Parliament and shall be binding on the income-tax authorities and on the assessee.

Guidelines under section 9B and section 45(4) of the Income-tax Act, 1961 [Circular No. 14/2021 dated 2.7.2021]

The amount taxed under section 45(4) is required to be attributed to the remaining capital assets of the specified entity, so that when such capital assets get transferred in the future, the amount attributed to such capital assets gets reduced from the full value of the consideration and to that extent the specified entity does not pay tax again on the same amount.

This attribution is given only for the purposes of section 48. Section 48 only applies to capital assets which are not forming block of assets. For capital assets forming block of assets there is section 43(6)(c) to determine written down value of the block of asset and section 50 to determine the capital gains arising on transfer of such assets.

However, the Act has not yet provided that amount taxed under section 45(4) can also be attributed to capital assets forming part of block of assets and which are covered by these two provisions.

The CBDT has, vide this circular, clarified that Rule 8AB also applies to capital assets forming part of block of assets. Wherever the terms capital asset is appearing in the Rule 8AB, it refers to capital asset whose capital gains is computed under section 48 as well as capital asset forming part of block of assets. Further, wherever reference is made for the purposes of section 48, such reference may be deemed to include reference for the purposes of section 43(6)(c) and section 50.

It is further clarified that in case the capital asset remaining with the specified entity is forming part of a block of asset, the amount attributed to such capital asset under rule 8AB shall be reduced from the full value of the consideration received or accruing as a result of subsequent transfer of such asset by the specified entity, and the net value of such consideration shall be considered for reduction from the written down value of such block under section 43(6)(c) or for calculation of capital gains, as the case may be, under section 50.

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For the purposes of understanding and for removing difficulties, if any, the application of section 9B and section 45(4) is explained with the help of the following examples:

Example 1: There are three partners “A”, “B” and "C" in a firm "FR", having one third share each. Each partner has a capital balance of ₹ 10 lakh in the firm. There are three pieces of lands “S”, “T” and “U” in that firm and there is no other capital asset in that firm. Book value of each of the land is ₹ 10 lakh which is the cost of acquisition. All these three lands were acquired by the firm more than two years ago.

Partner “A” wishes to exit. The firm revalues its lands based on valuation report from a registered valuer, as defined in rule 11U, and as per that valuation report fair market value of lands “S” and “T” is ₹ 70 lakh each, while fair market value of land “U” is ₹ 50 lakh. On the exit of partner “A", the firm decides to give him ₹ 11 lakh of money and land “U” to settle his capital balance on 14.5.2025.

In accordance with the provisions of section 9B, it would be deemed that the firm “FR" has transferred land “U” to the partner "A" at its fair market value of ₹ 50 lakh.

Now on account of the deeming provisions of section 9B, it is deemed that the firm “FR" has transferred land “U” to partner “A". Thus, an amount of ₹ 50 lakh less ₹ 10 lakh would be charged to tax in the hands of firm “FR" under the head “Capital gains”. For partner “A", the cost of acquisition of this land would be ₹ 50 lakh. Hence, the amount of ₹ 40 lakh is charged to long term capital gains and let us assume that the tax is ₹ 5,00,000 (assume no surcharge or cess just for ease of calculation and illustration purposes).

This net book profit after tax of ₹ 35 lakh (capital gains of ₹ 40 lakh less tax of ₹ 5 lakh) is to be credited in the capital account of each of the three partners, i.e. ₹ 11,66,667 each. Thus, partner “A" capital account would increase to ₹ 21,66,667. This exercise is required to be carried out since section 9B mandates that it is to be deemed that the firm “FR" has transferred the land “U" to partner "A" and the long term capital gains of ₹ 40 lakh is chargeable to tax in the hands of the firm “FR".

As against capital balance of ₹ 21,66,667, partner “A" has received ₹ 61 lakh (₹ 11 lakh of money plus land “U" of fair market value of ₹ 50 lakh). Thus, ₹ 39,33,333 is required to be charged to tax under section 45(4). This shall be in addition to an amount of ₹ 40 lakh charged to tax under section 9B.

On account of clause (iii) of section 48, read with rule 8AB, this ₹ 39,33,333 is to be attributed to the remaining assets of the firm “FR" on the basis of increase in their value due to revaluation based on the valuation report of registered valuer. In this case as per revaluation there are only two capital assets remaining; lands “S" and “T". In both cases the value has increased by ₹ 60 lakh each. Thus, out of ₹ 39,33,333, ₹ 19,66,666.50 shall be attributed to land “S" and

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₹ 19,66,666.50 to land “T". When either of these lands gets sold, this amount attributed to them would be reduced from sales consideration under clause (iii) of section 48.

The amount of ₹ 39,33,333 which is charged to tax under section 45(4) shall be charged as long term capital gains in view of rule 8AA(5), since the amount of ₹ 39,33,333 is attributed to land “S" and land “T" which are both long term capital assets at the time of taxation of ₹ 39,33,333 under section 45(4).

Example 2: There are three partners “A", “B" and “C" in a firm “FR", having one third share each. Each partner has a capital balance of ₹ 10 lakh in the firm. There are three pieces of lands “S", “T" and “U" in that firm and there is no other capital asset in that firm. All these three lands were acquired by the firm more than two years ago.

Book value of each of the land is ₹ 10 lakh. Partner “A" wishes to exit. The firm sells land “U" on 20.6.2025 for its fair market value of ₹ 50 lakh. The cost of acquisition of land “U" is same as its book value. Thus, an amount of ₹ 50 lakh less ₹ 10 lakh would be charged to tax in the hands of firm “FR" under the head “Capital gains". Hence, the amount of ₹ 40 lakh is charged to long term capital gains and let us assume that the tax is ₹ 5 lakh (assume no surcharge or cess just for ease of calculation and illustration purposes).

This net book profit after tax of ₹ 35 lakh (capital gains of ₹ 40 lakh less tax of ₹ 5 lakh) is to be credited in the capital account of each of the three partners, i.e. ₹ 11,66,667 each. Thus, partner “A” capital account would increase to ₹ 21,66,667 lakh.

Partner “A” decides to exit the firm “FR”. The firm revalues its lands “S” and “T” based on valuation report from a registered valuer, as defined in Rule 11U, and as per that valuation report fair market value of lands “S” and “T” is ₹ 70 lakh each. On the exit of partner “A”, the firm decides to give him ₹ 61 lakh of money to settle his capital balance. Thus, as against capital balance of ₹ 21,66,667, partner “A” has received ₹ 61 lakh of money. Thus ₹ 39,33,333 is required to be charged to tax section 45(4). This will be in addition to ₹ 40 lakh already charged to capital gains.

On account of section 48(iii), read with rule 8AB, this ₹ 39,33,333 is to be attributed to the remaining assets of the firm “FR” on the basis of increase in their value due to revaluation based on the valuation report of registered valuer. In this case, as per revaluation, there are only two capital assets remaining: lands “S” and “T”. In both cases, the value has increased by ₹ 60 lakh each. Thus, out of ₹ 39,33,333, ₹ 19,66,666.50 shall be attributed to land “S” and ₹ 19,66,666.50 to land “’T’’. When either of these lands gets sold, this amount attributed to them would be reduced from sales consideration under section 48(iii).

The amount of ₹ 39,33,333 which is charged to tax under section 45(4) shall be charged as long term capital gains in view of rule 8AA(5), since the amount of ₹ 39,33,333 is attributed to land “S”

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and land “T” which are both long term capital assets at the time of taxation of ₹ 39,33,333 under section 45(4).

Note: The final result in both example 1 and 2 is same due to the operation of section 9B.

Example 3: There are three partners “A”, “B” and “C” in a firm “FR”, having one third share each. Each partner has a capital balance of ₹ 100 lakh in the firm. There is a piece of land “S” of book value of ₹ 45 lakh. There is patent “T” of written down value of ₹ 45 lakh. And there is cash of ₹ 225 lakh. The land was acquired by the firm more than two years ago. The patent was acquired/ developed/ registered one year back.

Partner “A” wishes to exit. The firm revalues its land and patent based on valuation report from a registered valuer, as defined in rule 11U, and as per that valuation report, fair market value of land “S” is ₹ 45 lakh and fair market value of patent “T” is ₹ 60 lakh. As per the valuation report, there is also self-generated goodwill of ₹ 30 lakh. On the exit of partner “A”, the firm decides to give him ₹ 75 lakh in money and land “S" to settle his capital balance on 14.7.2025.

In accordance with the provisions of section 9B, it would be deemed that the firm “FR" has transferred land “S" to the partner “A" at its fair market value of ₹ 45 lakh. The cost of acquisition of land “S" is same as its book value.

Now, on account of the deeming provisions of section 9B, it is deemed that the firm “FR" has transferred land “S" to partner “A". However, since the sale consideration is equal to cost of acquisition, there will not be any capital gains tax. For partner “A", the cost of acquisition of this land would be ₹ 45 lakh.

As against capital balance of ₹ 100 lakh, partner “A" has received ₹ 120 lakh (money of ₹ 75 lakh plus land “S" of fair market value of ₹ 45 lakh). Thus, ₹ 20 lakh is required to be charged to tax under section 45(4).

On account of section 48(iii), read with rule 8AB and this guidance note, this ₹ 20 lakh is to be attributed to the remaining capital assets of the firm “FR" on the basis of increase in the value due to revaluation of existing capital assets, or due to recognition of the value of self-generated goodwill, based on the valuation report of registered valuer. In this case, as per this report, the value of patent “T" has increased by ₹ 15 lakh and the self-generated goodwill value has been recognised at ₹ 30 lakh. Thus, one third of ₹ 20 lakh (i.e. ₹ 6,66,667) would be attributed to patent “T", while two third of ₹ 20 lakh (i.e. ₹ 13,33,333) would be attributed to self-generated goodwill. ₹ 6,66,667 attributed to patent “T" shall not be added to the block of the assets and no depreciation shall be available on the same. When patent “T" gets transferred subsequently, this ₹ 6,66,667 attributed shall be reduced from the full value of the consideration received or accruing as a result of transfer of patent “T" by the firm “FR", and the net value shall be considered for reduction from the written down value of the intangible block under section 43(6)(c) or for

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calculation of capital gains, as the case may be, under section 50. Let us say that Patent T is sold for ₹ 25 lakh. ₹ 6,66,667 shall be reduced from ₹ 25 lakh and only net amount of ₹ 18,33,333 shall be considered for reduction from the written down value of the intangible block under section 43(6)(c) or for calculation of capital gains, as the case may be, under section 50. Similarly, when goodwill gets sold subsequently, ₹ 13,33,333 would be reduced from its sales consideration under section 48(iii).

The amount ₹ 20 lakh which is charged to tax under section 45(4) shall be charged as short term capital gains, as ₹ 6,66,667 is attributed to the Patent "T" which is part of block of assets and ₹ 13,33,333 is attributed to self-generated goodwill. In accordance with rule 8AA(5), both of these are to be characterised as short term capital gains.

Note: For the purpose of calculation of depreciation under section 32, the written down value of the block of asset "intangible" of which Patent "T" is part, would remain ₹ 45 lakh and would not be increased to ₹ 60 lakh due to revaluation during the year. In this regard it may be highlighted that the following provisions are relevant in determining the amount on which depreciation is allowable under the Act:

- *Explanation 2* of section 32(1) provides that the term "written down value of the block of assets" shall have the same meaning as in section 43(6)(c).
- Section 43(6)(c), with respect to block of assets, inter alia, provides that the aggregate of the written down values of all the assets falling within that block of assets at the beginning of the previous year is to be increased by the actual cost of any asset falling within that block, acquired during the previous year. This clause does not allow any increase on account of revaluation.
- Section 43(1) which defines "Actual cost" as actual cost of the assets to the assessee. In revaluation, there is no actual cost to the assessee.

Further, section 32 does not allow depreciation on goodwill. If in the given example "self-generated goodwill" is replaced by "self-generated asset", even then, the depreciation will not be admissible on the amount of ₹ 30 lakh recognised in valuation. In this regard it may be highlighted that the above mentioned provisions, in the immediate preceding paragraph, are also applicable to "self-generated asset" and since there is no actual cost to assessee in case of "self-generated asset", depreciation is not allowable under section 32 on an asset whose actual cost is nil.

(8) Compensation on compulsory acquisition [Section 45(5)]

Sometimes, a building or some other capital asset belonging to a person is taken over by the Central Government by way of compulsory acquisition. In that case, the consideration for the transfer is determined by the Central Government or RBI. When the Central Government pays the

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above compensation, capital gains may arise. Such capital gains are **chargeable as income of the previous year in which such compensation or part thereof, was first received.**

Enhanced Compensation- Many times, persons whose capital assets have been taken over by the Central Government and who get compensation from the government go to the court of law for enhancement of compensation. If the court awards a compensation which is higher than the original compensation, the difference thereof will be chargeable to capital gains in the year in which the same is received from the government.

Cost of acquisition in case of enhanced compensation - For this purpose, the cost of acquisition and cost of improvement shall be taken to be *nil*.

Compensation received in pursuance of an interim order deemed as income chargeable to tax in the year of final order - In order to remove the uncertainty regarding the year in which the amount of compensation received in pursuance of an interim order of the court is to be charged to tax, a proviso has been inserted after clause (b) to provide that such compensation shall be deemed to be income chargeable under the head 'Capital gains' in the previous year in which the final order of such court, Tribunal or other authority is made.

Reduction of enhanced compensation - Where capital gain has been charged on the compensation received by the assessee for the compulsory acquisition of any capital asset or enhanced compensation received by the assessee and subsequently such compensation is reduced by any court, tribunal or any authority, the assessed capital gain of that year shall be recomputed by taking into consideration the reduced amount. This re-computation shall be done by way of rectification under section 155.

Death of the transferor- It is possible that the transferor may die before he receives the enhanced compensation. In that case, the enhanced compensation or consideration will be chargeable to tax in the hands of the person who receives the same.

(9) Taxability of capital gains in case of Specified Agreement [Section 45(5A)]

Genuine hardship on account of taxability of capital gains in the year of transfer of property to developer: The definition of 'transfer', *inter alia*, includes any arrangement or transaction where any rights are handed over in execution of <u>part performance of contract,</u> even though the legal title has not been transferred.

Applying the definition of transfer, under these development agreements, the transfer took place in the year in which the owner of the immovable property, being land or building or both handed over the immovable property to the developer.

Consequently, the capital gains tax liability in the hands of the owner would arise in the year in which the possession of immovable property is handed over to the developer for development of a

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project, in spite of the fact that the consideration thereof (i.e. the actual constructed property) will be received only after a couple of years.

Deferment of taxability of capital gains: With a view to minimise the genuine hardship which the owner of land or building may face in paying capital gains tax in the year of transfer, section 45(5A) provides that

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

Meaning of Specified Agreement: Specified agreement means the registered agreement in which a person owing land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of a share, being land or building or both in such project, whether with or without payment of part of the consideration in cash.

Full value of consideration: For the purpose of section 48, the stamp duty value of his share, being land or building or both, in the project on the date of issuing of said certificate of completion as increased by any consideration received in cash or by a cheque or draft or by any other mode, if any, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

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

Meaning of certain terms:

Term	Meaning
Competent authority	The authority empowered to approve the building plan by or under any law for the time being in force
Stamp duty value	The value adopted or assessed or reassessable by any authority of Government for the purpose of payment of stamp duty in respect of an immovable property being land or building or both.

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Taxability of capital gains in case of Specified Agreement: At a Glance

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4.6 CAPITAL GAINS ON DISTRIBUTION OF ASSETS BY COMPANIES IN LIQUIDATION [SECTION 46]

(1) **In the hands of liquidated company:** Where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall **not** be regarded as a transfer by the company for the purposes of section 45 [Section 46(1)].

The above section is restricted in its application to the circumstances mentioned therein *i.e.,* the assets of the company must be distributed to shareholders on the liquidation of the company. If, however, the liquidator sells the assets of the company resulting in a capital gain and distributes the funds so collected, the company will be liable to pay tax on such gains.

(2) **In the hands of shareholders:** Shareholders receive money or other assets from the company on its liquidation. They will be chargeable to income-tax under the head 'capital gains' in respect of the market value of the assets received on the date of distribution, or the moneys so received by them. The portion of the distribution which is attributable to the accumulated profits of the company is to be treated as dividend income of the shareholder under section 2(22)(c), which would be taxable in the hands of shareholders under the head "Income from other sources". The same will be deducted from the amount received/ fair market value for the purpose of determining the full value of consideration for computation of capital gains.

(3) **Capital gains tax on subsequent sale by the shareholders:** If the shareholder, after receipt of any such asset on liquidation of the company, transfers it, then Fair Market Value on the date of distribution would be treated as cost of acquisition of such asset.

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4.7 CAPITAL GAINS ON BUYBACK OF SHARES OR OTHER SECURITIES [SECTION 46A]

(1) **In case of shares of a company other than a domestic company and specified securities:** Any consideration received by a holder of specified securities (other than shares of a domestic company) from any company on purchase of its specified securities is chargeable to tax in the hands of the holder of specified securities. The difference between the cost of acquisition and the value of consideration received by the holder of securities is chargeable to tax as capital gains in his hands. The computation of capital gains shall be made in accordance with the provisions of section 48.

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Such capital gains shall be chargeable in the year in which such securities were purchased by the company. For this purpose, "specified securities" shall have the same meaning as given in *Explanation* to section 77A of the Companies Act, 1956[2].

As per Section 68 of the Companies Act, 2013, "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time.

***Note** – As far as shares are concerned, this provision would be attracted in the hands of the shareholder only if the shares are bought back by a company, other than a domestic company*.

(2) **In case of buy back of shares by domestic companies:** In case of buyback of shares (whether listed or unlisted) by a domestic company, the sum paid by a domestic company for purchase of its own shares would be treated as dividend and taxable under the head "Income from Other Sources" in the hands of shareholders. No deduction for expenses would be available against such dividend income.

Consequently, as per section 46A, the value of consideration received by a shareholder on buy back of shares by a domestic company would be Nil and the difference between the cost of acquisition and the value of consideration received by the shareholder will result into capital loss. The same can be set off and carried forward as per the applicable set-off & carry forward provisions of the Act. If it is long-term capital loss, it can be set-off only against long-term capital gains. If it is a short-term capital loss, it can set-off against both long term capital gains and short term capital gains. For details, refer Chapter: 7: Aggregation of income, Set-off and Carry Forward of Losses.

4.8 IMPORTANT DEFINITIONS

(a) **Amalgamation [Section 2(1B)] -** "Amalgamation", in relation to companies, means

- the merger of one or more companies with another company or
- the merger of two or more companies to form one company

(the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that -

[2] Now section 68 of the Companies Act, 2013

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(i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

(ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;

(iii) shareholders holding not less than three-fourth in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

(b) Demerger [Section 2(19AA)] - "Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 230 to 232 of the Companies Act, 2013, by a demerged company of its one or more undertaking to any resulting company in such a manner that -

(i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;

(ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

However, this provision does not apply where, in compliance to the Indian Accounting Standards specified in Annexure to the Companies (Indian Accounting Standards) Rules, 2015, the resulting company records the value of the property and the liabilities of the undertaking or undertakings at a value different from the value appearing in the books of account of the demerged company, immediately before the demerger.

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(iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;

Note *- If the resulting company is a shareholder of the demerged company, it cannot issue shares to itself. However, the resulting company has to issue shares to the other shareholders of the demerged company.*

(v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) the transfer of the undertaking is on a going concern basis;

(vii) the demerger is in accordance with the conditions, if any, notified under section 72A(5) by the Central Government in this behalf.

Explanation in respect of Certain Terms:

Explanation	Term	Particulars
1	**Undertaking**	Includes - any part of an undertaking or a unit or division of an undertaking or - a business activity taken as a whole, However, it does not include individual assets or liabilities or any combination thereof not constituting a business activity.
2	**Liabilities**	Includes (a) the liabilities which arise out of the activities or operations of the undertaking; (b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and (c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total

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		value of the assets of such demerged company immediately before the demerger.
3	**Property**	For the purpose of determining the value of the property, any change in the value of assets consequent to their revaluation shall be ignored.
4 & 5	**Splitting up or reconstruction**	(i) Splitting up or the reconstruction of - any authority or - a body constituted or established under a Central, State or Provincial Act, or - a local authority or - a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified by the Central Government in the Official Gazette. (ii) The reconstruction or splitting up of a company, which ceased to be a public sector company as a result of transfer of its shares by the Central Government, into separate companies, shall be deemed to be a demerger, if such reconstruction or splitting up has been made to give effect to any condition attached to the said transfer of shares and also fulfils such other conditions as may be notified by the Central Government.
6	**Reconstruction or splitting up of a public sector company**	The reconstruction or splitting up of a public sector company into separate companies shall be deemed to be a demerger, if such reconstruction or splitting up has been made to transfer any asset of the demerged company to the resulting company and the resulting company — (i) is a public sector company on the appointed day indicated in such scheme, as may be approved by the Central Government or any other body authorised under the provisions of the Companies Act, 2013 or any other law for the time being in force governing such public sector companies in this behalf; and (ii) fulfils such other conditions as may be notified by the Central Government.

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(c) **Demerged company [Section 2(19AAA)] -** Demerged company means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

(d) **Resulting company [Section 2(41A)] -** Resulting company means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

4.9 TRANSACTIONS NOT REGARDED AS TRANSFER [SECTION 47]

Section 47 specifies certain transactions which will not be regarded as transfer for the purpose of capital gains tax:

(1)	(2)	(3)	(4)
Clause of section 47	**Particulars of transfer of capital asset referred to in column (3)**	**Asset transferred**	**Conditions to be fulfilled**
47(i)	Any distribution on the total or partial partition of a HUF	Any capital asset	-
47(iii)	Any transfer **by an individual or HUF** under a gift or will or an irrevocable trust [Upto A.Y. 2024-25, transfer of a capital asset (other than shares, debentures or warrants allotted by a company under any ESOP) under a gift or will or irrevocable trust **by any person** was not considered as a transfer]	Any capital asset.	-
47(iv)	Any transfer by a holding company to its subsidiary company	Any capital asset	(a) The parent company or its nominees must hold the whole of the shares of the subsidiary company; and

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			(b) The subsidiary company must be an Indian company.
47(v)	Any transfer by a subsidiary company to the holding company	Any capital asset	(a) The whole of share capital of the subsidiary company must be held by the holding company; and (b) The holding company must be an Indian company. The exemption mentioned in section 47(iv) or (v) will not apply if a capital asset is transferred as stock-in-trade.
47(vi)	Any transfer by the amalgamating company to the amalgamated company, in a scheme of amalgamation.	Any capital asset	The amalgamated company should be an Indian company
47(via)	Any transfer by the amalgamating foreign company to the amalgamated foreign company, in a scheme of amalgamation of two foreign companies.	Capital asset, being shares held in an Indian company	(a) At least 25% of the shareholders of the amalgamating foreign company must continue to remain shareholders of the amalgamated foreign company; (b) Such transfer should not attract capital gains in the country in which the amalgamating company is incorporated.
47(viaa)	Any transfer by a banking company to banking institution, in a scheme of amalgamation of the banking company with the banking institution, sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949.	Any capital asset	-
47(viab)	Any transfer by the amalgamating foreign company to the amalgamated foreign company, in a scheme	Capital asset, being share of a foreign company, referred to in	(a) At least 25% of the shareholders of the amalgamating foreign company must continue to

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	of amalgamation of two foreign companies.	*Explanation 5* to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company	remain shareholders of the amalgamated foreign company; (b) Such transfer should not attract capital gains in the country in which the amalgamating company is incorporated.
47(vib)	Any transfer, in a demerger, by the demerged company to the resulting company	Any capital asset	The resulting company should be an Indian company.
47(vic)	Any transfer by the demerged foreign company to the resulting foreign company, in a scheme of demerger of a foreign company.	Capital asset, being a share or shares held in an Indian company	(a) The shareholders holding at least three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; (b) Such transfer should not attract tax on capital gains in the country, in which the demerged foreign company is incorporated. However, the provisions of sections 391 to 394 of the Companies Act, 1956[3], shall not apply in case of demergers referred to in this clause.
47(vica)	Any transfer by the predecessor co-operative bank to the successor co-operative bank or to the converted banking company, in a business reorganization of co-operative bank.	Any capital asset	-
47(vicb)	Any transfer by a shareholder of predecessor co-operative bank, in a business reorganization.	Capital asset, being a share or shares held by him in the predecessor co-operative bank	If the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank or the converted banking company.

[3]Sections 230 to 232 of the Companies Act, 2013

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			Note – Refer to section 44DB for the meanings of "business reorganisation", "converted banking company", "predecessor co-operative bank" and "successor co-operative bank".
47(vicc)	Any transfer by the demerged foreign company to the resulting foreign company, in a scheme of demerger of a foreign company	Capital asset, being a share of a foreign company referred to in *Explanation 5* to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company	(a) The shareholders holding at least three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; (b) Such transfer should not attract capital gains in the country in which the demerged foreign company is incorporated. However, the provisions of sections 391 to 394 of the Companies Act, 1956[3], shall not apply in case of demergers referred to in this clause.
47(vid)	Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company.	Capital asset, being shares	The transfer or issue should be made in consideration of demerger of the undertaking.
47(vii)	Any transfer by a shareholder of amalgamating company, in a scheme of amalgamation of companies	Capital asset, being shares held in the amalgamating company	(a) The transfer is made in consideration of the allotment to him of any share in the amalgamated company, except where the shareholder itself is the amalgamated company; and (b) The amalgamated company should be an Indian company.

Example:

Let us take a case where A Ltd., an Indian company, holds 60% of shares in B Ltd. B Ltd. amalgamates with A Ltd. Since A Ltd. itself is the shareholder of B Ltd., A Ltd., being the

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amalgamated company, cannot issue shares to itself. However, A Ltd. has to issue shares to the other shareholders of B Ltd.			
47(viia)	Any transfer by a non-resident to another non-resident outside India.	Capital asset, being bonds or Global Depository Receipts (GDRs) referred to in section 115AC(1)	Conditions laid down in section 115AC(1) should be fulfilled: (a) Bonds should be of: (i) an Indian company (issued in accordance with Notified scheme of Central Government); or (ii) a public sector company sold by the Government and purchased by the non-resident in foreign currency (b) GDRs should be issued: (i) in accordance with notified scheme of Central Government against initial issue of shares of an Indian company and purchased by the non-resident in foreign currency; or (ii) against the shares of a public sector company sold by the Government and purchased by him in foreign currency through an approved intermediary; or (iii) issued or reissued in accordance with Notified Scheme of Central Government against the existing shares of an Indian company purchased by him in foreign currency through an approved intermediary.

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47(viiaa)	Any transfer, made outside India, by a non-resident to another non-resident.	Capital asset, being a rupee denominated bond of an Indian company issued outside India	-
47(viiab)	Any transfer of specified capital assets by a non-resident on a recognised stock exchange located in any International Financial Services Centre (IFSC)	Capital asset, being - A bond or GDR referred to in section 115AC(1) (or) - A rupee denominated bond of an Indian company (or) - A derivative (or) - Any other security notified by the Central Government. Accordingly, the Central Government has, vide Notification No. 16/2020, dated 5.3.2020, Notification No. 89/2022 dated 3.8.2022 and Notification No. 71/2023 dated 12.9.2023, specified the following securities: (i) foreign currency denominated bond; (ii) unit of a Mutual Fund;	The consideration for such transaction is paid or payable in foreign currency.

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		(iii) unit of a business trust; (iv) foreign currency denominated equity share of a company; (v) unit of Alternative Investment Fund; (vi) Bullion Depository Receipt with underlying bullion (vii) unit of investment trust, being REITs or an InvITs; (viii) unit of a scheme (a scheme of a fund management entity launched under IFSC Authority (Fund Management) Regulations, 2022); (ix) unit of a Exchange Traded Fund launched under IFSC Authority (Fund Management) Regulations, 2022 which are listed on a recognised stock	

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		exchange located in any IFSC in accordance with the regulations made by the SEBI under the SEBI Act 1992 or the IFSC Authority under the IFSC Authority Act 2019, as the case may be.	
47(viiac)	Any transfer, in a relocation, of a capital asset by the original fund to the resulting fund	Any capital asset	-
47(viiad)	Any transfer by a shareholder or unit holder or interest holder of original fund, in a relocation of fund.	Capital asset, being share or unit or interest held by the shareholder in the original fund	Transfer of capital asset should be in consideration for the share or unit or interest in the resultant fund.

Original fund – Original Fund means

(A) a fund established or incorporated or registered outside India, which collects funds from its members for investing it for their benefit and fulfils the following conditions, namely-

(i) the fund is not a person resident in India;

(ii) the fund is a resident of a country or a specified territory with which an agreement referred to in section 90(1) or 90A(1) has been entered into; or is established or incorporated or registered in a country or a specified territory as may be notified by the Central Government in this behalf;

(iii) the fund and its activities are subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident; and

(iv) fulfils such other conditions as may be prescribed;

Accordingly, vide Notification No. 80/2022 dated 8.7.2022, Rule 21AL prescribes that the aggregate participation or investment in the original fund, directly or indirectly, by persons resident in India shall not exceed 5% of the corpus of such fund at the time of transfer of a capital asset to a resultant fund being a Category III AIF.

(B) an investment vehicle, in which Abu Dhabi Investment Authority is the direct or indirect sole shareholder or unit holder or beneficiary or interest holder and such investment vehicle is wholly owned and controlled, directly or indirectly, by the Abu Dhabi Investment Authority or the Government of Abu Dhabi; or

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(C) a fund notified by the Central Government subject to the conditions specified.

Relocation - Transfer of assets of the original fund, or of its wholly owned special purpose vehicle, to a resultant fund on or before ***31.3.2030***, where consideration for such transfer is discharged in the form of share or unit or interest in the resulting fund to –

(i) shareholder or unit holder or interest holder of the original fund, in the same proportion in which the share or unit or interest was held by such shareholder or unit holder or interest holder in such original fund, in lieu of their shares or units or interests in the original fund; or

(ii) the original fund, in the same proportion as referred to in (i), in respect of which the share or unit or interest is not issued by resultant fund to its shareholder or unit holder or interest holder.

Resultant fund - *A fund established or incorporated in India in the form of a trust or a company or a LLP, which is located in any IFSC as referred to in section 80LA(1A) and has been granted a certificate of registration as a Category I or Category II or Category III AIF or a certificate as a retail scheme or an Exchange Traded Fund, and is regulated under the SEBI (Alternative Investment Fund) Regulations, 2012 made under the SEBI Act, 1992 or regulated under the IFSC Authority (Fund Management) Regulations, 2022 made under the IFSC Authority Act, 2019.*

47(viiae)	Any transfer by India Infrastructure Finance Company Limited to an institution established for financing the infrastructure and development.	Any capital asset	The institution should be set up under an Act of Parliament and notified by the Central Government.
47(viiaf)	Any transfer by a public sector company to another public sector company notified by the Central Government for this purpose or to the Central Government or to a State Government.	Any capital asset	Transfer should be under a plan approved by the Central Government.
47(viib)	Any transfer of a capital asset made outside India by a non-resident to another non-resident.	Capital asset, being a Government Security carrying a periodic payment of interest.	The transfer should be through an intermediary dealing in settlement of securities.
47(viic)	Any transfer by way of redemption by an individual	Capital asset, being Sovereign Gold Bond issued by the RBI under the Sovereign Gold Bond Scheme, 2015	-

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Sovereign Gold Bond Scheme, 2015 This scheme of the Government of India is intended to reduce the demand for physical gold and consequently, reduce the foreign exchange outflow due to import of gold. The two-fold benefits of this scheme are: (1) The gold bond would serve as a substitute for physical gold; and (2) The gold bond would provide security to the individual investor investing in gold for meeting their social obligation.			
47(viid)	Any transfer of a capital asset	Capital asset, being conversion of gold into Electronic Gold Receipt issued by a Vault Manager, or conversion of Electronic Gold Receipts into gold.	Vault Manager – Any person who carries on or intends to carry on the business of providing vaulting services. Vaulting service" in relation to gold means the storage and safekeeping of gold deposited with the Vault Manager, by the depositor, for the purpose of trading in Electronic Gold Receipt and providing services incidental thereto, and includes—(i) utilizing the services of assayers empanelled with the Stock Exchanges for testing as per the gold standard, wherever required; (ii) coordination with depositories for creation, transfer and extinguishment of Electronic Gold Receipt; and (iii) providing deposit, storage and withdrawal services to the beneficial owners
47(ix)	Any transfer to the Government or to a University or the National Museum, National Art Gallery, National Archives or any other public museum or institution notified by the Central Government to be of national importance or to be of renown throughout any State	(i) work of art (ii) archaeological, scientific or art collection (iii) book (iv) manuscript (v) drawing (vi) painting	-

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		(vii) photograph or (viii) print.	
47(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	Capital asset, being bonds or debentures, debenture-stock or deposit certificates in any form, of a company	-
47(xa)	Any transfer by way of conversion of bonds into shares or debentures of any company	Capital asset, being bonds referred to in section 115AC(1)(a)	Conditions laid down in section 115AC(1) should be fulfilled i.e., Bonds should be of: (i) an Indian company (issued in accordance with Notified scheme of Central Government); or (ii) a public sector company sold by the Government and purchased by the non-resident in foreign currency
47(xb)	Any transfer by way of conversion of preference shares of a company into equity shares of that company	Conversion of preference shares of a company	-
47(xii)	Any transfer under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985, by a sick industrial company which is managed by its workers' co-operative	Land of a sick industrial company	Such transfer is made in the period commencing from the previous year in which the said company has become a sick industrial company and ending with the previous year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.
47(xiii)	- Transfer of a capital asset or intangible asset by a firm to a company on succession of the firm by a company in the business carried on by the firm - Transfer of a capital asset by AOP/BOI to company	- Any capital asset or intangible asset - Capital Asset	**Discussed in detail at the end of this table**

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	consequent to demutualisation or corporatisation of a recognised stock exchange in India		
47(xiiia)	Any transfer of a membership right by a member of 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 approved by SEBI	Capital asset, being membership right	-
47(xiiib)	- Transfer of capital asset or intangible asset by private company or unlisted public company to LLP - Transfer of shares held in the company by the shareholder as a result of conversion of the company into a LLP	- Any Capital asset or intangible asset - Capital asset, being shares in the company	**Discussed in detail at the end of this table**
47(xiv)	Transfer of capital asset or intangible asset by sole proprietary concern to a company on succession of the sole proprietary concern by the company	Capital asset or intangible asset	(i) All assets and liabilities of the sole proprietary concern relating to the business immediately before the succession should become the assets and liabilities of the company; (ii) The sole proprietor should hold not less than 50% of the total voting power in the company, and his shareholding should continue in such manner for a period of 5 years from the date of succes-sion;

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			(iii) The sole proprietor should not receive any consideration or benefit in any form, directly or indirectly, other than by way of allotment of shares in the company.
47(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 SEBI or the RBI	-	-
47(xvi)	Transfer of capital asset under Reverse Mortgage		**Discussed in detail at the end of this table**
47(xvii)	Any transfer of a capital asset to a business trust	Capital asset, being share of a special purpose vehicle	Capital asset should be transferred in exchange of units allotted by that trust to the transferor
47(xviii)	Any transfer by a unit holder in the consolidating scheme of a mutual fund	A unit or units, held by him in the consolidating scheme of a mutual fund	Transfer is made in consideration of the allotment to unit holder of a capital asset, being a unit or units, in the consolidated scheme of the mutual fund. However, this exemption would be available only if, the consolidation takes place of two or more schemes of equity oriented fund or of two or more schemes of a fund other than equity oriented fund.
47(xix)	Any transfer by a unit holder in the consolidating plan of a mutual fund scheme	A unit or units, held by him in the consolidating plan of a mutual fund scheme	Transfer should be made in consideration of the allotment to unit holder of a capital asset, being a unit or units, in the consolidated plan of that scheme of the mutual fund.

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Consolidating scheme - The scheme of a mutual fund which merges under the process of consolidation of the schemes of mutual fund in accordance with the SEBI (Mutual Funds) Regulations, 1996 made under SEBI Act, 1992. **Consolidated scheme -** The scheme with which the consolidating scheme merges or which is formed as a result of such merger. **Consolidating plan -** The plan within a scheme of a mutual fund which merges under the process of consolidation of the plans within a scheme of mutual fund in accordance with the SEBI (Mutual Funds) Regulations, 1996 made under SEBI Act, 1992. **Consolidated plan -** The plan with which the consolidating plan merges or which is formed as a result of such merger. **Mutual Fund -** A mutual fund specified under section 10(23D), i.e., (i) a Mutual Fund registered under the SEBI Act, 1992 or regulations made thereunder; (ii) such other Mutual Fund set up by a public sector bank or a public financial institution or authorised by the Reserve Bank of India and subject to conditions notified by the Central Government.			
47(xx)	Any transfer of a capital asset held by a public sector company	Capital asset, being an interest in a joint venture.	Transfer should be in exchange of shares of a company incorporated outside India by the Government of a foreign State, in accordance with the laws of that foreign State. "Joint venture" means a business entity, as may be notified by the Central Government.

ILLUSTRATION 2

M held 2000 shares in a company ABC Ltd. This company amalgamated with another company during the previous year ending 31-3-2026. Under the scheme of amalgamation, M was allotted 1000 shares in the new company. The market value of shares allotted is higher by ₹ 50,000 than the value of holding in ABC Ltd.

The Assessing Officer proposes to treat the transaction as an exchange and to tax ₹ 50,000 as capital gain. Is he justified?

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SOLUTION

In the above example, assuming that the amalgamated company is an Indian company, the transaction is squarely covered by the exemption under section 47(vii) and the proposal of the Assessing Officer to treat the transaction as an exchange is not justified.

Transfer of capital asset or intangible asset on succession of the firm by a company or by AOP/ BOI to company consequent to demutualisation or corporatisation of a recognised stock exchange [Section 47(xiii)]:

Any transfer of a capital asset or intangible asset (in the case of a firm) –

(i) by a firm to a company where such firm is succeeded by that company; or

(ii) to a company in the course of demutualisation or corporatisation of a recognised stock exchange in India as a result of which an AOP or BOI is succeeded by that company.

Conditions –

(i) All assets and liabilities of the firm or AOP or BOI relating to the business immediately before the succession become the assets and liabilities of the company;

(ii) All the partners of the firm immediately before the succession become the shareholders of the company in the same the proportion in which their capital accounts stood in the books of the firm on the date of succession;

(iii) The partners of the firm do not receive any consideration or benefit in any form, directly or indirectly, other than by way of allotment of shares in the company;

(iv) The partners of the firm together hold not less than 50% of the total voting power in the company, and their shareholding continues in such manner for a period of 5 years from the date of succession;

(v) The demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation approved by SEBI.

Transfer of capital asset or intangible asset by private company and share held by shareholder to LLP in a conversion of private company into a LLP [Section 47(xiiib)]:

(i) Any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP or

(ii) Any transfer of a share or shares held in a company by a shareholder on conversion of a company into a LLP

in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008.

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Conditions –

(i) All assets and liabilities of the company immediately before the conversion become the assets and liabilities of the LLP;

(ii) all the shareholders of the company immediately before the conversion become partners of the LLP and their capital contribution and profit sharing ratio in the LLP are in the same proportion as their shareholding in the company on the date of conversion;

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

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

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

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

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

Transfer of capital asset under Reverse Mortgage [Section 47(xvi)]:

Any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government.

The Reverse Mortgage scheme is for the benefit of senior citizens, who own a residential house property. In order to supplement their existing income, they can mortgage their house property with a scheduled bank or housing finance company, in return for a lump-sum amount or for a regular monthly/ quarterly/ annual income. The senior citizens can continue to live in the house and receive regular income, without the botheration of having to pay back the loan.

The loan will be given up to, say, 60% of the value of residential house property mortgaged. Also, the bank/housing finance company would undertake a revaluation of the property once every 5 years. The borrower can use the loan amount for renovation and extension of residential property, family's medical and emergency expenditure etc., amongst others. However, he cannot use the amount for speculative or trading purposes.

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The Reverse Mortgage Scheme, 2008, includes within its scope, disbursement of loan by an approved lending institution, in part or in full, to the annuity sourcing institution, for the purposes of periodic payments by way of annuity to the reverse mortgagor. This would be an additional mode of disbursement i.e., in addition to direct disbursements by the approved lending institution to the Reverse Mortgagor by way of periodic payments or lump sum payment in one or more tranches.

An annuity sourcing institution has been defined to mean Life Insurance Corporation of India or any other insurer registered with the Insurance Regulatory and Development Authority.

Maximum Period of Reverse Mortgage Loan:

	Mode of disbursement	Maximum period of loan
(a)	Where the loan is disbursed directly to the Reverse Mortgagor	20 years from the date of signing the agreement by the reverse mortgagor and the approved lending institution.
(b)	Where the loan is disbursed, in part or in full, to the annuity sourcing institution for the purposes of periodic payments by way of annuity to the Reverse Mortgagor	The residual life time of the borrower.

The bank will recover the loan along with the accumulated interest by selling the house after the death of the borrower. The excess amount will be given to the legal heirs. However, before resorting to sale of the house, preference will be given to the legal heirs to repay the loan and interest and get the mortgaged property released.

Therefore, section 47(xvi) clarifies that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government would not amount to a transfer for the purpose of capital gains.

Exemption of income received in a transaction of reverse mortgage [Section 10(43)]: Section 10(43), further, provides that the amount received by the senior citizen as a loan, either in lump sum or in instalments, in a transaction of reverse mortgage would be exempt from income-tax.

Capital gains tax liability would be attracted only at the stage of alienation of the mortgaged property by the bank/ housing finance company for the purposes of recovering the loan.

ILLUSTRATION 3

In which of the following situations capital gains tax liability does not arise?

(i) Mr. A purchased gold in 1970 for ₹ 25,000. In the P.Y. 2025-26, he gifted it to his son at the time of marriage. Fair market value (FMV) of the gold on the day the gift was made was ₹ 1,00,000.

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(ii) A house property is purchased by a Hindu undivided family in 1945 for ₹ 20,000. It is given to one of the family members in the P.Y. 2025-26 at the time of partition of the family. FMV on the day of partition was ₹ 12,00,000.

(iii) Mr. B purchased 50 convertible debentures for ₹ 40,000 in 1995 which are converted into 500 shares worth ₹ 85,000 in November 2025 by the company.

SOLUTION

We know that capital gains arise only when we transfer a capital asset. The liability of capital gains tax in the situations given above is discussed as follows:

(i) As per the provisions of section 47(iii), transfer of a capital asset by an individual under a gift is **not** regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

(ii) As per the provisions of section 47(i), transfer of a capital asset (being in kind) on the total or partial partition of Hindu undivided family is **not** regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

(iii) As per the provisions of section 47(x), transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form of a company into shares or debentures of that company is **not** regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

ILLUSTRATION 4

Mr. Abhishek a senior citizen, mortgaged his residential house with a bank, under a notified reverse mortgage scheme. He was getting loan from bank in monthly installments. Mr. Abhishek did not repay the loan on maturity and hence gave possession of the house to the bank, to discharge his loan. How will the treatment of long-term capital gain be on such reverse mortgage transaction?

SOLUTION

Section 47(xvi) provides that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government shall not be considered as a transfer for the purpose of capital gain.

Accordingly, the mortgaging of residential house with bank by Mr. Abhishek will not be regarded as a transfer. Therefore, no capital gain will be charged on such transaction.

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Further, section 10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in instalment, in a transaction of reverse mortgage would be exempt from income-tax. Therefore, the monthly instalment amounts received by Mr. Abhishek would not be taxable.

However, capital gains tax liability would be attracted at the stage of alienation of the mortgaged property by the bank for the purposes of recovering the loan.

4.10 WITHDRAWAL OF EXEMPTION IN CERTAIN CASES

Section 47A provides for withdrawal of the benefit of exemption given by section 47 in certain cases.

(1) Conditions for transfer of capital asset by holding to its wholly owned subsidiary and *vice versa* [Section 47(iv) or 47(v)]: As noted above, capital gains arising from the transfer of a capital asset by a company to its wholly owned subsidiary company is exempt from tax.

Similarly, capital gains arising from the transfer of a capital asset by the subsidiary company to its 100% holding company is also exempt from tax, provided under both circumstances the transferee is an Indian company.

Section 47A provides that the above exemption will be withdrawn if at any time before the expiry of 8 years from the date of transfer of a capital asset referred to above

(1) such capital asset is converted by the transferee company or is treated by it as stock-in-trade of its business; or

(2) the parent company or its nominees ceases to hold the whole of the share capital of the subsidiary company.

In the above two cases, the amount of capital gains exempt from tax by virtue of the provisions contained in section 47 will be deemed to be the income of the transferor company chargeable under the head 'capital gains' of the year in which such transfer took place.

(2) Transfer of membership of a recognised stock exchange for shares [Section 47(xi)]: Capital gains not charged to tax under clause (xi) of section 47 shall be deemed to be the income chargeable under the head "capital gains" of the previous year in which such transfer took place if the shares of the company received in exchange for transfer of membership in a recognised stock exchange, are transferred at any time before the expiry of 3 years from the date of such transfer.

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(3) **Transfer of capital asset or intangible asset on succession of firm/ sole proprietary concern by a company [Section 47(xiii) or 47(xiv)]**: Where any of the conditions laid down in section 47(xiii) or (xvi), as the case may be, for succession of a firm or sole proprietary concern by a company are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset shall be deemed to be the profits and gains **chargeable to tax of the successor company** for the previous year in which the conditions are not complied with.

(4) **Transfer of capital asset or intangible asset by private company or unlisted public company and share held by shareholder to LLP in a conversion of private company or unlisted public company by a LLP [Section 47(xiiib)]**: If subsequent to the conversion of a private company or unlisted company into an LLP, any of the conditions laid down in section 47(xiiib) are not complied with, the capital gains not charged under section 45 would be deemed to be chargeable to tax in the previous year in which the conditions are not complied with, **in the hands of the LLP or the shareholder of the predecessor company**, as the case may be.

4.11 MODE OF COMPUTATION OF CAPITAL GAINS [SECTION 48]

(1) **Computation of capital gains:** The income chargeable under the head 'capital gains' shall be computed by deducting the following items from the full value of the consideration received or accruing as a result of the transfer of the capital asset:

(i) Expenditure incurred wholly and exclusively in connection with such transfer like, brokerage, stamp duty, registration fee, legal expenses etc.

(ii) The cost of acquisition and cost of any improvement thereto.

However, the cost of acquisition of the asset or the cost of improvement thereto would not include the deductions claimed in respect of interest u/s 24(b) or under the provisions of Chapter VI-A.

Deduction from cost of acquisition of a unit of a business trust - The cost of acquisition of a unit of a business trust **has to be reduced -**

- by any sum received by a unit holder from the business trust with respect to such unit, **which is not in the nature of interest and dividend** referred to in section 10(23FC) or **rental income** referred to in section 10(23FCA) and

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- which **is not chargeable to tax in the hands of unit holders** under section 56(2)(xii) and **in the hands of business trust** under section 115UA(2).

However, where transaction of transfer of a unit is not considered as transfer under section 47 and cost of acquisition of such unit is determined under section 49, sum received with respect to such unit before such transaction as well as after such transaction has to be reduced from the cost of acquisition.

(iii) in case of value of any money or capital asset received by a specified person from a specified entity referred to in section 45(4), **the amount chargeable to income-tax as income of such specified entity** under that section **which is attributable to the capital asset being transferred by the specified entity**, calculated in the prescribed manner ***[The manner of attribution is prescribed under Rule 8AB, which was discussed in earlier paras along with section 45(4)]***.

(2) No deduction in respect of STT paid: No deduction, however, shall be allowed in computing the income chargeable under the head "Capital Gains" in respect of any amount paid on account of securities transaction tax under Chapter VII of the Finance (No.2) Act, 2004.

(3) Cost inflation index: Under section 48, the cost of acquisition and cost of improvement will be increased by applying the cost inflation index (CII). Once the cost inflation index is applied to the cost of acquisition and cost of improvement, it becomes indexed cost of acquisition and indexed cost of improvement.

"Cost Inflation Index" in relation to a previous year means such index as may be notified by the Central Government having regard to 75% of average rise in the Consumer Price Index (Urban) for the immediately preceding previous year to such previous year.

Indexed cost of acquisition means an amount which bears to the cost of acquisition, the same proportion as CII for the year in which the asset is transferred bears to the CII for the first year in which the asset was held by the assessee or for the year beginning on 1st April, 2001, whichever is later.

Similarly, indexed cost of any improvement means an amount which bears to the cost of improvement, the same proportion as CII for the year in which the asset is transferred bears to the CII for the year in which the improvement to the asset took place.

Indexation benefit was available while computing long-term capital gains arising on transfer long-term capital assets before 23.7.2024.

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While computing tax liability u/s 112, option of taking indexation benefit is available to an individual or HUF, resident in India on transfer of long term capital asset, being land or building or both which is acquired before 23.7.2024:

A resident individual or HUF, while computing tax on LTCG on transfer of land or building or both, has the option to take the benefit of indexation under section 112 in respect of long-term capital gains arising on transfer of land or building or both which is acquired before 23.7.2024.

Accordingly, LTCG on transfer of such land or building or both are subject to lower of tax

- @12.5% on LTCG computed without indexation benefit or
- @20% on LTCG computed with indexation benefit.

It may be noted that this benefit to a resident individual or HUF is to be given only while computing tax on LTCG under section 112 on transfer of land or building or both and not while computing Income under the head "Capital Gains" which would form part of gross total income/total income. Thus, for computing income under the head "Capital Gains" to be included in gross total income, indexation benefit is **not** to be given.

The cost inflation indices for the financial years so far have been notified as under:

Financial Year	Cost Inflation Index
2001-02	100
2002-03	105
2003-04	109
2004-05	113
2005-06	117
2006-07	122
2007-08	129
2008-09	137
2009-10	148
2010-11	167
2011-12	184
2012-13	200
2013-14	220
2014-15	240
2015-16	254

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2016-17	264
2017-18	272
2018-19	280
2019-20	289
2020-21	301
2021-22	317
2022-23	331
2023-24	348
2024-25	363
2025-26	***376***

(4) **Full value of consideration of shares, debentures or warrants issued under ESOP in case of transfer under a gift etc. upto A.Y. 2024-25 -** In case where shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees' Stock Option Plan or Scheme in accordance with the guidelines issued in this behalf by the Central Government are transferred under a gift or irrecoverable trust, then 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 of such asset.

(5) **Special provision for non-residents -** In case of non-residents who invest foreign exchange to acquire capital assets, capital gains arising from the transfer of shares or debentures of an Indian company is to be computed in the following manner:

- The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares were acquired. The conversion has to be done at the average of Telegraphic Transfer Buying Rate (TTBR) and Telegraphic Transfer Selling Rate (TTSR) on the respective dates.
- The resulting capital gains shall be reconverted into Indian currency by applying the TTBR on the date of transfer.

The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures of an Indian company. This will provide relief from risk of foreign currency fluctuation to non-residents. Rule 115A is relevant for this purpose.

Note – *Refer to Chapter 21: Non-resident Taxation of Module 4 where Rule 115A is detailed.*

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On long-term capital gains arising from transfer of unlisted securities or shares of a company in which public are not substantially interested, non-residents and foreign companies are subject to tax at a concessional rate of @12.5% (without currency conversion) [Section 112].

Rupee Denominated Bonds (RDBs)

As a measure to enable Indian companies to raise funds from outside India, the RBI has permitted them to issue rupee denominated bonds outside India. Accordingly, in case of non-resident assessees, any gains arising on account of appreciation of rupee between the date of purchase and the date of redemption of rupee denominated bond of an Indian company held by him against foreign currency in which investment is made shall not be included in computation of full value of consideration. This would provide relief to the non-resident investor who bears the risk of currency fluctuation.

Note – *The benefit of currency fluctuation would* ***not*** *be applicable to the long-term capital gains arising from the transfer of the following assets referred to in section 112A –*

(i) equity share in a company on which STT is paid both at the time of acquisition and transfer

(ii) unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.

4.12 ASCERTAINMENT OF COST IN SPECIFIED CIRCUMSTANCES [SECTION 49]

A person becomes the owner of a capital asset not only by purchase but also by several other methods. Section 49 gives guidelines as to how to compute the cost under different circumstances.

Section	Circumstance	Cost of acquisition
49(1)	**Cost to previous owner deemed as cost of acquisition of asset:**	
	Where the capital asset became the property of the assessee: (i) on any distribution of assets on the total or partition of a HUF; (ii) under a gift or will by an individual or HUF (by any person upto 31.3.2024); (iii) by succession, inheritance or devolution;	Cost for which the previous owner of the property acquired it. ***Notes*** – ***Cost of improvement*** *– To the cost of acquisition, the cost of improvement to the asset, incurred*

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	(iv) on any distribution of assets on the liquidation of a company; (v) under a transfer to revocable or an irrevocable trust; (vi) under any transfer of capital asset by a holding company to its wholly owned subsidiary Indian company or by a subsidiary company to its 100% holding Indian company, referred to in section 47(iv) and 47(v), respectively; (vii) under any transfer referred to in section 47(vi) of a capital asset by amalgamating company to the amalgamated Indian company, in a scheme of amalgamation; (viii) under any transfer referred to in section 47(via) of shares held in an Indian company, in a scheme of amalgamation, by amalgamating foreign company to the amalgamated foreign company; (ix) under any transfer referred to in section 47(viaa) by a banking company to the banking institution, in a scheme of amalgamation of the banking company with a banking institution; (x) under any transfer of a capital asset, being a share of a foreign company, which derives directly or indirectly its value substantially from the share(s) of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, in the scheme of amalgamation referred to under section 47(viab); (xi) under any transfer referred to in section 47(vib), of a capital asset by the demerged company to the resulting Indian company, in a scheme of demerger; (xii) by any transfer of a capital asset, being share(s) held in an Indian company, by the demerged foreign company to the resulting foreign company, in a scheme of demerger referred to in section 47(vic);	*by the previous owner or the assessee on or after 1.4.2001 must be added.* ***Period of holding*** *- It may be noted that section 2(42A) provides that in all such cases, for determining the period for which the capital asset is held by the transferee, the period of holding of the asset by the previous owner shall also be considered.* ***Benefit of indexation*** *- The Bombay High Court, in CIT v. Manjula J. Shah 16 Taxman 42, held that the indexed cost of acquisition in case of gifted asset has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.* *As per the plain reading of the provisions of section 48, however, the indexed cost of acquisition would be determined by taking CII for the year in which asset is first held by the assessee.* *The benefit of indexation can be opted by a resident individual or HUF while computing tax liability u/s 112 only for long-term capital assets, being land or building or both which are acquired before 23.7.2024.*

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	(xiii) by any transfer of a capital asset in a business reorganization under section 47(vica), by the predecessor co-operative bank to the successor co-operative bank; (xiv) by any transfer by a shareholder, in a business reorganisation referred to under section 47(vicb), of a capital asset being a share or shares held by him in the predecessor co-operative bank, if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank; (xv) by transfer of a capital asset, being a share in a foreign company, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company in the scheme of demerger referred under section 47(vicc); (xvi) by any transfer referred to in section 47(viiac), in a relocation, of a capital asset by the original fund to the resulting fund; (xvii) under any transfer referred to in section 47(viiad) by a shareholder or unit holder or interest holder, in a relocation, of a capital asst being a share or unit or interest held by him in the original fund in consideration for the share or unit or interest in the resultant fund; (xviii)under any transfer referred to in section 47(viiae) of capital asset by India Infrastructure Finance Company Limited to an institution established for financing the infrastructure and development, set up under any Act of Parliament and notified by the Central Government; (xix) under any transfer referred to in section 47(viiaf) of a capital asset, under a plan approved by the Central Government, by a public sector company to another public sector company notified by the Central	

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	Government for this purpose or to the Central Government or to a State Government; (xx) by any transfer of capital asset or intangible asset on succession of a firm by a company in a business carried on by it or any transfer of a capital asset on succession of an AOP/BOI by a company on demutualisation or corporatisation of a recognized stock exchange referred to in section 47(xiii); (xxi) under any transfer under section 47(xiiib) of a capital asset or intangible asset by a private company or unlisted public company to a LLP; (xxii) by any transfer of capital asset or intangible asset on succession of a sole proprietorship concern by a company in a business carried on by it, fulfilling the conditions mentioned in section 47(xiv); (xxiii) by conversion by an individual of his separate property into a HUF property, by the mode referred to in section 64(2).	
49(2)	**Shares received under the scheme of amalgamation**	
	Where shares in an amalgamated company which is an Indian company become the property of the assessee in consideration of the transfer of shares referred to in section 47(vii) held by him in the amalgamating company under a scheme of amalgamation	The cost of acquisition to him of the shares in the amalgamated company shall be taken as the cost of acquisition of the shares in the amalgamating company. This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB [Section 49(2E)].
49(2A)	**Shares or debentures received during the process of conversion of bonds or debentures, debenture stock or deposit certificates**	
	Where a person becomes the owner of shares or debentures in a company during the process of conversion of bonds or debentures, debenture stock or deposit certificates referred under section 47(x).	That part of the cost of debentures, debenture stock, bond or deposit certificate in relation to which such asset (shares or debentures) is acquired by that person.

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49(2AA)	**Specified security or sweat equity shares**	
	Where the capital gain arises from the transfer of specified security or sweat equity shares referred to in section 17(2)(vi)	Fair market value which has been taken into account for perquisite valuation.
49(2AAA)	**Rights received in a firm by shareholders on conversion of private or unlisted public company into LLP**	
	Where a shareholder of a company receives rights in a partnership firm as consideration for transfer of shares on conversion of a company into a LLP referred to in section 47(xiiib)	The cost of acquisition of the capital asset being rights of a partner referred to in section 42 of the LLP Act, 2008 shall be deemed to be the cost of acquisition to him of the shares in the predecessor company, immediately before its conversion.
49(2ABB)	**Shares acquired on redemption of Global Depository Receipts**	
	Where the capital asset, being share or shares of a company is acquired by a non-resident on redemption of GDR referred to in section 115AC(1)(b) held by such assessee	The cost of acquisition of the share or shares would be the price of such share or shares prevailing on any recognized stock exchange on the date on which a request for such redemption was made.
49(2AC)	**Unit of business trust in consideration of shares of a special purpose vehicle**	
	Where the capital asset, being unit of a business trust, became the property of the assessee in consideration of transfer of shares of a special purpose vehicle as referred to in section 47(xvii)	The cost of acquisition of the unit would be deemed to be the cost of acquisition of the shares to him.
49(2AE)	**Equity shares received at the time of conversion of preference shares**	
	Where equity shares of a company, became the property of the assessee in consideration of transfer by way of conversion of preference shares of the company [Section 47(xb)]	That part of the cost of the preference share in relation to which such equity shares are acquired by the assessee.
49(2AF)	**Units acquired under consolidated plan of Mutual Fund scheme**	
	Where the capital asset, being a unit or units in a consolidated plan of a mutual fund scheme, became the property of the assessee in consideration of a transfer referred to in section 47(xix)	The cost of acquisition of the asset shall be deemed to be the cost of acquisition to him of the unit or units in the consolidating plan of the scheme of the mutual fund.

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49(2AG)/ 49(2AH)	**A unit or units in the segregated portfolio**	
	In case of segregated portfolio	The cost of acquisition of a unit or units in the segregated portfolio shall be the amount which bears, to the cost of acquisition of a unit or units held by the assessee in the total portfolio, the same proportion as the net asset value of the asset transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios. The cost of the acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the amount as so arrived at under sub-section (2AG)

Term	Meaning
Main portfolio	the scheme portfolio excluding the segregated portfolio
Segregated portfolio	a portfolio, comprising of debt or money market instrument affected by a credit event, that has been segregated in a mutual fund scheme
Total portfolio	the scheme portfolio including the securities affected by the credit event

SEBI has, vide circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018, permitted creation of segregated portfolio of debt and money market instruments by Mutual Fund schemes. As per the SEBI circular, all the existing unit holders in the affected scheme as on the day of the credit event i.e. downgrade in credit rating by a SEBI registered Credit Rating Agency (CRA), shall be allotted equal number of units in the segregated portfolio as held in the main portfolio. On segregation, the unit holders come to hold same number of units in two schemes – the main scheme and segregated scheme.

49(2AI)	**Shares of a company incorporated outside India by the Government of a foreign State, in accordance with the laws of that foreign State**	
	Where the capital asset, being shares of a company incorporated outside India by the Government of a foreign State, in accordance with the laws of that foreign State as referred to in section 47(xx), became the property of the assessee	The cost of acquisition of such asset would be deemed to be the cost of acquisition to it of the interest in the joint venture.

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49(2C)	**Shares received in the resulting company in the scheme of demerger**	
	In case of demerger	The cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.
		Cost of acquisition of shares in the resulting company = $A \times \frac{B}{C}$ A = Cost of acquisition of shares held in the demerged company B = Net book value of the assets transferred in a demerger C = Net worth of the demerged company i.e., the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.
	"Net worth" means the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.	
49(2D)	**Shares held in the demerged company**	
	In case of demerger	The cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived under the sub-section (2C). The provisions of section 49(2C) and 49(2D) also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB.

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49(3)	**Capital asset transferred by holding company to its wholly owned subsidiary Indian company or *vice a versa*, in case of attraction of section 47A**	
	Where the capital gain arising from the transfer of a capital asset referred to in section 47(iv) or section 47(v) is deemed to be income chargeable under the head "Capital gains" by virtue of the provisions contained in section 47A	The cost of acquisition of such asset to the transferee-company shall be the cost for which such asset was acquired by it.
49(4)	**Property subject to tax under section 56(2)(x)**	
	Where the capital gain arises from the transfer of such property which has been subject to tax under section 56(2)(x)	The value taken into account for the purposes of section 56(2)(x).
49(6)	**Specified capital asset referred under clause (c) of the *Explanation* to section 10(37A) [Refer diagram at the end of this table]**	
	Where the capital gain arises from the transfer of a reconstituted plot or land, (received by the assessee in lieu of land or building or both transferred under the Land Pooling Scheme of Andhra Pradesh) which has been transferred after the expiry of 2 years from the end of the financial year in which the possession of such plot or land was handed over to the assessee	The cost of acquisition of such reconstituted plot or land shall be deemed to be its stamp duty value as on the last day of the second financial year after the end of the financial year in which the possession of the said plot or land was handed over to the assessee.
	Exemption in respect of capital gains arising on transfer of Specified Capital Assets under the Land Pooling Scheme notified under the provisions of Andhra Pradesh Capital Region Development Authority Act, 2014 [Section 10(37A)] ♦ As per section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2014, the specified compensation received by the landowner in lieu of acquisition of land is exempt from income tax. The Land Pooling Scheme is an alternative form of arrangement made by the Government of Andhra Pradesh for formation of new capital city of Amaravati to avoid land acquisition disputes and lessen the financial burden associated with payment of compensation under that Act. ♦ In Land Pooling Scheme, the compensation in the form of reconstituted plot or land is provided to land owners. However, the existing provisions of the	

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	Act do not provide for exemption from tax on transfer of land under the land pooling scheme as well as on transfer of Land Pooling Ownership Certificates (LPOCs) or reconstituted plot or land. With a view to provide relief to an individual or Hindu undivided family who was the owner of such land as on 2nd June, 2014, and has transferred their land under the Land Pooling Scheme notified under the provisions of Andhra Pradesh Capital Region Development Authority Act, 2014, clause (37A) of section 10 provides that in respect of said persons, capital gains arising from the transfer of the specified capital assets shall not be chargeable to tax under the Act: **Meaning of Specified Capital Asset:** Specified Capital Assets means - the land or building or both owned by the assessee as on 2nd June, 2014 and which has been transferred under the land pooling scheme; or - the land pooling ownership certificate (LPOC) issued to the assessee in lieu of transferred land or building or both or - the reconstituted plot or land, as the case may be received by the assessee in lieu of land or building or both in accordance with the scheme, if such plot or land, as the case may be, so received is transferred within two years from the end of the financial year in which the possession of such plot or land was handed over to him.	
49(7)	**Capital asset, being share in the project referred under section 45(5A)**	
	Where the capital gain arises from the transfer of a capital asset, being share in the project, in the form of land or building or both, referred to in section 45(5A) which is chargeable to tax in the previous year in which the completion of certificate for the whole or part of the project is issued by the competent authority)	The cost of acquisition of such asset, would be the amount which is deemed as full value of consideration in that sub-section i.e., stamp duty value on the date of issue of certificate of completion plus cash consideration. However, this does not apply to a capital asset, being share in the project which is transferred on or before the date of issue of said completion certificate.
49(8)	**Capital assets of entities in case of levy of tax on accreted income under section 115TD**	
	Where the capital gain arises from the transfer of an asset, being the asset held	The cost of acquisition of such asset shall be deemed to be the fair market value of the asset which has been

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	by a trust or an institution in respect of which accreted income has been computed, and the tax has been paid thereon in accordance with the provisions relating to tax on accreted income of certain trusts and institutions under Chapter XII-EB	taken into account for computation of accreted income as on the specified date referred to in section 115TD(2). ***Note:*** *Refer to Chapter 10 on "Assessment of Trusts and Institutions, Political Parties and Other Special Entities" for understanding the concept of related income.*
49(9)	**Capital asset which was used by the assessee as an inventory before its conversion into capital asset**	
	Where the capital gain arises from the transfer of a capital asset which was used by the assessee as inventory earlier before its conversion into capital asset	The fair market value of the inventory as on the date on such conversion determined in the prescribed manner
49(10)	**Capital asset, being an Electronic Gold Receipt or Gold**	
	Where a capital asset, being an Electronic Gold Receipt issued by a Vault Manager became the property of the person as consideration for transfer of gold [Section 47(viid)]	The cost of gold in the hands of the person in whose name Electronic Gold Receipt is issued.
	Where gold is released against an Electronic Gold Receipt, which became the property of the person as consideration for transfer of Electronic Gold Receipt [Section 47(viid)]	The cost of the Electronic Gold Receipt in the hands of such person.

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Taxability/ Exemption of Capital Gains arising on transfer of Specified Capital Assets

ILLUSTRATION 5

Neerja was carrying on the textile business under a proprietorship concern, Neerja Textiles. On 30.12.2025 the business of Neerja Textiles was succeeded by New Look Textile Private Limited and all the assets and liabilities of Neerja Textiles on that date became the assets and liabilities of New Look Textile Private Limited and Neerja was given 52% share in the share capital of the company. No other consideration was given to Neerja on account of this succession.

The assets and liabilities of Neerja Textiles transferred to the company include an urban land which was acquired by Neerja on 19.7.2013 for ₹ 9,80,000. The company sold the same on 30.03.2026 for ₹ 16,00,000.

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Examine the tax implication of the above-mentioned transaction and compute the income chargeable to tax in such case(s).

Cost Inflation Index: F.Y. 2013-14: 220; F.Y. 2025-26: 376

SOLUTION

Taxability in case of succession of Neerja Textiles by New Look Textile Private Limited

As per provisions of section 47(xiv), in case a proprietorship concern is succeeded by a company in the business carried by it and as a result of which any capital asset or intangible asset is transferred to the company, then the same shall not be treated as transfer and will not be chargeable to capital gain tax in case the following conditions are satisfied:

(1) all the assets and liabilities of sole proprietary concern becomes the assets and liabilities of the company.

(2) the shareholding of the sole proprietor in the company is not less than 50% of the total voting power of the company and continues to remain as such for a period of 5 years from the date of succession.

(3) the sole proprietor does not receive any consideration or benefit in any form from the company other than by way of allotment of shares in the company.

In the present case, all the conditions mentioned above are satisfied therefore, the transfer of capital asset by Neerja Textiles to New Look Textile Private Limited shall not attract capital gain tax provided Neerja continues to hold 50% or more of voting power of New Look Textiles Private Limited for a minimum period of 5 years.

Taxability in case of transfer of land by New Look Textile Private Limited

As per the provisions of section 49(1) and *Explanation 1* to section 2(42A), in case a capital asset is transferred in the circumstances mentioned in section 47(xiv), the cost of the asset in the hands of the company shall be the cost of the asset in the hands of the sole proprietor. Consequently, for the determining the period of holding of the asset, the period for which the asset is held by the sole proprietor shall also be considered.

Therefore, in the present case, the urban land shall be a long-term capital asset since it is held for more than 24 months by New Look Textile Private Limited and Neerja Textiles taken together. Cost of acquisition of land in the hands of the company shall be ₹ 9,80,000 i.e., the purchase cost of the land in the hands of Neerja.

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Computation of capital gain chargeable to tax in the hands of New Look Textile Private Ltd.

Particulars	₹
Net Sale Consideration	16,00,000
Less: Cost of acquisition	9,80,000
Long-term capital gain	6,20,000

***Note**: Indexation benefit would not be available to New Look Textile Private Ltd. since transfer took place on or after 23.7.2024.*

4.13 COST OF ACQUISITION [SECTION 55(2)]

Cost of acquisition is the price that the assessee has paid, or the amount that the assessee has incurred, for acquisition of the asset. Expenses incurred for completing the title are a part of the cost of acquisition. For eg: Stamp duty.

Cost of acquisition in relation to the following assets is as follows:

(1) Goodwill of a business or profession or a trademark or brand name associated with a business or profession or any other intangible asset or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession, tenancy rights, stage carriage permits and loom hours, or any other right

(i) In case of acquisition from previous owner: In the case of the above capital assets, if the assessee has purchased them from a previous owner, the cost of acquisition means the amount of the purchase price.

> ***Example:***
>
> *If A purchases a stage carriage permit from B for ₹ 2 lakhs, ₹ 2 lakhs will be the cost of acquisition for A.*

However, in case of a capital asset, being goodwill of a business or profession, in respect of which depreciation under section 32(1) has been obtained by the assessee in any previous year (upto P.Y.2019-20), the cost of acquisition of such goodwill would be the amount of the purchase price as reduced by the total amount of depreciation (upto P.Y.2019-20) obtained by the assessee under section 32(1).

(ii) In case of circumstances mentioned under section 49(1)(i)/(ii)/(iii)/(iv): In cases where the capital asset became the property of the assessee by any of the following modes from the previous owner, and such capital assets were acquired by the

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previous owner by purchase, cost of acquisition to the assessee will be the amount of the purchase price for such previous owner:-

(1) On any distribution of assets on the total or partial partition of a Hindu undivided family.

(2) Under a gift or will by an individual or HUF (Upto A.Y. 2024-25, gift or will by any person).

(3) By succession, inheritance or devolution.

(4) On any distribution of assets on the liquidation of a company.

(5) Under a transfer to a revocable or an irrevocable trust.

(6) Under any transfer of a capital asset referred to in section 47(iv)/(v)/(vi)/(via)/(via)/(viaa)/(viab)/(vib)/(vic)/(vica)/(vicb)/(vicc)/(viiac)/(viiad)/(viiae)/(viiaf)/(xiii)/(xiiib)/(xiv)

(7) Where the assessee is a Hindu undivided family, by the mode referred to in section 64(2) i.e., conversion of self-acquired property of a member of a HUF into the property of the HUF (For details, read Chapter 6).

However, in case of a capital asset, being goodwill of a business or profession, in respect of which depreciation under section 32(1) has been obtained by **the assessee** in any previous year (upto P.Y.2019-20), the cost of acquisition of such goodwill would be the amount of the purchase price for such previous owner as reduced by the total amount of depreciation (upto P.Y.2019-20) obtained by **the assessee** under section 32(1).

(iii) **In any other case [i.e., in case of self-generated assets]**: In case of self-generated assets namely, goodwill of a business or profession or a trademark or brand name associated with a business or profession or any other intangible asset or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession, tenancy rights, stage carriage permits, or loom hours, or any other right, the cost of acquisition will be taken to be Nil.

(2) **Financial assets** - Many a time, persons who own shares or other securities become entitled to subscribe to any additional shares or securities. Further, they are also allotted additional shares or securities without any payment. Such shares or securities are referred to as financial assets in Income-tax Act. Section 55 provides the basis for ascertaining the cost of acquisition of such financial assets.

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(i) **Original shares (which form the basis of entitlement of rights shares):** In relation to the original financial asset on the basis of which the assessee becomes entitled to any additional financial assets, cost of acquisition means the amount actually paid for acquiring the original financial assets.

(ii) **Rights entitlement (which is renounced by the assessee in favour of a person):** In relation to any right to renounce the said entitlement to subscribe to the financial asset, when such a right is renounced by the assessee in favour of any person, cost of acquisition shall be taken to be *nil* in the case of such assessee.

(iii) **Rights shares acquired by the assessee:** In relation to the financial asset, to which the assessee has subscribed on the basis of the said entitlement, cost of acquisition means the amount actually paid by him for acquiring such asset.

(iv) **Rights shares which are purchased by the person in whose favour the assessee has renounced the rights entitlement:** In the case of any financial asset purchased by the person in whose favour the right to subscribe to such assets has been renounced, cost of acquisition means the aggregate of the amount of the purchase price paid by him to the person renouncing such right and the amount paid by him to the company or institution for acquiring such financial asset.

(v) **Bonus Shares:** In relation to the financial asset allotted to the assessee without any payment and on the basis of holding of any other financial assets, **cost of acquisition shall be taken to be <u>nil</u> in the case of such assessee.**

In other words, where bonus shares are allotted without any payment on the basis of holding of original shares, the cost of such bonus shares will be nil in the hands of the original shareholder.

Bonus shares allotted before 01.04.2001: However, in respect of bonus shares allotted before 1.4.2001, although the cost of acquisition of the shares is nil, the assessee may opt for the fair market value as on 1.4.2001 as the cost of acquisition of such bonus shares.

Bonus shares allotted before 1.2.2018, on which STT has been paid at the time of transfer – In case of transfer of bonus shares allotted before 1.2.2018 on which STT has been paid at the time of transfer, the cost would be the higher of –

(i) **Actual cost of acquisition** (i.e., Nil, in case of bonus shares allotted on or after 1.4.2001; and FMV on 1.4.2001, in case of business shares allotted before 1.4.2001)

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(ii) Lower of –

(a) FMV as on 31.1.2018; and

(b) Actual sale consideration

(3) Equity shares received on demutualisation or corporatisation of a recognised stock exchange – In relation to equity shares allotted to a shareholder of a recognised stock exchange in India under a scheme for demutualisation or corporatisation approved by SEBI, the cost of acquisition of such shares shall be the cost of acquiring his original membership of the exchange.

(4) Clearing or trading right acquired on demutualisation or corporatisation of a recognised stock exchange – The cost of a capital asset, being trading or clearing rights of a recognised stock exchange acquired by a shareholder (who has been allotted equity share or shares under such scheme of demutualisation or corporatisation), shall be deemed to be nil.

(5) Long-term capital assets referred to in section 112A

The cost of acquisition in relation to the long-term capital assets being,

- equity shares in a company on which STT is paid both at the time of purchase and transfer or
- unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.

acquired before 1st February, 2018 shall be the higher of

(i) cost of acquisition of such asset; and

(ii) lower of

(a) the fair market value of such asset; and

(b) the full value of consideration received or accruing as a result of the transfer of the capital asset.

Meaning of Fair Market Value:

S.No.	Circumstance	Fair Market Value
(i)	In a case where the capital asset is listed on any recognised stock exchange as on 31.01.2018	**<u>If there is trading in such asset on such exchange on 31.01.2018</u>** The highest price of the capital asset quoted on such exchange on the said date

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		<u>If there is no trading in such asset on such exchange on 31.01.2018</u> The highest price of such asset on such exchange on a date immediately preceding 31.01.2018 when such asset was traded on such exchange.
(ii)	In a case where the capital asset is a unit which is not listed on any recognised stock exchange as on 31.01.2018	The net asset value of such unit as on the said date
(iii)	In a case where the capital asset is an equity share in a company which is - not listed on a recognised stock exchange as on 31.01.2018 but listed on such exchange on the date of transfer - not listed on a recognized stock exchange as on 31.01.2018 or which became the property of the assessee in consideration of shares which is not listed on such exchange as on 31.1.2018 by way of transaction covered under section 47 but listed on such exchange subsequent to the date of transfer (where transfer is in respect of sale of unlisted equity shares under an offer for sale to the public included in an initial public offer) - listed on a recognised stock exchange on the date of transfer and which became the property of the assessee in consideration of share which is not listed on such exchange as on 31.01.2018 by way of transaction not regarded as transfer under section 47	An amount which bears to the cost of acquisition the same proportion as CII for the financial year 2017-18 bears to the CII for the first year in which the asset was held by the assessee or on 01.04.2001, whichever is later.

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(6) Any other capital asset–

(i) Where the capital asset become the property of the assessee before 1-4-2001, cost of acquisition means the cost of acquisition of the asset to the assessee or the fair market value of the asset on 1-4-2001 at the option of the assessee.

However, in case of capital asset, being land or building or both, the fair market value of such asset on 1-4-2001 shall not exceed the stamp duty value, wherever available, of such asset as on 1-4-2001.

(ii) Where the capital asset became the property of the assessee by any of the modes specified in section 49(1): The cost of acquisition to the assessee will be the cost of acquisition to the previous owner. Even in such cases, where the capital asset became the property of the previous owner before 1-4-2001, the assessee has got a right to opt for the fair market value as on 1-4-2001.

However, in case of capital asset, being land or building or both, the fair market value of such asset on 1-4-2001 shall not exceed the stamp duty value, wherever available, of such asset as on 1-4-2001.

Note: *The provisions contained in (i) & (ii) of (6) above shall also apply to the financial assets mentioned in (i) to (v) of (2) and long term capital assets referred to in section 112A of (5) above.*

(iii) Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to capital gains in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution.

(iv) A share or a stock of a company may become the property of an assessee under the following circumstances:

(a) the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares.

(b) the conversion of any shares of the company into stock,

(c) the re-conversion of any stock of the company into shares,

(d) the sub-division of any of the shares of the company into shares of smaller amount, or

(e) the conversion of one kind of shares of the company into another kind.

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In the above circumstances the cost of acquisition to the assessee will mean the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.

(7) **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.

Cost of Acquisition of assets: At a Glance

Sl. No.	Nature of asset	Cost of acquisition
1	Goodwill of business or profession, trademark, brand name or any other intangible asset etc., -	
	- Self generated	Nil
	- Acquired from previous owner	Purchase price
	However, in case of capital asset, being goodwill of a business or profession, in respect of which depreciation u/s 32(1) has been obtained by the assessee in any P.Y. (upto P.Y.2019-20)	Purchase price as reduced by the total amount of depreciation obtained by the assessee under section 32(1).
	- became the property of the assessee by way of distribution of assets on total or partial partition of HUF, under a gift or will by an individual or HUF (by any person upto 31.3.2024), by succession, inheritance, distribution of assets on liquidation of a company, etc. and previous owner has acquired it by purchase	Purchase price for such previous owner
	However, in case of capital asset, being goodwill of a business or profession which was acquired by the previous owner by purchase and in respect of which depreciation u/s 32(1) has been obtained by the assessee in any P.Y. (upto P.Y.2019-20)	Purchase price for such previous owner as reduced by the total amount of depreciation obtained by the assessee u/s 32(1).
2.	**Bonus Shares:**	
	Allotted before 1.4.2001	FMV as on 1.4.2001
	Allotted on or after 1.4.2001	Nil

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	Bonus shares allotted before 1.2.2018, on which STT has been paid at the time of transfer	The higher of – (i) Actual cost of acquisition (i.e., Nil, in case of bonus shares allotted on or after 1.4.2001; and FMV on 1.4.2001, in case of bonus shares allotted before 1.4.2001) (ii) Lower of – (a) FMV as on 31.1.2018; and (b) Actual sale consideration
3	**Right Shares:** Original shares (which form the basis of entitlement of rights shares) Rights entitlement (which is renounced by the assessee in favour of a person) Rights shares acquired by the assessee Rights shares which are purchased by the person in whose favour the assessee has renounced the rights entitlement	 Amount actually paid for acquiring the original shares Nil Amount actually paid for acquiring the rights shares Purchase price paid to the renouncer of rights entitlement as well as the amount paid to the company which has allotted the rights shares.
4.	Equity shares received on demutualisation or corporatisation of a recognised stock exchange	Cost of acquisition of such shares shall be the cost of acquiring his original membership of the exchange.
5.	Clearing or trading right acquired on demutualisation or corporatisation of a recognised stock exchange	NIL
6.	**Long term capital assets being,** - **equity shares** in a company on which STT is paid both at the time of purchase and transfer or - **unit of equity oriented fund or unit of business trust** on which STT is paid at the time of transfer, **acquired before 1st February, 2018**	Cost of acquisition shall be the higher of (i) cost of acquisition of such asset; and (ii) lower of - the fair market value of such asset; and - the full value of consideration received or accruing as a result of the transfer of the capital asset.

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7.	**Any other capital asset** Where such capital asset became the property of the assessee before 1.4.2001	Cost of the asset to the assessee, or FMV as on 1.4.2001, at the option of the assessee. However, in case of capital asset being land or building, FMV as on 1.4.2001 shall not exceed stamp duty value as on 1.4.2001.
	Where capital assets became the property of the assessee by way of distribution of assets on total or partial partition of HUF, under a gift or will by an individual or HUF (by any person upto 31.3.2024), by succession, inheritance, distribution of assets on liquidation of a company, etc. and the capital asset became the property of the previous owner before 1.4.2001	Cost to the previous owner or FMV as on 1.4.2001, at the option of the assessee. However, in case of capital asset being land or building, FMV as on 1.4.2001 shall not exceed stamp duty value as on 1.4.2001.
	The provisions contained in (7) above shall also apply to the assets mentioned in (2), (3) and (6) above.	
8.	Where cost of the property in the hands of previous owner **cannot be ascertained**	The **FMV on the date on which the capital asset become the property of the previous owner** would be considered as cost of acquisition.

ILLUSTRATION 6

ABC Ltd. converts its capital asset acquired for an amount of ₹ 50,000 in June, 2004 into stock-in-trade in the month of November, 2024. The fair market value of the asset on the date of conversion is ₹ 4,50,000. The stock-in-trade was sold for an amount of ₹ 6,50,000 in the month of September, 2025. What will be the tax treatment?

SOLUTION

The capital gains on the sale of the capital asset converted to stock-in-trade is taxable in the given case. It arises in the year of conversion (i.e. P.Y. 2024-25) but will be taxable only in the year in which the stock-in-trade is sold (i.e. P.Y. 2025-26). Profits from business will also be taxable in the year of sale of the stock-in-trade (P.Y. 2025-26).

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The long-term capital gains and business income for the A.Y.2026-27 are calculated as under:

Particulars	₹	₹
Profits and Gains from Business or Profession		
Sale proceeds of the stock-in-trade	6,50,000	
Less: Cost of the stock-in-trade (FMV on the date of conversion)	4,50,000	2,00,000
Long Term Capital Gains		
Full value of the consideration (FMV on the date of the conversion)	4,50,000	
Less: Cost of acquisition	50,000	4,00,000

Note: For the purpose of indexation, the cost inflation index of the year in which the asset is converted into stock-in-trade should be considered. However, since capital asset is converted on or after 23.7.2024, no indexation benefit is allowed.

ILLUSTRATION 7

Ms. Usha purchases 1,000 equity shares in X (P) Ltd., an unlisted company, at a cost of ₹ 30 per share (brokerage 1%) in January 1996. She gets 100 bonus shares in August 2000. She again gets 1,100 bonus shares by virtue of her holding in February 2006. Fair market value of the shares of X (P) Ltd. on April 1, 2001 is ₹ 80.

On 1st January 2026, she transfers all her shares @ ₹ 200 per share (brokerage 2%).

Compute the capital gains taxable in the hands of Ms. Usha for the A.Y. 2026-27

Cost Inflation Index for F.Y. 2001-02: 100, F.Y.2005-06: 117 & F.Y.2025-26: 376.

SOLUTION

Computation of capital gains for the A.Y. 2026-27

Particulars	₹
1000 Original shares	
Sale proceeds (1000 × ₹ 200)	2,00,000
Less: Brokerage paid (2% of ₹ 2,00,000)	4,000
Net sale consideration	1,96,000
Less: Cost of acquisition [₹ 80 × 1000]	80,000
Long term capital gains (A)	**1,16,000**
100 Bonus shares	
Sale proceeds (100 × ₹ 200)	20,000
Less: Brokerage paid (2% of ₹ 20,000)	400

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Net sale consideration	19,600
Less: Cost of acquisition [₹ 80 × 100] [See Note below]	8,000
Long term capital gains (B)	**11,600**
1100 Bonus shares	
Sale proceeds (1100 × ₹ 200)	2,20,000
Less: Brokerage paid (2% of ₹2,20,000)	4,400
Net sale consideration	2,15,600
Less: Cost of acquisition	NIL
Long term capital gain (C)	**2,15,600**
∴ **Long term capital gain (A+B+C)**	**3,43,200**

Note: Cost of acquisition of bonus shares acquired before 1.4.2001 is the FMV as on 1.4.2001 (being the higher of the cost or the FMV as on 1.4.2001).

ILLUSTRATION 8

Mr. R holds 1,000 shares in Star Minus Ltd., an unlisted company, acquired in the year 2001-02 at a cost of ₹ 75,000. He has been offered right shares by the company in the month of April, 2025 at ₹ 160 per share, in the ratio of 2 for every 5 held. He retains 50% of the rights and renounces the balance right shares in favour of Mr. Q for ₹ 30 per share in May 2025. All the shares are sold by Mr. R for ₹ 300 per share on 15.7.2025 and Mr. Q sells his shares in December 2025 at ₹ 280 per share. What are the capital gains taxable in the hands of Mr. R and Mr. Q?

Financial year	*Cost Inflation Index*
2001-02	*100*
2025-26	*376*

SOLUTION

Computation of capital gains in the hands of Mr. R for the A.Y.2026-27

Particulars	₹
1000 Original shares	
Sale proceeds (1000 × ₹ 300)	3,00,000
Less: Cost of acquisition **[Note 1]**	75,000
Long-term capital gain (A)	2,25,000
200 Right shares	
Sale proceeds (200 × ₹ 300)	60,000
Less: Cost of acquisition [₹ 160 × 200] **[Note 2]**	32,000
Short-term capital gain (B)	28,000

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Sale of Right Entitlement	
Sale proceeds (200 × ₹ 30)	6,000
Less: Cost of acquisition **[Note 3]**	NIL
Short-term capital gain (C)	6,000
Capital Gains (A+B+C)	**2,59,000**

Note 1: The benefit of indexation is not available, since the transfer took place on or after 23.07.2024.

Note 2: Since the holding period of these shares is less than 24 months, they are short term capital assets.

Note 3: The cost of the rights renounced in favour of another person for a consideration is taken to be nil. The consideration so received is taxed as short-term capital gains in full. The period of holding is taken from the date of the rights offer to the date of the renouncement.

Computation of capital gains in the hands of Mr. Q for the A.Y.2026-27

Particulars	₹
Sale proceeds (200 shares × ₹ 280)	56,000
Less: Cost of acquisition [200 shares × (₹ 30 + ₹ 160)] ***[See Note below]***	38,000
Short-term capital gain	**18,000**

Note: The cost of the rights is the amount paid to Mr. R as well as the amount paid to the company. Since the holding period of these shares is less than 24 months, they are short term capital assets.

4.14 COST OF IMPROVEMENT [SECTION 55(1)]

(1) Goodwill or any other intangible asset of a business, etc. [Section 55(1)(b)(1)]: In relation to a capital asset being goodwill or any other intangible asset of a business or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession or any other right, the cost of improvement shall be taken to be **Nil**.

(2) Any other capital asset [Section 55(1)(b)(2)]:

Circumstance			Cost of improvement
(i)	**Where the capital asset became the property of the previous owner or the assessee before 1.4.2001**		
	(a)	**In a case covered u/s 49(1)**, where the capital asset became the property	All expenditure of a capital nature incurred in making any addition or

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		of the previous owner and the assessee before 1.4.2001	alteration to the capital asset **on or after 1.4.2001 by the assessee**.
	(b)	**In a case covered u/s 49(1)**, where the capital asset became the property of the previous owner before 1.4.2001 but became the property of the assessee on or after 1.4.2001	All expenditure of a capital nature incurred in making any addition or alteration to the capital asset **on or after 1.4.2001 by the previous owner and the assessee.**
	(c)	**In a case not covered u/s 49(1)**	All expenditure of a capital nature incurred in making any addition or alteration to the capital asset **on or after 1.4.2001 by the assessee.**
(ii)	**Where the capital asset became the property of the previous owner and the assessee on or after 1.4.2001**		
	(a)	**In a case covered u/s 49(1)**	All expenditure of a capital nature incurred in making any addition or alteration to the capital asset **by the previous owner and the assessee**.
	(b)	**In a case not covered u/s 49(1)**	All expenditure of a capital nature incurred in making any addition or alteration to the capital asset **by the assessee after it became the assessee's property.**

In a nutshell, in a case covered under section 49(1), cost of improvement would include expenditure of a capital nature on addition or alteration to the capital asset by the previous owner or the assessee or both on or after 1.4.2001. In a case not covered under section 49(1), cost of improvement would include expenditure of a capital nature on addition or alteration to the capital asset by the assessee on or after 1.4.2001.

However, cost of improvement does not include any expenditure which is deductible in computing the income chargeable under the head "Income from house property", "Profits and gains of business or profession" or "Income from other sources". Routine expenses on repairs and maintenance do not form part of cost of improvement.

ILLUSTRATION 9

X & sons, HUF, purchased a land for ₹ 1,20,000 in the P.Y. 2002-03. In the P.Y. 2006-07, a partition took place when Mr. A, a coparcener, is allotted this plot valued at ₹ 1,50,000. In P.Y. 2007-08, he had incurred expenses of ₹ 2,35,000 towards fencing of the plot. Mr. A sells this plot of land for ₹ 15,00,000 in June 2025 after incurring expenses to the extent of ₹ 20,000. You are required to compute the capital gain for the A.Y. 2026-27.

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Financial year	*Cost Inflation Index*
2002-03	*105*
2006-07	*122*
2007-08	*129*
2025-26	*376*

SOLUTION

Computation of taxable capital gains for the A.Y.2026-27

Particulars	₹	₹
Sale consideration		15,00,000
Less: Expenses incurred for transfer		20,000
		14,80,000
Less: (i) Cost of acquisition	1,20,000	
(ii) Cost of improvement	2,35,000	3,55,000
Long term capital gains		**11,25,000**

Note *– The benefit of indexation is not available, since the transfer took place on or after 23.07.2024.*

ILLUSTRATION 10

Mr. C purchases a house property for ₹ 1,06,000 on May 15, 1975. The following expenses are incurred by him for making addition/alternation to the house property:

	Particulars	*₹*
a.	*Cost of construction of first floor in 1982-83*	*3,10,000*
b.	*Cost of construction of the second floor in 2002-03*	*7,35,000*
c.	*Reconstruction of the property in 2012-13*	*5,50,000*

Fair market value of the property on April 1, 2001 is ₹ 8,50,000 and stamp duty value on the said date was ₹ 8,10,000. The house property is sold by Mr. C on July 10, 2025 for ₹ 78,00,000 (expenses incurred on transfer: ₹ 50,000). Compute the capital gain for the assessment year 2026-27.

Cost Inflation Index: F.Y. 2001-02: 100, F.Y. 2002-03: 105, F.Y. 2012-13: 200, F.Y. 2025-26: 376

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SOLUTION

Computation of capital gain of Mr. C for the A.Y.2026-27

Particulars	₹	₹
Gross sale consideration		78,00,000
Less: Expenses on transfer		50,000
Net sale consideration		77,50,000
Less: Cost of acquisition (Note 1)	8,10,000	
Less: Cost of improvement (Note 2)	12,85,000	20,95,000
Long-term capital gain		**56,55,000**

Notes:

1. Fair market value on April 1, 2001 (actual cost of acquisition is ignored as it is lower than market value on April 1, 2001) however, it should not exceed ₹ 8,10,000, being the stamp duty value on 1.4.2001.

2. **Cost of improvement is determined as under:**

Particulars	₹
Construction of first floor in 1982-83 (Expenses incurred prior to April 1, 2001 are not considered)	Nil
Construction of second floor in 2002-03	7,35,000
Alternation/reconstruction in 2012-13	5,50,000
Cost of improvement	**12,85,000**

4.15 COMPUTATION OF CAPITAL GAINS IN CASE OF DEPRECIABLE ASSETS [SECTIONS 50 & 50A]

(1) Transfer of depreciable assets [Section 50]: Section 50 provides for the computation of capital gains in case of depreciable assets. It may be noted that where the capital asset is a depreciable asset forming part of a block of assets, section 50 will have overriding effect in spite of anything contained in section 2(42A) which defines a short-term capital asset.

Accordingly, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed, the provisions of sections 48 and 49 shall be subject to the following modifications:

- Where the full value of consideration received or accruing for the transfer of the asset ***plus*** the full value of such consideration for the transfer of any other capital

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asset falling with the block of assets during previous year exceeds the aggregate of the following amounts namely:

(1) expenditure incurred wholly and exclusively in connection with such transfer(s);

(2) WDV of the block of assets at the beginning of the previous year;

(3) the actual cost of any asset falling within the block of assets acquired during the previous year

such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

- Where all assets in a block are transferred during the previous year, the block itself will cease to exist. In such a situation, the difference between the sale value of the assets and the WDV of the block of assets at the beginning of the previous year together with the actual cost of any asset falling within that block of assets acquired by the assessee during the previous year will be deemed to be the capital gains arising from the transfer of short- term capital assets.

Symbol	Description
V	Full value of consideration
C	Opening WDV of Block (+) Actual Cost of Asset acquired in the Block during the P.Y. (+) Expenses in connection with transfer of asset
STCG	Short Term Capital Gain
STCL	Short Term Capital Loss
WDV	Written Down Value

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(2) Cost of acquisition in case of power sector assets [Section 50A]: With respect to the power sector, in case of depreciable assets referred to in section 32(1)(i), the provisions of sections 48 and 49 shall apply subject to the modification that the WDV of the asset [as defined in section 43(6)], as adjusted, shall be taken to be the cost of acquisition.

ILLUSTRATION 11

Rajawat & Co., a sole proprietorship owns six machines, put in use for business in March, 2024. The depreciation on these machines is charged @15%. The opening balance of these machines after providing depreciation for P.Y. 2024-25 was ₹ 8,50,000. Three of the old machines were sold on 10th June, 2025 for ₹ 11,00,000. A second hand plant was bought for ₹ 8,50,000 on 30th November, 2025.

You are required to:

(i) determine the claim of depreciation for Assessment Year 2026-27.

(ii) compute the capital gains liable to tax for Assessment Year 2026-27.

(iii) If Rajawat & Co. had sold the three machines in June, 2025 for ₹ 21,00,000, will there be any difference in your above workings? Examine.

SOLUTION

(i) Computation of depreciation for A.Y.2026-27

Particulars	₹
Opening balance of the block as on 1.4.2025 [i.e., W.D.V. as on 31.3.2025 after providing depreciation for P.Y. 2024-25]	8,50,000
Add: Purchase of second hand plant during the year in November, 2025	8,50,000
	17,00,000
Less: Sale consideration of old machinery during the year	11,00,000
W.D.V of the block as on 31.03.2026	**6,00,000**

Since the value of the block as on 31.3.2026 comprises of a new asset which has been put to use for less than 180 days, depreciation is restricted to 50% of the prescribed percentage of 15% i.e. depreciation is restricted to 7½%. Therefore, the depreciation allowable for the year is ₹ 45,000, being 7½% of ₹ 6,00,000.

(ii) The provisions under section 50 for computation of capital gains in the case of depreciable assets can be invoked only under the following circumstances:

(a) When one or some of the assets in the block are sold for consideration more than the value of the block.

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(b) When all the assets are transferred for a consideration more than the value of the block.

(c) When all the assets are transferred for a consideration less than the value of the block.

Since in the first two cases, the sale consideration is more than the written down value of the block, the computation would result in short term capital gains.

In the third case, since the written down value exceeds the sale consideration, the resultant figure would be a short-term capital loss.

In the given case, capital gains will not arise as the block of asset continues to exist, and some of the assets are sold for a price which is lesser than the written down value of the block.

(iii) If the three machines are sold in June, 2025 for ₹ 21,00,000, then short term capital gains would arise, since the sale consideration is more than the aggregate of the written down value of the block at the beginning of the year and the additions made during the year.

Particulars	₹	₹
Sale consideration		21,00,000
Less: Opening balance of the block as on 1.4.2025 [i.e., W.D.V. as on 31.3.2025 after providing depreciation for P.Y. 2024-25]	8,50,000	
Purchase of second hand plant during the year	8,50,000	17,00,000
Short term capital gains		**4,00,000**

4.16 COMPUTATION OF CAPITAL GAINS IN CASE OF MARKET LINKED DEBENTURES [SECTION 50AA]

(1) **Transfer of unit of a Specified Mutual Fund or Market Linked Debenture or unlisted bond or unlisted debenture:** Section 50AA provides for the computation of capital gains in case of transfer or redemption or maturity of

- unit(s) of a Specified Mutual Fund acquired on or after 1.4.2023 or
- a Market Linked Debenture or
- an unlisted bond or unlisted debentures

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Section 50AA will have an overriding effect in spite of anything contained in section 2(42A) which defines a short-term capital asset and section 48 providing the manner of computation of capital gains.

Accordingly, capital gain arising from the transfer or redemption or maturity of unit of a Specified Mutual Fund acquired on or after 1.4.2023 or Market Linked Debenture or an unlisted bond or unlisted debentures would be deemed to be short term capital gains and chargeable to tax at normal rate of tax.

(2) **Computation of capital gains:** The full value of consideration received or accruing as a result of the transfer or redemption or maturity of such debenture or unit or bond as reduced by the cost of acquisition of the debenture or unit and the expenditure incurred wholly and exclusively in connection with such transfer or redemption or maturity would be deemed to be the capital gains.

(3) **No deduction in respect of STT:** No deduction would be allowed in computing the income chargeable under the head "Capital Gains" in respect of any sum paid on account of securities transaction tax (STT).

(4) **Meaning of certain terms:**

Term	Meaning
Market Linked Debenture	A security (i) which has an underlying principal component in the form of debt security; and (ii) where the returns are linked to market returns on other underlying securities or indices. It includes any security classified or regulated as a market linked debenture by the SEBI.
Specified Mutual Fund	*A Mutual Fund which invests more than 65% of its total proceeds in debt and money instruments or a fund which invests 65% or more of its total proceeds in units of above fund.* *However, the percentage of investment in debt and money market instruments or in units of a fund in respect of the Specified Mutual Fund, shall be computed with reference to the annual average of the daily closing figures.*
Debt and money market instrument	*It includes any securities classified or regulated as debt and money market instruments by the SEBI.*

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4.17 CAPITAL GAINS IN RESPECT OF SLUMP SALE [SECTION 50B]

(1) **Meaning of slump sale [Section 2(42C)] –** Slump sale means transfer of one or more undertakings, by any means, for a lump sum consideration without values being assigned to the individual assets and liabilities in such transfer.

Term	Meaning
Undertaking ***[Explanation 1]***	It includes any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.
Transfer ***[Explanation 3]***	Meaning assigned to it in section 2(47) [It would include sale, exchange, relinquishment of capital asset, extinguishment of any rights therein, compulsory acquisition under any law etc. – See detailed definition in page 4.13]

Note - The determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities.

(2) **Capital gains – Whether long-term or short-term? [Section 50B(1)] -** Any profits or gains arising from the slump sale of one or more undertakings held for more than 36 months, 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.

Any profits and gains arising from such transfer of one or more undertakings held by the assessee for not more than 36 months shall be deemed to be short-term capital gains.

(3) **Deemed cost of acquisition and cost of improvement [Section 50B(2)(i)] -** The net worth of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 in relation to capital assets of such undertaking or division transferred. No indexation benefit would be available.

(4) **Deemed full value of consideration [Section 50B(2)(ii)] –** Fair market value of the capital assets as on the date of transfer, calculated in the prescribed manner, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset.

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Accordingly, the CBDT has inserted Rule 11UAE to determine fair market value of the capital assets.

The fair market value of the capital assets shall be the FMV1 or FMV2, whichever is higher.

FMV1 = The fair market value of the capital assets transferred by way of slump sale determined in accordance with the formula

A+B+C+D - L, where,

A = Book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) as appearing in the books of accounts of the undertaking or the division transferred by way of slump sale as reduced by the following amount which relate to such undertaking or the division, —

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

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

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

C = Fair market value of shares and securities as determined in the manner provided in rule 11UA(1);

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

L = Book value of liabilities as appearing in the books of accounts of the undertaking or the division transferred by way of slump sale, but not including the following amounts which relates to such undertaking or division, namely: —

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

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

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

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

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

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

FMV2 = The fair market value of the consideration received or accruing as a result of transfer by way of slump sale determined in accordance with the formula –

E+F+G+H, where,

E = value of the monetary consideration received or accruing as a result of the transfer;

F = fair market value of non-monetary consideration received or accruing as a result of the transfer represented by property referred to in rule 11UA(1) determined in the manner provided in rule 11UA(1) for the property covered in that sub-rule;

G = the price which the non-monetary consideration received or accruing as a result of the transfer represented by property, other than immovable property, which is not referred to in rule 11UA(1) would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer, in respect of property;

H = the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property (i.e., Stamp duty value) in case the non-monetary consideration received or accruing as a result of the transfer is represented by the immovable property.

The **fair market value of the capital assets** shall be determined **on the date of slump sale** and for this purpose, **valuation date** shall also mean the **date of slump sale**.

(5) Report of a Chartered Accountant - Every assessee, in the case of slump sale, shall furnish in the prescribed form on or before 30th September of the A.Y. [i.e., the specified date referred under section 44AB, being the date one month prior to the due date for filing return of income under section 139(1)], a report of a chartered accountant indicating the computation of net worth of the undertaking or division, as the case may be, and certifying

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that the net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section [Sub-section (3)].

(6) Meaning of Certain Terms:

Explanation	Term	Particulars
1	Net worth	Aggregate value of total assets of the undertaking or division **as reduced by** the value of liabilities of such undertaking or division as appearing in the books of account. However, any change in the value of assets on account of revaluation of assets shall not be considered for this purpose.
2	Aggregate value of total assets of undertaking or division	**In the case of depreciable assets:** The written down value of block of assets determined in accordance with the provisions contained in sub-item (C) of item (i) of section 43(6)(c); **In case of capital asset, being goodwill of a business or profession, which has not been acquired by the assessee by purchase from a previous owner [self-generated goodwill]:** *Nil* Capital asset in respect of which 100% deduction is claimed: In case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD: **Nil**; **For all other assets:** Book value

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Capital Gains on Slump Sale of an Undertaking [Section 50B]

* *Higher of FMV1 and FMV2*
***Ignore revaluation effect*

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ILLUSTRATION 12

M/s Sriram Enterprises, a proprietorship having 2 units. Unit 1 is transferred on 1.4.2025 by way of slump sale for a total consideration of ₹ 14 lakhs. Unit 1 was started in the year 2005-06. The expenses incurred for this transfer were ₹ 38,000. Balance Sheet as on 31.3.2025 is as under:

Liabilities	Total (₹)	Assets	Unit 1 (₹)	Unit 2 (₹)	Total (₹)
Own Capital	17,00,000	Land	13,00,000	3,00,000	16,00,000
Revaluation Reserve (for land of unit 1)	5,00,000	Machinery	4,00,000	2,00,000	6,00,000
Bank loan (70% for unit 1)	4,00,000	Debtors	2,00,000	1,40,000	3,40,000
Trade creditors (25% for unit 1)	3,50,000	Patents	2,50,000	1,60,000	4,10,000
Total	**29,50,000**	**Total**	**21,50,000**	**8,00,000**	**29,50,000**

Other information:

(i) Revaluation reserve is created by revising upward the value of the land of Unit 1. The stamp duty value on 1.4.2025 is ₹ 10 lakhs.

(ii) No individual value of any asset is considered in the transfer deed.

(iii) Patents were acquired on 1.7.2023 on which no depreciation has been charged.

(iv) The value of machinery represents the written down value as per the Income-tax Act, 1961.

Compute the capital gain for the assessment year 2026-27.

SOLUTION

Computation of capital gains on slump sale of Unit 1

Particulars	₹
Full value of consideration [Fair market value on 1.4.2025]	14,82,500
Less: Expenses on sale	38,000
Net sale consideration	14,44,500
Less: Net worth **(See Note 1 below)**	11,73,125
Long-term capital gain	**2,71,375**

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Notes:

1. Computation of Full value of consideration

Particulars				₹
Fair market value of the capital assets transferred by way of slump sale				
Land, being an immovable property [stamp duty value on 1.4.2025, being the date of slump sale] **[A]**				10,00,000
Machinery [Book value as appearing in the books of accounts] **[B]**				4,00,000
Debtors [Book value as appearing in the books of accounts] **[C]**				2,00,000
Patents [Book value as appearing in the books of accounts] **[D]**				2,50,000
				18,50,000
Less: Liabilities of Unit 1 [₹ 29,50,000 - ₹ 1,20,000 - ₹ 2,62,500] **[L]**			25,67,500	
Excluding				
(i)	Own Capital	17,00,000		
(ii)	Revaluation reserve	5,00,000	22,00,000	3,67,500
Fair market value of the capital assets transferred by way of slump sale [A+B+C+D- L] **[FMV1]**				14,82,500
Fair market value of the consideration received or accruing as a result of transfer by way of slump sale [Value of the monetary consideration received] **[FMV2]**				14,00,000
Full value of consideration [Higher of FMV1 or FMV2]				14,82,500

2. Computation of net worth of Unit 1 of Akash Enterprises

Particulars	₹	₹
Land (excluding ₹ 5 lakhs on account of revaluation)		8,00,000
Machinery		4,00,000
Debtors		2,00,000
Patents **(See Note 2 below)**		1,40,625
Total assets		15,40,625
Less: Creditors [₹ 3,50,000 x 25%]	87,500	
Bank Loan [₹ 4,00,000 x 70%]	2,80,000	3,67,500
Net worth		**11,73,125**

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3. **Written down value of patents as on 1.4.2025**

Value of patents	₹
Cost as on 1.7.2023	2,50,000
Less: Depreciation @ 25% for Financial Year 2023-24	62,500
WDV as on 1.4.2024	1,87,500
Less: Depreciation for Financial Year 2024-25	46,875
WDV as on 1.4.2025	**1,40,625**

For the purposes of computation of net worth, the written down value determined as per section 43(6) has to be considered in the case of depreciable assets. The problem has been solved assuming that the Balance Sheet values of ₹ 4 lakh represent the written down value of machinery of Unit 1.

4. Since the Unit is held for more than 36 months, capital gain arising would be long-term capital gain.

4.18 DEEMED FULL VALUE OF CONSIDERATION FOR COMPUTING CAPITAL GAINS [SECTION 50C, 50CA & 50D]

S. No.	Capital Asset	Section	Circumstance			Deemed Full Value of consideration for computing Capital Gains
1.	**Land or Building or both**	50C	(1)	If Stamp Duty Value > 110% of consideration received or accruing as a result of transfer		Stamp Duty Value
				(a)	If date of agreement is different from the date of transfer and whole or part of the consideration is received by way of account payee cheque or bank draft or ECS or through such other prescribed electronic mode (IMPS, UPI, RTGS, NEFT, Net banking, debit card, credit card or BHIM Aadhar Pay) on or before the date of agreement	Stamp Duty Value on the date of agreement

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				(b)	If date of agreement is different from the date of transfer but the whole or part of the consideration has not been received by way of account payee cheque or bank draft or ECS or through such other prescribed electronic mode (IMPS, UPI, RTGS, NEFT, Net banking, debit card, credit card or BHIM Aadhar Pay) on or before the date of agreement	Stamp Duty Value on the date of transfer
				However, if the stamp duty value on the date of agreement or the date of transfer, as the case may be ≤ 110% of the sale consideration received.		Actual consideration so received
				Example: Let us take a case where for transfer of building – • the actual consideration is ₹ 100 lakh; • the stamp duty value on the date of agreement is ₹ 109 lakh; and • the stamp duty value on the date of transfer is ₹ 112 lakh **(i) If any part of the consideration is paid by prescribed electronic mode on or before the date of agreement** The actual consideration of ₹ 100 lakh would be the full value of consideration, since stamp duty value of ₹ 109 lakhs on the date of agreement does not exceed 110% of actual consideration of ₹ 100 lakhs.		

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				(ii) If no part of the consideration is paid by prescribed electronic mode on or before the date of agreement Stamp duty value of ₹ 112 lakhs on the date of transfer would be the full value of consideration, since the same exceeds 110% of actual consideration of ₹ 100 lakhs.		
			(2)	Where the Assessing Officer refers the valuation to a Valuation Officer, on the assessee's claim that the stamp duty value exceeds the FMV of the property on the date of transfer and the stamp duty value has not been disputed in any appeal or revision or no reference has been made before any other authority, court or High Court		
				(a)	If Valuation by Valuation Officer > Stamp Duty Value	Stamp Duty Value
				(b)	If Valuation by Valuation Officer < Stamp Duty Value	Valuation by Valuation Officer
		155(15)	(3)	If stamp duty value has been adopted as full value of consideration, and subsequently the value is revised in any appeal or revision		Value so revised in such appeal or revision
2.	**Shares other than quoted shares**	50CA	If consideration received or accruing as a result of transfer < FMV of such share determined in the prescribed manner The provisions of this section would not, however, be applicable to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.			FMV of such share determined in the prescribed manner

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	Prescribed class of persons for the purpose of section 50CA Rule 11UAD provides that the provisions of section 50CA shall not apply to transfer of any movable property, being unquoted shares, of a company and its subsidiary and the subsidiary of such subsidiary by an assessee, where - (i) the Tribunal, on an application moved by the Central Government under section 241 of the Companies Act, 2013, has suspended the Board of Directors of such company and has appointed new directors nominated by the Central Government under section 242 of the said Act; and (ii) share of such company and its subsidiary and the subsidiary of such subsidiary has been transferred pursuant to a resolution plan approved by the Tribunal under section 242 of the Companies Act, 2013 after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner. **Meaning of certain terms** **(1) A company shall be a subsidiary of another company**, if such other company holds more than half in nominal value of the equity share capital of the company. **(2) Tribunal** shall have the same meaning assigned to it in section 2(90) of the Companies Act, 2013 i.e., National Company Law Tribunal constituted under section 408 of the said Act.			
Note: The fair market value of the shares other than quoted shares would be determined in the manner provided in sub-clause (b) or sub-clause (c), as the case may be, of Rule 11UA(1)(c) and for this purpose the reference to valuation date in the Rule 11U and 11UA shall mean the date on which the capital asset, being share other than quoted shares of a company is transferred (Rule 11UAA) [4].				
3.	**Any Capital asset**	50D	Where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined	FMV of the said asset on the date of transfer

Meaning of certain terms:

S. No.	Term	Section	Meaning
(i)	Stamp Duty Value	50C	The value adopted or assessed or assessable by any authority of a State Government (Stamp Valuation Authority) for the purpose of payment of stamp duty
(ii)	Assessable	50C	The term 'assessable' has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such

[4] For detailed reading of Rule 11U to 11UAA of the Income-tax Rules, 1962, refer to Annexure 3 at the end of this module

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			authority for the purposes of the payment of stamp duty. The term "assessable" has been added to cover transfers executed through power of attorney.
(iii)	Quoted Shares	50CA	The share quoted on any recognised stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business.

4.19 ADVANCE MONEY RECEIVED [SECTION 51]

It is possible for an assessee to receive some advance in regard to the transfer of capital asset. Due to the break-down of the negotiation, the assessee may have retained the advance.

Section 51 provides that while calculating capital gains, the above advance retained by the assessee must go to reduce the cost of acquisition. However, if advance has been received and retained by the previous owner and not the assessee himself, then the same will not go to reduce the cost of acquisition of the assessee.

Section 56(2)(ix) provides for the taxability of any sum of money, received as an advance or otherwise in the course of negotiations for transfer of a capital asset. Consequently, such sum shall be chargeable to income-tax under the head 'Income from other sources', if such sum is forfeited on or after 1st April, 2014 and the negotiations do not result in transfer of such capital asset.

In order to avoid double taxation of the advance received and retained, section 51 provides that where any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset has been included in the total income of the assessee for any previous year in accordance with section 56(2)(ix), then, such amount shall not 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.

However, any such sum of money forfeited before 1st April, 2014, will be deducted from the cost of acquisition before applying indexation, if any, for computing capital gains.

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ILLUSTRATION 13

Mr. Kay purchases a house property on April 10, 1992 for ₹ 65,000. The fair market value of the house property on April 1, 2001 was ₹ 2,70,000 and Stamp duty value was ₹ 2,20,000. On August 31, 2004, Mr. Kay enters into an agreement with Mr. Jay for sale of such property for ₹ 3,70,000 and received an amount of ₹ 60,000 as advance. However, as Mr. Jay did not pay the balance amount, Mr. Kay forfeited the advance. In May 2008, Mr. Kay constructed the first floor by incurring a cost of ₹ 2,35,000. Subsequently, in January 2009, Mr. Kay gifted the house to his brother Mr. Dee. On June 10, 2025, Mr. Dee sold the house for ₹ 15,00,000.

CII for F.Y.2001-02: 100; 2004-05: 113; 2008-09: 137; 2025-26: 376.

Compute the capital gains in the hands of Mr. Dee for A.Y.2026-27.

SOLUTION

Computation of taxable capital gains of Mr. Dee for A.Y.2026-27

Particulars	₹	₹
Sale consideration		15,00,000
Less: Cost of acquisition	2,20,000	
Cost of improvement	2,35,000	4,55,000
Long-term capital gain		**10,45,000**

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Note: For the purpose of capital gains, holding period is considered from the date on which the house was purchased by Mr. Kay, till the date of sale. The house property was acquired before 1st April, 2001, higher of fair market value on 1.4.2001 or actual cost of acquisition can be considered as cost of acquisition. However, fair market value cannot exceed stamp duty value on 1.4.2001.

Amount forfeited by previous owner, Mr. Kay, shall not be deducted from cost of acquisition.

Note 1- *Since the property was gifted prior to 1.10.2009, it is a case falling u/s 49(1) and not 49(4). Accordingly, the cost of acquisition of the previous owner, Mr. Kay, or the FMV as on 1.4.2001 (since the asset was acquired by the previous owner, Mr. Kay, before 1.4.2001), has to be considered.*

Note 2- *Since the property was acquired before 23.7.2024, while computing tax on such LTCG, Mr. Dee has the option to pay tax under section 112 at lower of 12.5% on LTCG computed without indexation benefit or 20% on LTCG computed with indexation benefit.*

ILLUSTRATION 14

Mr. X purchases a house property in December 1993 for ₹ 5,25,000 and an amount of ₹ 1,75,000 was spent on the improvement and repairs of the property in March, 1997. The property was proposed to be sold to Mr. Z in the month of May, 2007 and an advance of ₹ 40,000 was taken from him. As the entire money was not paid in time, Mr. X forfeited the advance and subsequently sold the property to Mr. Y in the month of March, 2026 for ₹ 52,00,000. The fair value of the property on April 1, 2001 was ₹ 11,90,000 and Stamp duty value on the said date was ₹ 10,20,000. What is the capital gain chargeable in the hands of Mr. X for the A.Y. 2026-27?

Financial year	*Cost Inflation Index*
2001-02	*100*
2007-08	*129*
2025-26	*376*

SOLUTION

Capital gains in the hands of Mr. X for the A.Y.2026-27 is computed as under

Particulars	₹
Sale proceeds	52,00,000
Less: Cost of acquisition **[Note 1]**	9,80,000
Cost of improvement **[Note 2]**	-
Long term capital gains	**42,20,000**

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Note 1: Computation of cost of acquisition

Cost of acquisition (higher of fair market value as on April 1, 2001 and the actual cost of acquisition. Fair market value, however, should not exceed ₹ 10,20,000, being the stamp duty value on 1.4.2001)	10,20,000
Less: Advance taken and forfeited before 1.4.2014	40,000

Note 2: Any improvement cost incurred prior to 1.4.2001 is to be ignored.

Note 3: Since the house property was acquired before 23.7.2024, while computing tax on such LTCG, Mr. X has the option to pay tax under section 112 at lower of 12.5% on LTCG computed without indexation benefit or 20% on LTCG computed with indexation benefit.

4.20 EXEMPTION OF CAPITAL GAINS

(1) Exemption under section 10

The following are the exemption in respect of capital gains under section 10:

(i) Exemption of capital gain on transfer of a unit of Unit Scheme, 1964 (US 64) [Section 10(33)]

This clause provides that any income arising from the transfer of unit of US 64, shall be exempt from tax. Such transfer should take place on or after 1.4.2002.

(ii) Exemption of capital gains on compulsory acquisition of agricultural land situated within specified urban limits [Section 10(37)]

With a view to mitigate the hardship faced by the farmers whose agricultural land situated in specified urban limits has been compulsorily acquired, clause (37) provide to exempt the capital gains arising to an individual or a HUF from transfer of urban agricultural land by way of compulsory acquisition.

Such exemption is available where the compensation or the enhanced compensation or consideration, as the case may be, is received on or after 1.4.2004.

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The exemption is available only when such land has been **used for agricultural purposes** during the **immediately preceding two years from the date of transfer** by such individual or a parent of his or by such HUF.

Clarification on taxability of the compensation received by the land owners for the land acquired under the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 (RFCTLARR Act) ***[Circular No. 36/2016, dated 25-10-2016]***

The RFCTLARR Act which came into effect from 1st January, 2014, in section 96, *inter alia* provides that income-tax shall not be levied on any award or agreement made (except those made under section 46) under the RFCTLARR Act. Therefore, compensation received for compulsory acquisition of land under the RFCTLARR Act (except those made under section 46 of RFCTLARR Act), is exempted from the levy of income-tax.

As no distinction has been made between compensation received for compulsory acquisition of agricultural land and non-agricultural land in the matter of providing exemption from income-tax under the RFCTLARR Act, the exemption provided under section 96 of the RFCTLARR Act is wider in scope than the tax-exemption provided under the existing provisions of Income-tax Act, 1961.

The CBDT has clarified that compensation received in respect of award or agreement which has been exempted from levy of income-tax vide section 96 of the RFCTLARR Act shall also not be taxable under the provisions of Income-tax Act, 1961 even if there is no specific provision for exemption of such compensation in the Income-tax Act, 1961.

ILLUSTRATION 15

Mr. Kumar has an agricultural land costing ₹ 6 lakh in Lucknow on 1.4.2003 and has been using it for agricultural purposes till 1.8.2012 when the Government took over compulsory acquisition of this land. A compensation of ₹ 12 lakhs was settled. The compensation was received by Mr. Kumar on 1.7.2025. Compute the amount of capital gains taxable in the hands of Mr. Kumar.

Cost Inflation Index: 2003-04: 109, 2012-13: 200, 2025-26: 376

SOLUTION

In the given problem, compulsory acquisition of an urban agricultural land has taken place and the compensation is received after 1.4.2004. This land had also been used for at least 2 years by the assessee himself for agricultural purposes. Thus, as per section 10(37), entire capital gains arising on such compulsory acquisition will be fully exempt and nothing is taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e., A.Y.2026-27.

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ILLUSTRATION 16

Will your answer be different if Mr. Kumar had on his own will sold this land to his friend Mr. Sharma? Examine.

SOLUTION

As per section 10(37), exemption is available if compulsory acquisition of urban agricultural land takes place. Since the sale is out of own will and desire, the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Kumar.

ILLUSTRATION 17

Will your answer be different if Mr. Kumar had not used this land for agricultural activities? Examine and compute the amount of capital gains taxable in the hands of Mr. Kumar, if any.

SOLUTION

As per section 10(37), exemption is available only when such land has been used for agricultural purposes during the preceding two years by such individual or his parent or by such HUF. Since the assessee has not used it for agricultural activities, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e., A.Y. 2026-27.

Computation of capital gains

Particulars	Amount (₹)
Sales consideration	12,00,000
Less: Indexed Cost of acquisition [₹ 6,00,000 x 200/109]	11,00,917
Long term capital Gains	99,083

ILLUSTRATION 18

Will your answer be different if the land belonged to ABC Ltd. and not Mr. Kumar and compensation on compulsory acquisition was received by the company? Examine.

SOLUTION

Section 10(37) exempts capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition. If the land belongs to ABC Ltd., a company, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of ABC Ltd.

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(2) Exemption of Capital Gains under section 54/54B/54D/54EC/54F/54G/54GA

(i) Capital Gains on sale of residential house [Section 54]

Eligible assessees – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of residential house (buildings or lands appurtenant thereto)
- It must be a long-term capital asset
- Income from such house should be chargeable under the head "Income from house property"
- **Where the amount of capital gains exceeds ₹ 2 crore**

  Where the amount of capital gain exceeds ₹ 2 crore, **one residential house in India** should be –

  - purchased within 1 year before or 2 years after the date of transfer (or)
  - constructed within a period of 3 years after the date of transfer.
- **Where the amount of capital gains does not exceed ₹ 2 crore**

  Where the amount of capital gains does not exceed ₹ 2 crore, the assessee i.e., individual or HUF, may at his option,

  - purchase **two residential houses in India** within 1 year before or 2 years after the date of transfer (or)
  - construct **two residential houses in India** within a period of 3 years after the date of transfer.

  Where during any assessment year, the assessee has exercised the option to purchase or construct two residential houses in India, he shall not be subsequently entitled to exercise the option for the same or any other assessment year.

  This implies that if an assessee has availed the option of claiming benefit of section 54 in respect of purchase of two residential houses in Jaipur and Jodhpur, say, in respect of capital gains of ₹ 1.50 crores arising from transfer of residential house at Mumbai in the P.Y.2025-26 then, he will not be entitled to avail the benefit of section 54 again in respect of purchase of two residential houses in, say, Pune and Baroda, in respect of capital gains of ₹ 1.20 crores arising from transfer of residential house

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in Jaipur in the P.Y.2028-29, even though the capital gains arising on transfer of the residential house at Jaipur does not exceed ₹ 2 crore.

- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the Capital Gains Account Scheme (CGAS) *[Refer points (viii) and (ix) of this sub-heading (2)]*. However, the capital gain in excess of ₹ 10 crore would not be taken into account for the purpose of deposit in CGAS.
- Amount utilised by the assessee for purchase or construction of new asset and the amount so deposited shall be deemed to be the cost of new asset. The deemed cost of the new asset would be restricted to ₹ 10 crores for the purpose of exemption under section 54.

Quantum of Exemption

- If cost of new residential house or houses, as the case may be ≥ long-term capital gains, entire long-term capital gains is exempt.
- If cost of new residential house or houses, as the case may be < long-term capital gains, long-term capital gains to the extent of cost of new residential house is exempt

However, if the cost of new residential house(s) exceeds ₹ 10 crores, the amount exceeding ₹ 10 crore would not be taken into account for exemption. It means the maximum exemption that can be claimed by the assessee u/s 54 is ₹ 10 crore.

Examples

1. If the long-term capital gains is ₹ 2.05 crores and the cost of the new house is ₹ 3 crores, then, the entire long-term capital gains of ₹ 2.05 crores is exempt.
2. If long-term capital gains is ₹ 2.05 crores and cost of new house is ₹ 1.55 crores, then, long-term capital gains is exempt only upto ₹ 1.55 crores. Balance ₹ 50 lakhs is taxable u/s 112.

Example

(1)	*(2)*	*(3)*	*(4)*	*(5)*
S. No.	*LTCG computed*	*Cost of new residential house*	*Amount in column (3) or ₹ 10 crore, whichever is lower*	*Exempt LTCG [Lower of column (2) and column (4)]*
(1)	*₹ 7 crore*	*₹ 12 crore*	*₹ 10 crore*	*₹ 7 crore*
(2)	*₹ 12 crore*	*₹ 14 crore*	*₹ 10 crore*	*₹ 10 crore*
(3)	*₹ 11 crore*	*₹ 9 crore*	*₹ 9 crore*	*₹ 9 crore*
(4)	*₹ 15 crore*	*₹ 13 crore*	*₹ 10 crore*	*₹ 10 crore*

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Examples

1. *If the LTCG is ₹ 8 crore and the assessee has incurred ₹ 5 crore in construction of new residential house upto the due date u/s 139(1) i.e., 31.7.2026/ 31.10.2026, as the case may be, then, as per section 54(2), he can deposit the amount of ₹ 3 crore not appropriated by him towards construction of house upto 31.7.2026/31.10.2026, as the case may be, in Capital Gains Account Scheme (CGAS) for claiming exemption under section 54. If he deposits, say, ₹ 2 crore, in CGAS on or before the due date u/s 139(1), the deemed cost of the new residential house would be ₹ 7 crore (₹ 5 crore + ₹ 2 crore). The amount exempt u/s 54 would be ₹ 7 crore.*

2. *If the LTCG is ₹ 14 crore and the assessee has already incurred ₹ 7 crore in construction of new residential house upto 31.7.2026/31.10.2026, as the case may be, then, as per section 54(2), he can deposit the difference of ₹ 3 crore (₹ 10 crore - ₹ 7 crore) in CGAS for claiming exemption u/s 54. If he deposits, say, ₹ 2 crore in CGAS on or before the due date u/s 139(1), the deemed cost of the new residential house would be ₹ 9 crore (₹ 7 crore + ₹ 2 crore). The amount exempt under section 54 would be ₹ 9 crore.*

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its acquisition or construction, then, cost of the asset will be reduced by capital gains exempted earlier for computing capital gains.

- **Example:** The long-term capital gains is ₹ 2.05 crore and the cost of the new house is ₹ 3 crore, the entire long-term capital gains of ₹ 2.05 crore will be exempt. If the new house was sold after 18 months for ₹ 5 crore, then, short term capital gain chargeable to tax would be –

Particulars	₹
Net Consideration	5,00,00,000
Less: Cost of acquisition **minus** capital gains exempt earlier (₹ 3,00,00,000 – ₹ 2,05,00,000)	95,00,000
Short term capital gains chargeable to tax	**4,05,00,000**

ILLUSTRATION 19

Mr. Cee purchased a residential house on July 20, 2023 for ₹ 10,00,000 and made some additions to the house incurring ₹ 2,00,000 in August 2023. He sold the house property in

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April, 2025 for ₹ 20,00,000. Out of the sale proceeds, he spent ₹ 5,00,000 to purchase another house property in September, 2025.

What is the amount of capital gains taxable in the hands of Mr. Cee for the A.Y. 2026-27?

SOLUTION

The house is sold before 24 months from the date of purchase. Hence, the house is a short-term capital asset and no benefit of indexation would be available.

Particulars	₹
Sale consideration	20,00,000
Less: Cost of acquisition	10,00,000
Cost of improvement	2,00,000
Short-term capital gains	**8,00,000**

Note: *The exemption of capital gains under section 54 is available only in case of long-term capital asset. As the house is short-term capital asset, Mr. Cee cannot claim exemption under section 54. Thus, the amount of taxable short-term capital gains is ₹ 8,00,000.*

(ii) Capital Gains on transfer of agricultural land [Section 54B]

Eligible assessee – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of urban agricultural land.
- Such land must have been used for agricultural purposes by the assessee, being an individual or his parent, or a HUF in the 2 years immediately preceding the date of transfer.
- He should purchase another agricultural land (urban or rural) within 2 years from the date of transfer.
- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS *[Refer points (viii) and (ix) of this sub-heading (2)]*. Amount utilised by the assessee for purchase of new asset and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of exemption

- If cost of new agricultural land ≥ capital gains, entire capital gains is exempt.
- If cost of new agricultural land < capital gains, capital gains to the extent of cost of new agricultural land is exempt.

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Examples

1. If the capital gains is ₹ 3 lakhs and the cost of the new agricultural land is ₹ 4 lakhs, then the entire capital gains of ₹ 3 lakhs is exempt.
2. If capital gains is ₹ 3 lakhs and cost of new agricultural land is ₹ 2 lakhs, then capital gains is exempt only upto ₹ 2 lakhs.

Consequences of transfer of new agricultural land before 3 years

- If the new agricultural land is transferred before 3 years from the date of its acquisition, then cost of the land will be reduced by capital gains exempted earlier for computing capital gains of new agricultural land.
- However, if the new agricultural land is a rural agricultural land, there would be no capital gains on transfer of such land.
- Continuing in the above example, if the new agricultural land (urban land) is sold after, say, 1 year for ₹ 6 lakhs, then short-term capital gain chargeable to tax would be –

Particulars	₹
Net consideration	6,00,000
Less: Cost of acquisition minus capital gains exempt earlier (₹ 4,00,000 – ₹ 3,00,000)	1,00,000
Short-term capital gains chargeable to tax	**5,00,000**

(iii) Capital Gains on transfer by way of compulsory acquisition of land and building of an industrial undertaking [Section 54D]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There must be compulsory acquisition of land and building or any right in land or building forming part of an industrial undertaking.
- The land and building should have been used by the assessee for purposes of the business of the industrial undertaking in the 2 years immediately preceding the date of transfer.
- The assessee must purchase any other land or building or any right in land or building or construct any building (for shifting or re-establishing the existing

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undertaking or setting up a new industrial undertaking) within 3 years from the date of transfer.

- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS *[Refer points (viii) and (ix) of this sub-heading (2)].* Amount utilised by the assessee for purchase of new asset and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of exemption

- If cost of new asset ≥ Capital gains, entire capital gains is exempt.
- If cost of new asset < Capital gains, capital gains to the extent of cost of new asset is exempt.

Note: The exemption in respect of capital gains from transfer of capital asset would be available even in respect of short-term capital asset, being land or building or any right in any land or building, provided such capital asset is used by assessee for the industrial undertaking belonging to him, even if he was not the owner for the said period of 2 years.

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its purchase or construction, then cost of the asset will be reduced by capital gains exempted earlier for computing capital gains.

ILLUSTRATION 20

PQR Ltd. purchased a land for industrial undertaking in May 2004, at a cost of ₹ 3,50,000. The above property was compulsorily acquired by the State Government at a compensation of ₹ 13,00,000 in the month of January, 2026. The compensation was received in February, 2026. The company purchased another land for its industrial undertaking at a cost of ₹ 2,00,000 in the month of March, 2026. What is the amount of the capital gains chargeable to tax in the hands of the company for the A.Y. 2026-27?

Financial year	*Cost Inflation Index*
2004-05	*113*
2025-26	*376*

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SOLUTION

Computation of capital gains in the hands of PQR Ltd. for the A.Y.2026-27

Particulars	₹
Sale proceeds (Compensation received)	13,00,000
Less: Cost of acquisition	3,50,000
	9,50,000
Less: Exemption under section 54D (Cost of acquisition of land for its undertaking)	2,00,000
Taxable long-term capital gain	**7,50,000**

(iv) Capital Gains not chargeable on investment in certain bonds [Section 54EC]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There should be transfer of a long-term capital asset **being land or building or both**.
- Such asset can also be a depreciable asset being a building held for more than 24 months. [*CIT v. Dempo Company Ltd (2016) 387 ITR 354 (SC)]*
- The capital gains arising from such transfer should be invested in a long-term specified asset within 6 months from the date of transfer.
- Long-term specified asset means specified bonds, redeemable after 5 years, issued on or after 1.4.2018 by the National Highways Authority of India (NHAI) or the Rural Electrification Corporation Limited (RECL) or any other bond notified by the Central Government in this behalf [Bonds of Power Finance Corporation (PFC), Indian Railways Finance Corporation (IRFC)]. *Bonds, redeemable after 5 years, issued on or after 1.4.2025 by Housing and Urban Development Corporation Limited (HUDCO) and bonds, redeemable after 5 years, issued on or after 9.7.2025 by the Indian Renewable Energy Development Agency (IREDA) are also specified by the Central Government for this purpose*.
- The assessee should not transfer or convert or avail loan or advance on the security of such bonds for a period of **5 years** from the date of acquisition of such bonds.

Note - In case of conversion of capital asset into stock in trade and subsequent sale of stock in trade - Period of 6 months to be reckoned from the date of sale of stock in trade for the purpose of section 54EC exemption *[CBDT Circular No.791 dated 2-6-2000]*.

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Quantum of exemption

Capital gains or amount invested in specified bonds, whichever is lower.

Ceiling limit for investment in long-term specified asset

The maximum investment which can be made in notified bonds or bonds of NHAI and RECL, out of capital gains arising from transfer of one or more assets, during the previous year in which the original asset is transferred and in the subsequent financial year cannot exceed ₹ 50 lakhs.

Violation of condition

In case of transfer or conversion of such bonds or availing loan or advance on security of such bonds before the expiry of 5 years, the capital gain exempted earlier shall be taxed as long-term capital gain in the year of violation of condition.

ILLUSTRATION 21

Long-term capital gain of ₹ 75 lakh arising from transfer of building on 1.5.2025 will be fully exempt from tax if such capital gain is invested in the bonds redeemable after five years, issued by NHAI under section 54EC. Examine with reasons whether the given statement is true or false having regard to the provisions of the Income-tax Act, 1961.

SOLUTION

False: The exemption under section 54EC has been restricted, by limiting the maximum investment in long term specified assets (i.e., bonds of NHAI or RECL or any other bond notified by Central Government in this behalf, redeemable after 5 years) to ₹ 50 lakh, whether such investment is made during the relevant previous year or the subsequent previous year, or both. Therefore, in this case, the exemption under section 54EC can be availed only to the extent of ₹ 50 lakh, provided the investment is made before 1.11.2025 (i.e., within six months from the date of transfer).

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**The exemption under section 54EC is available in respect of capital gains on transfer of capital asset being land or building or both.*

(v) Capital gains in cases of investment in residential house [Section 54F]

Eligible assessees: Individuals/ HUF

Conditions to be fulfilled

- There must be transfer of a **long-term capital asset, <u>not being a residential house</u>**.
- Transfer of plot of land is also eligible for exemption
- The assessee should -
  - Purchase **<u>one residential house situated in India</u>** within a period of 1 year before or 2 years after the date of transfer; or
  - Construct one residential house in India within 3 years from the date of transfer.

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- If such investment is not made before the date of filing of return of income, then the net sale consideration has to be deposited under the CGAS *[Refer points (viii) and (ix) of this sub-heading (2)]*. However, the net consideration in excess of ₹ 10 crore would not be taken into account for the purpose of deposit in CGAS.
- Amount utilised by the assessee for purchase or construction of new asset and the amount so deposited shall deemed to be the cost of new asset. The deemed cost of new asset would be restricted to ₹ 10 crores for the purpose of exemption under section 54F.
- The assessee should not own more than one residential house on the date of transfer.
- The assessee should not –
  - purchase any other residential house within a period of 2 years or
  - construct any other residential house within a period of 3 years

  from the date of transfer of the original asset.

Quantum of exemption

- If cost of new residential house ≥ Net sale consideration of original asset, entire capital gains is exempt.
- If cost of new residential house < Net sale consideration of original asset, only proportionate capital gains is exempt i.e.

$$\text{LTCG} \times \frac{\text{Amount invested in new residential house}}{\text{Net sale consideration}}$$

However, if the cost of new residential house/ amount invested in new residential house exceeds ₹ 10 crore, the amount exceeding ₹ 10 crore would not be taken into account for exemption.

Example

(1)		*(2)*	*(3)*	*(4)*	*(5)*
	Net Consider-ation	***LTCG computed***	***Cost of new residential house***	***Amount in column (3) or ₹ 10 crores, whichever is lower***	***Exempt LTCG***
(1)	*₹ 15 crore*	*₹ 7.5 crore*	*₹ 12 crore*	*₹ 10 crore*	*₹ 7.5 crore x 10/15 = ₹ 5 crore*

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(2)	₹ 20 crore	₹ 12 crore	₹ 15 crore	₹ 10 crore	₹ 12 crore x 10/20 = ₹ 6 crore
(3)	₹ 16 crore	₹ 12 crore	₹ 8 crore	₹ 8 crore	₹ 12 crore x 8/16 = ₹ 6 crore
(4)	₹ 10 crore	₹ 6 crore	₹ 10 crore	₹ 10 crore	₹ 6 crore x 10/10 = ₹ 6 crore
(5)	₹ 12 crore	₹ 6 crore	₹ 12 crore	₹ 10 crore	₹ 6 crore x 10/12 = ₹ 5 crore

Examples

1. *If the net consideration is ₹ 9 crore, the capital gain is ₹ 4.50 crore and the amount incurred for construction of new residential house upto 31.7.2026/31.10.2026, as the case may be, is ₹ 5 crore, then, as per section 54F(4), the assessee can deposit the amount of ₹ 4 crore (i.e., ₹ 9 crore – ₹ 5 crore) not appropriated towards construction upto 31.7.2026/ 31.10.2026, as the case may be, in CGAS for claiming exemption u/s 54F. If the assessee has deposited, say, ₹ 3 crore on or before 31.7.2026/ 31.10.2026, as the case may be, the deemed cost of new residential house would be ₹ 8 crore (₹ 5 crore + ₹ 3 crore). The exemption u/s 54F would be ₹ 4 crore [i.e., ₹ 4.50 crore x ₹ 8 crore/₹ 9 crore].*

2. *If the net consideration is ₹ 15 crore, the capital gain is ₹ 7.50 crore and the amount incurred for construction of new residential house upto 31.7.2026/31.10.2026, as the case may be, is ₹ 6 crore, the assessee can deposit ₹ 4 crore [i.e., ₹ 10 crore – ₹ 6 crore] on or before 31.7.2026/31.10.2026, as the case may be, in CGAS for claiming exemption u/s 54F. If the assessee has deposited, say, ₹ 3 crore on or before the due date of filing return u/s 139(1), the deemed cost of new residential house would be ₹ 9 crore (₹ 6 crore + ₹ 3 crore). The exemption u/s 54F would be ₹ 4.50 crore [i.e., ₹ 7.50 crore x ₹ 9 crore/₹ 15crore].*

ILLUSTRATION 22

From the following particulars, compute the taxable capital gains of Mr. D for A.Y.2026-27 -

Particulars	Amount (₹)
Cost of jewellery [Purchased in F.Y.2005-06]	4,52,000
Sale price of jewellery sold in June 2025	14,50,000
Expenses on transfer	7,000
Residential house purchased in March 2026	5,00,000

The Cost Inflation Index are as follows:

Financial Year	Cost Inflation Index
2005-06	117
2025-26	376

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SOLUTION

Computation of taxable capital gains for A.Y.2026-27

Particulars	₹
Gross consideration	14,50,000
Less: Expenses on transfer	7,000
Net consideration	14,43,000
Less: Cost of acquisition	4,52,000
	9,91,000
Less: Exemption under section 54F (₹ 9,91,000 × ₹ 5,00,000/₹ 14,43,000)	3,43,382
Taxable long-term capital gains	**6,47,618**

Consequences if the new house is transferred within 3 years from the date of its purchase

If the new asset is transferred before the expiry of 3 years from the date of its purchase or construction, as the case may be, then capital gains arises on transfer of the new house and the capital gains exempted earlier under section 54F would be taxable as long-term capital gains.

Note – In case the new residential house is sold after 2 years, the capital gains would be long-term capital gains and indexation benefit would be available.

Consequences where assessee purchases any other residential house within 2 years or constructs within 3 years from the date of transfer of original asset

The capital gain exempted earlier under section 54F would be deemed to be long-term capital gains and chargeable to tax in the previous year in which such residential house is purchased or constructed.

(vi) Exemption of capital gains for shifting of industrial undertaking from urban areas [Section 54G]

Eligible assessees: Any assessee

Conditions to be fulfilled

- There should be a shifting of the industrial undertaking from an urban area to any other area other than an urban area.

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- There should be a transfer of machinery, plant, building or land or any right in building or land used for the business of an industrial undertaking situated in an urban area.
- Such transfer should be in the course of, or in consequence of, shifting the industrial undertaking from an urban area to any other area other than an urban area.
- The capital gain (short-term or long-term) should be utilised for any of the following purposes within 1 year before or 3 years after the date of transfer –
  - purchase of new plant and machinery for the purposes of business of the industrial undertaking in the area to which the said undertaking is shifted;
  - acquisition of building or land or construction of building for the purposes of his business in the said area;
  - shifted the original asset and transferred the establishment of such industrial undertaking from the urban area to the other area;
  - incurred expenses on such other purpose as may be specified in a scheme framed by the Central Government.
- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS. *[Refer points (viii) at the end of this sub-heading (2)].* Amount utilised by the assessee for purchase of new asset and expenses of shifting and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of exemption

- If cost of new assets plus expenses incurred for the specified purpose ≥ Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new assets plus expenses incurred for the specified purpose < Capital gains, capital gains (short-term or long-term) to the extent of such cost and expenses is exempt.

Consequences if the new asset is transferred within a period of 3 years

If the new asset is transferred within a period of 3 years of its purchase or construction, then the capital gain, which was exempt earlier under section 54G would be deducted from the cost of acquisition of the new asset for the purpose of computation of capital gains in respect of the transfer of the new asset.

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(vii) Exemption of capital gains on transfer of certain capital assets in case of shifting of an industrial undertaking from an urban area to any SEZ [Section 54GA]

Eligible assesses – Any assessee

Conditions to be fulfilled

- There must be transfer of capital assets
- Such transfer must be effected in the course of, or in consequence of the shifting of an industrial undertaking from an urban area to any SEZ, whether developed in an urban area or not.
- The capital asset should be either machinery or plant or building or land or any rights in building or land used for the purposes of the business of an industrial undertaking situated in an urban area.
- The assessee should, within a period of 1 year before or 3 years after the date of transfer,
  - purchase machinery or plant for the purposes of business of the industrial undertaking in the SEZ;
  - acquire building or land or construct building for the purposes of his business in the SEZ;
  - shifted the original asset and transferred the establishment of such industrial undertaking from the urban area to the SEZ; and
  - incurred expenses for such other purposes as may be specified in a scheme framed by the Central Government.
- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS *[Refer points (viii) at the end of this sub-heading (2)].* Amount utilised by the assessee for purchase of new asset and expenses of shifting and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of exemption

- If cost of new assets plus expenses incurred for shifting ≥ Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new assets plus expenses incurred for shifting < Capital gains, capital gains (short-term or long-term) to the extent of such cost and expenses is exempt.

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Consequences if the new asset is transferred within a period of 3 years

- If the new asset is transferred within a period of 3 years of its purchase or construction, then the capital gain, which was exempt earlier under section 54GA would be deducted from the cost of acquisition of the new asset for the purpose of computation of capital gains in respect of the transfer of the new asset.

(viii) Capital Gains Account Scheme (CGAS)

Under sections 54, 54B, 54D, 54F, 54G and 54GA, capital gains is exempt to the extent of investment of such gains/ net consideration (in the case of section 54F) in specified assets within the specified time. If such investment is not made before the date of filing of return of income, then the capital gain or net consideration (in case of exemption under section 54F) has to be deposited under the CGAS. However, the capital gain in excess of ₹ 10 crore would not be taken into account for the purpose of deposit in CGAS in case of section 54 and the net consideration in excess of ₹ 10 crore would not be taken into account for the purpose of deposit in CGAS in case of section 54F.

Time limit

Such deposit in CGAS should be made before filing the return of income or on or before the due date of filing the return of income, whichever is earlier. In such cases, the amount already utilized for purchase or construction of new asset plus the amount deposited under the CGAS on or before due date u/s 139(1) would be deemed to be the cost of new asset. However, for the purpose of sections 54 and 54F, the amount so deemed to be the cost of the new asset cannot exceed ₹ 10 crore.

Proof of such deposit should be attached with the return. The deposit can be withdrawn for utilization for the specified purposes in accordance with the scheme.

Consequences if the amount deposited in CGAS is not utilized within the stipulated time of 2 years / 3 years

If the amount deposited is not utilized for the specified purpose within the stipulated period, then the **unutilized amount shall be charged as capital gain** of the previous year in which the specified period expires. In the case of section 54F and 54GB, proportionate amount will be taxable.

CBDT Circular No.743 dated 6.5.96 clarifies that in the event of death of an individual before the stipulated period, the unutilized amount is not chargeable to tax in the hands of the legal heirs of the deceased individual. Such unutilized amount is not income but is a part of the estate devolving upon them.

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(ix) Extension of time for acquiring new asset or depositing or investing amount of Capital Gain [Section 54H]

In case of compulsory acquisition of the original asset, where the compensation is not received on the date of transfer, the period available for acquiring a new asset or making investment in CGAS under sections 54, 54B, 54D, 54EC and 54F would be considered from the date of receipt of such compensation and not from the date of the transfer.

4.21 REFERENCE TO VALUATION OFFICER [SECTION 55A]

Section 55A provides that the Assessing Officer may refer the valuation of a capital asset to a Valuation Officer in the following circumstances with a view to ascertaining the fair market value of the capital asset for the purposes of capital gains -

(i) In a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of the opinion that the value so claimed is at variance with its fair market value.

Under this provision, the Assessing Officer can make a reference to the Valuation Officer in cases where the fair market value is taken to be the sale consideration of the asset. An Assessing Officer can also make a reference to the Valuation Officer in a case where the fair market value of the asset as on 01.04.2001 is taken as the cost of the asset, if he is of the view that there is any variation between the value as on 01.04.2001 claimed by the assessee in accordance with the estimate made by a registered valuer and the fair market value of the asset on that date.

(ii) If the Assessing Officer is of the opinion that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than 15% of the value of asset as so claimed or by more than ₹ 25,000.

(iii) The Assessing Officer is of the opinion that, having regard to the nature of asset and other relevant circumstances, it is necessary to make the reference.

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4.22 TAX ON SHORT TERM CAPITAL GAINS IN RESPECT OF EQUITY SHARES/ UNITS OF AN EQUITY ORIENTED FUND/ UNITS OF A BUSINESS TRUST [SECTION 111A]

(1) **Applicability of concessional rate of tax:** This section provides for a concessional rate of tax on the short-term capital gains on transfer of -

(i) an equity share in a company or

(ii) a unit of an equity oriented fund or

(iii) a unit of a business trust.

(2) **Concessional rate of tax in respect of STCG on transfer of certain assets:** The concessional rate of tax on the short-term capital in respect of transfer of above-mentioned assets is 20%

(3) **Conditions**: The conditions for availing the benefit of this concessional rate are –

(i) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004, being the date on which Chapter VII of the Finance (No. 2) Act, 2004 came into force; and

(ii) such transaction should be chargeable to securities transaction tax under the said Chapter.

However, short-term capital gains arising from transactions undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Centre (IFSC) would be taxable at a concessional rate of 20%, even though STT is not leviable in respect of such transaction.

(4) **Adjustment of Unexhausted Basic Exemption Limit**: In the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then, such short-term capital gain will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 20%. However, the benefit of availing the basic exemption limit is not available in the case of non-residents.

(5) **No deduction under Chapter VI-A against STCG taxable under section 111A**: Deductions under Chapter VI-A cannot be availed in respect of such short-term capital

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gains on equity shares of a company or units of an equity oriented fund or unit of a business trust included in the total income of the assessee.

4.23 TAX ON LONG TERM CAPITAL GAINS [SECTION 112]

(1) **Concessional rate of tax:** Long term capital gains on transfer of all long-term capital assets (other than referred to in u/s 112A) would be taxable 12.5%.

However, in case of an individual or HUF, being a resident in India, capital gains arising on transfer of long-term capital asset, being land or building or both if acquired before 23.7.2024 would be taxable –

- @ 12.5% without indexation; or

- @ 20% with indexation

whichever is beneficial.

Further, in case of non-residents, LTCG on transfer of unlisted securities, or shares of a closely held company, would be taxable @12.5% without foreign currency fluctuation.

Important Points to remember –

(1) **For Individuals or HUF (Residents):** In the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then, such long-term capital gain will be reduced by the unexhausted basic exemption limit. However, the benefit of adjustment of unexhausted basic exemption limit is not available in the case of non-residents.

(2) **Non-Residents and Foreign Companies:** Long-term capital gains from the transfer of listed shares (other than listed equity shares covered u/s 112A) or debentures of an Indian company (acquired in foreign currency) will be taxed at 12.5% with foreign currency fluctuation adjustments.

(3) **No Chapter VI-A deduction against LTCG**: The provisions of section 112 make it clear that the deductions under Chapter VIA cannot be availed in respect of the long-term capital gains included in the total income of the assessee.

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4.24 TAX ON LONG TERM CAPITAL GAINS ON CERTAIN ASSETS [SECTION 112A]

(1) **Applicability of concessional rate of tax:** Section 112A provides that notwithstanding anything contained in section 112, a concessional rate of tax of 12.5% will be leviable on the long-term capital gains exceeding ₹ 1,25,000 on transfer of –

(a) an equity share in a company or

(b) a unit of an equity oriented fund or

(c) a unit of a business trust.

(2) **Conditions:** The conditions for availing the benefit of this concessional rate are–

(a) In case of equity share in a company, STT has been paid on acquisition and transfer of such capital asset

(b) In case of unit of an equity oriented fund or unit of business trust, STT has been paid on transfer of such capital asset.

However, the Central Government may, by notification in the Official Gazette, specify the nature of acquisition of equity share in a company on which the condition of payment of STT on acquisition would not be applicable.

Accordingly, the Central Government has, vide notification No. 60/2018, dated 1st October, 2018, notified that the condition of chargeability of STT shall not apply to the acquisition of equity shares entered into

- before 1st October, 2004 or
- on or after 1st October, 2004 which are not chargeable to STT, other than the following transactions.

In effect, only in respect of the following transactions mentioned in column (2), the requirement of paying STT at the time of acquisition for availing the benefit of concessional rate of tax under section 112A would apply. In may be noted that the exceptions are listed in column (3) against the transaction. The requirement of payment of STT at the time of acquisition for availing benefit of concessional tax rate under section 112A will not apply to acquisition transactions mentioned in column (3).

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(1)	(2)	(3)	
	Transaction	Non-applicability of condition of chargeability of STT	
(a)	Where acquisition of existing listed equity share in a company whose equity shares are not frequently traded in a recognised stock exchange of India is made through a preferential issue	Where acquisition of listed equity share in a company –	
		(i)	has been approved by the Supreme Court, High Court, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf;
		(ii)	is by any non-resident in accordance with foreign direct investment guidelines issued by the Government of India;
		(iii)	is by an investment fund referred to in clause (a) of Explanation 1 to section 115UB or a venture capital fund referred to in section 10(23FB) or a Qualified Institutional Buyer;
		(iv)	is through preferential issue to which the provisions of chapter VII of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 does not apply.
(b)	Where transaction for acquisition of existing listed equity share in a company is not entered through a recognised stock exchange in India	Following acquisitions of listed equity share in a company made in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956:	
		(i)	acquisition through an issue of share by a company other than through preferential issue referred to in (a);
		(ii)	acquisition by scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business;
		(iii)	acquisition approved by the Supreme Court, High Courts, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf;
		(iv)	acquisition under employee stock option scheme or employee stock purchase scheme framed under the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines,1999;
		(v)	acquisition by any non-resident in accordance with foreign direct investment guidelines of the Government of India;

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		(vi)	acquisition in accordance with Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011;
		(vii)	acquisition from the Government;
		(viii)	acquisition by an investment fund referred to in clause (a) to Explanation 1 to section 115UB or a venture capital fund referred to in section 10(23FB) or a Qualified Institutional Buyer;
		(ix)	acquisition by mode of transfer referred to in section 47 (e.g., transfer of capital asset under a gift, an irrevocable trust, transfer of capital asset between holding company and its subsidiary, transfer pursuant to amalgamation, demerger, etc.) or section 50B (slump sale) or section 45(3) (Introduction of capital asset as capital contribution in firm/ AOPs/ BOIs) or section 45(4) (Tax implications on receipt of money or capital assets or both on reconstitution of firm/AOP or BOI) of the Income-tax Act, if the previous owner or the transferor, as the case may be, of such shares has not acquired them by any mode referred to in (a), (b) or (c) listed in column (2) [other than the exceptions listed in column (3)]
(c)	acquisition of equity share of a company during the period beginning from the date on which the company is delisted from a recognised stock exchange and ending on the date immediately preceding the date on which the company is again listed on a recognised stock exchange in accordance with the Securities Contracts (Regulation) Act, 1956 read with SEBI Act,1992 and the rules made thereunder.		

Further, long-term capital gains arising from transaction undertaken on a recognized stock exchange located in an International Financial Service Centre (IFSC) would be taxable at a concessional rate of 12.5%, where the consideration for transfer is received or receivable in foreign currency, even though STT is not leviable in respect of such transaction.

(3) Adjustment of Unexhausted Basic Exemption Limit: In the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then such long-term capital gain exceeding ₹ 1,25,000 will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 12.5%.

However, the benefit of adjustment of unexhausted basic exemption limit is not available in the case of non-residents. It is also not available in case of resident AOPs and BOIs.

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(4) **No deduction under Chapter VI-A against LTCG taxable under section 112A:** Deductions under Chapter VI-A cannot be availed in respect of such long-term capital gains on equity shares of a company or units of an equity oriented fund or unit of a business trust included in the total income of the assessee.

(5) **No benefit of rebate under section 87A against LTCG taxable under section 112A:** In case the assessee opts out of the default tax regime, rebate under section 87A is not available in respect of tax payable @12.5% on LTCG under section 112A.

Subsequent to insertion of section 112A, the CBDT has issued clarification F. No. 370149/20/2018-TPL dated 04.02.2018 in the form of a Question and Answer format to clarify certain issues raised in different fora on various issues relating to the new tax regime for taxation of long-term capital gains. The relevant questions raised and answers to such questions as per the said Circular are given hereunder. [Answers to certain questions have been revised to reflect the latest position of law]:

Q 1. What is the meaning of long term capital gains under the new tax regime for long term capital gains?

Ans 1. Long term capital gains mean gains arising from the transfer of long-term capital asset.

It provides for a new long-term capital gains tax regime for the following assets –

(i). Equity Shares in a company listed on a recognised stock exchange;

(ii). Unit of an equity oriented fund; and

(iii). Unit of a business trust.

The concessional tax rate u/s 112A applies to the above assets, if–

a. the assets mentioned are held for a period of "more than 12 months" from the date of acquisition; and

b. the Securities Transaction Tax (STT) is paid at the time of transfer. However, in the case of equity shares acquired after 1.10.2004, STT is required to be paid even at the time of acquisition (subject to notified exemptions).

Q 2. What is the point of chargeability of the tax?

Ans 2. The tax will be levied only upon transfer of the long-term capital asset on or after 1st April, 2018, as defined in section 2(47) of the Act.

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Q 3. What is the method for calculation of long-term capital gains?

Ans 3. The long-term capital gains will be computed by deducting the cost of acquisition from the full value of consideration on transfer of the long-term capital asset.

Q 4. How do we determine the cost of acquisition for assets acquired on or before 31st January, 2018?

Ans 4. The cost of acquisition for the long-term capital asset acquired on or before 31st January, 2018 will be the actual cost.

However, if the actual cost is less than the fair market value of such asset as on 31st January, 2018, the fair market value will be deemed to be the cost of acquisition.

Further, if the full value of consideration on transfer is less than the fair market value, then such full value of consideration or the actual cost, whichever is higher, will be deemed to be the cost of acquisition.

Q 5. Please provide illustrations for computing long-term capital gains in different scenarios, in the light of answer to question 4.

Ans 5. The computation of long-term capital gains in different scenarios is illustrated as under

Scenario 1 – An equity share is acquired on 1st January, 2017 at ₹ 100, its fair market value is ₹ 200 on 31st January, 2018 and it is sold on 1st April, 2025 at ₹ 250. As the actual cost of acquisition is less than the fair market value as on 31st January, 2018, the fair market value of ₹ 200 will be taken as the cost of acquisition and the long-term capital gain will be ₹ 50 (₹ 250 – ₹ 200).

Scenario 2 – An equity share is acquired on 1st January, 2017 at ₹ 100, its fair market value is ₹ 200 on 31st January, 2018 and it is sold on 1st April, 2025 at ₹ 150. In this case, the actual cost of acquisition is less than the fair market value as on 31st January, 2018. However, the sale value is also less than the fair market value as on 31st January, 2018. Accordingly, the sale value of ₹ 150 will be taken as the cost of acquisition and the long-term capital gain will be NIL (₹ 150 – ₹ 150).

Scenario 3 – An equity share is acquired on 1st January, 2017 at ₹ 100, its fair market value is ₹ 50 on 31st January, 2018 and it is sold on 1st April, 2024 at ₹ 150. In this case, the fair market value as on 31st January, 2018 is less than the actual cost of acquisition, and therefore, the actual cost of ₹ 100 will be taken as actual cost of acquisition and the long-term capital gain will be ₹ 50 (₹ 150 – ₹ 100).

Scenario 4 – An equity share is acquired on 1st January, 2017 at ₹ 100, its fair market value is ₹ 200 on 31st January, 2018 and it is sold on 1st April, 2025 at ₹ 50. In this case, the actual cost of acquisition is less than the fair market value as on 31st January, 2018. The sale value

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is less than the fair market value as on 31st January, 2018 and also the actual cost of acquisition. Therefore, the actual cost of ₹ 100 will be taken as the cost of acquisition in this case. Hence, the long-term capital loss will be ₹ 50 (₹ 50 – ₹ 100) in this case.

Q 6. What will be the tax treatment of transfer made on or after 1st April 2018?

Ans 6. The long-term capital gains exceeding ₹ 1,25,000 arising from transfer of listed equity shares/ units of equity oriented fund/business trust on or after 1st April, 2018 will be taxed at 12.5%. However, there will be no tax on gains accrued upto 31st January, 2018.

Q 7. What is the date from which the holding period will be counted?

Ans 7. The holding period will be counted from the date of acquisition.

Q 8. Whether tax will be deducted at source in case of gains by resident tax payer?

Ans 8. No. There will be no deduction of tax at source from the payment of long-term capital gains to a resident tax payer.

Q 9. What will be the cost of acquisition in the case of bonus shares acquired before 1st February 2018?

Ans 9. The cost of acquisition of bonus shares acquired before 31st January, 2018 will be determined as per section 55(2)(ac). Therefore, the fair market value of the bonus shares as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 5), and hence, the gains accrued upto 31st January, 2018 will continue to be exempt[5].

Q 10. What will be the cost of acquisition in the case of right share acquired before 1st February 2018?

Ans 10. The cost of acquisition of right share acquired before 31st January, 2018 will be determined as per section 55(2)(ac). Therefore, the fair market value of right share as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 5), and hence, the gains accrued upto 31st January, 2018 will continue to be exempt.

Q 11. What will be the treatment of long-term capital loss arising from transfer made on or after 1st April, 2018?

Ans 11. Long-term capital loss arising from transfer made on or after 1st April, 2018 will be allowed to be set-off and carried forward in accordance with existing provisions of the Act.

[5] Subject to the notification issued by the Central Government to specify the nature of acquisition of equity share in a company on which the condition of payment of STT on acquisition would not be applicable.

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Therefore, it can be set-off against any other long-term capital gains and unabsorbed loss can be carried forward to subsequent eight years for set-off against long-term capital gains.

ILLUSTRATION 23

Calculate the income-tax liability for the assessment year 2026-27 in the following cases:

	Mr. A (age 45)	***Mrs. B (age 62)***	***Mr. C (age 81)***	***Mr. D (age 82)***
Status	***Non-resident***	***Non-resident***	***Resident***	***Non-resident***
Total income other than long-term capital gain	*2,40,000*	*4,10,000*	*5,90,000*	*4,80,000*
Long-term capital gain	*85,000 from sale of vacant site*	*10,000 from sale of listed equity shares (STT paid on sale and purchase of shares)*	*60,000 from sale of agricultural land in rural area*	*Nil*

(i) If Mr. A, Mrs. B, Mr. C and Mr. D pay tax under default tax regime u/s 115BAC.

(ii) If Mr. A, Mrs. B, Mr. C and Mr. D exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the normal provisions of the Act.

SOLUTION

(i) If Mr. A, Mrs. B, Mr. C and Mr. D pay tax under default tax regime u/s 115BAC

Computation of income-tax liability for the A.Y.2026-27

Particulars	**Mr. A (age 45)**	**Mrs. B (age 62)**	**Mr. C (age 81)**	**Mr. D (age 82)**
Residential Status	Non-resident	Non-resident	Resident	Non-resident
Applicable basic exemption limit	₹ 4,00,000	₹ 4,00,000	₹ 4,00,000	₹ 4,00,000
Asset sold	Vacant site	Listed equity shares (STT paid on both sale and purchase of shares)	Rural agricultural land	-
Long-term capital gain (on sale of above asset)	₹ 85,000 [Taxable @12.5% u/s 112]	₹ 10,000 [exempt u/s 112A since it is less than ₹ 1,25,000]	₹ 60,000 (Exempt –not a capital asset)	-
Other income	₹ 2,40,000	₹ 3,10,000	₹ 5,90,000	₹ 4,80,000

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Tax liability				
On LTCG	₹ 10,625	-	-	-
On Other income	Nil	₹ 500	₹ 9,500	₹ 4,000
	₹ 10,625	₹ 500	₹ 9,500	₹ 4,000
Less: Rebate u/s 87A	-	-	₹ 9,500	-
	₹ 10,625	₹ 500	Nil	₹ 4,000
Add: Health & education cess (HEC) @4%	₹ 425	₹ 20	Nil	₹ 160
Total tax liability	**₹ 11,050**	**₹ 520**	**Nil**	**₹ 4,160**

Note: Since Mr. C is a resident whose total income does not exceed ₹ 12 lakhs, he is eligible for rebate of ₹ 60,000 or the actual tax payable, whichever is lower, under section 87A.

(ii) If Mr. A, Mrs. B, Mr. C and Mr. D exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the normal provisions of the Act

Computation of income-tax liability for the A.Y.2026-27

Particulars	Mr. A (age 45)	Mrs. B (age 62)	Mr. C (age 81)	Mr. D (age 82)
Residential Status	Non-resident	Non-resident	Resident	Non-resident
Applicable basic exemption limit	₹ 2,50,000	₹ 2,50,000	₹ 5,00,000	₹ 2,50,000
Asset sold	Vacant site	Listed equity shares (STT paid on both sale and purchase of shares)	Rural agricultural land	-
Long-term capital gain (on sale of above asset)	₹ 85,000 [Taxable @12.5% u/s 112]	₹ 10,000 [exempt u/s 112A since it is less than ₹ 1,25,000]	₹ 60,000 (Exempt –not a capital asset)	-
Other income	₹ 2,40,000	₹ 4,10,000	₹ 5,90,000	₹ 4,80,000
Tax liability				
On LTCG	₹ 10,625	-	-	-
On Other income	Nil	₹ 8,000	₹ 18,000	₹ 11,500
	₹ 10,625	₹ 8,000	₹ 18,000	₹ 11,500
Less: Rebate u/s 87A	-	-	-	-
	₹ 10,625	₹ 8,000	₹ 18,000	₹ 11,500

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Add: Health & education cess (HEC) @4%	₹ 425	₹ 320	₹ 720	₹ 460
Total tax liability	**₹ 11,050**	**₹ 8,320**	**₹ 18,720**	**₹ 11,960**

Notes:

Since Mrs. B and Mr. D are non-residents, they cannot avail the higher basic exemption limit of ₹ 3,00,000 and ₹ 5,00,000 for persons over the age of 60 years and 80 years, respectively. Also, they along with Mr. A, being non-residents are not eligible for rebate under section 87A even though their total income does not exceed ₹ 5 lakh.

4.25 SURPLUS ON SALE OF SHARES AND SECURITIES - WHETHER TAXABLE AS CAPITAL GAINS OR BUSINESS INCOME? [CIRCULAR NO. 06/2016, DATED 29-2-2016]

Section 2(14) defines the term "capital asset" to include 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 or personal assets subject to certain exceptions. As regards shares and other securities, the same can be held either as capital assets or stock-in-trade/trading assets or both.

Determination of the character of a particular investment in shares or other securities, whether the same is in the nature of a capital asset or stock-in-trade, is essentially a fact-specific determination and has led to a lot of uncertainty and litigation in the past.

Parameters laid down by CBDT and Courts to distinguish shares held as investments and shares held as stock in trade

Over the years, the courts have laid down different parameters to distinguish the shares held as investments from the shares held as stock-in-trade. The CBDT has also, through Instruction No. 1827, dated August 31, 1989 and Circular No. 4 of 2007 dated June 15, 2007, summarized the said principles for guidance of the field formations.

Principles to determine whether gains on sale of listed shares and other securities would constitute capital gains or business income

Disputes, however, continue to exist on the application of these principles to the facts of an individual case since the taxpayers find it difficult to prove the intention in acquiring such shares/securities. In this background, while recognizing that no universal principle in absolute

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terms can be laid down to decide the character of income from sale of shares and securities (i.e. whether the same is in the nature of capital gain or business income), CBDT realizing that major part of shares/securities transactions takes place in respect of the listed ones and with a view to reduce litigation and uncertainty in the matter, in partial modification to the aforesaid Circulars, further instructs the Assessing Officers to take into account the following while deciding whether the surplus generated from sale of listed shares or other securities would be treated as Capital Gain or Business Income—

a) **Where assessee opts to treat such shares and securities as stock-in-trade**: Where the assessee itself, irrespective of the period of holding the listed shares and securities, opts to treat them as stock-in-trade, the income arising from transfer of such shares/securities would be treated as its business income,

b) **Listed shares and securities held for a period of more than 12 months**: In respect of listed shares and securities held for a period of more than 12 months immediately preceding the date of its transfer, if the assessee desires to treat the income arising from the transfer thereof as Capital Gain, the same shall not be put to dispute by the Assessing Officer. However, this stand, once taken by the assessee in a particular Assessment Year, shall remain applicable in subsequent Assessment Years also and the taxpayers shall not be allowed to adopt a different/contrary stand in this regard in subsequent years;

c) **Other cases:** In all other cases, the nature of transaction (i.e. whether the same is in the nature of capital gain or business income) shall continue to be decided keeping in view the aforesaid Circulars issued by the CBDT.

Principles listed above not to apply in case of sham transactions

It is, however, clarified that the above shall not apply in respect of such transactions in shares/securities where the genuineness of the transaction itself is questionable, such as bogus claims of Long-term Capital Gain/Short Term Capital Loss or any other sham transactions.

Objective of formulation of principles: Reducing litigation and ensuring consistency

It is reiterated that the above principles have been formulated with the sole objective of reducing litigation and maintaining consistency in approach on the issue of treatment of income derived from transfer of shares and securities. All the relevant provisions of the Act shall continue to apply on the transactions involving transfer of shares and securities.

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SIGNIFICANT SELECT CASES

S.No.	Case Law	
1.	***PCIT and another vs Jupiter Capital Pvt. Ltd. [2025] 472 ITR 616 (SC)***	
	Issue	**Facts, Analysis and Decision**
	Whether the reduction in share capital by a company, without any change in the shareholding pattern and face value of shares, constitutes a "transfer" under section 2(47) in the hands of shareholders?	**Facts of the case:** The assessee company held 15,33,40,900 shares, representing 99.88% of total shares of an Indian company. That company incurred losses, as a result of which the net worth of the company got eroded. On petition filed by the Company, the High Court ordered a reduction in the share capital of the company from 15,35,05,750 shares to 10,000 shares. Consequently, the shareholding of the assessee was reduced proportionately from 15,33,40,900 shares to 9,988 shares. However, the face value of the shares remained the same at ₹ 10 even after the reduction in the share capital. The High Court also directed the company to pay ₹ 3,17,83,474 to the assessee as consideration. The assessee claimed long-term capital loss accrued on the reduction in share capital. However, the Assessing Officer and CIT(A) disallowed the assessee's claim for capital loss, arguing there was no "transfer". The Tribunal reversed the order passed by CIT (A) and High Court also affirmed the order passed by the Tribunal. **Analysis:** The Apex Court observed that the expression "extinguishment of any right therein" is of wide import. It covers every possible transaction which results in the destruction, annihilation, extinction, termination, cessation or cancellation, by satisfaction or otherwise, of all or any of the bundle of rights qualitative or quantitative, which the assessee has in a capital asset, whether such asset is corporeal or incorporeal. In the present case, the face value per share has remained the same before the reduction of share capital and after the reduction of share capital. However, as the total number of shares have been reduced from 15,35,05,750 to 10,000 and out of this the assessee was holding 15,33,40,900 shares prior to reduction and 9,988 shares after reduction, it can be said that on account of reduction in the number of shares, the assessee has extinguished its right of 15,33,40,900 shares, and in lieu thereof, the assessee received 9,988 shares at ₹ 10 each along with an amount of ₹ 3,17,83,474.

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		The Supreme Court *in the case of Karthikeya V. Sarabhai v. CIT*[6] observed that reduction of right in a capital asset would amount to "transfer" under section 2(47). Sale is only one of the modes of transfer envisaged by section 2(47). Relinquishment of any rights in it, which may not amount to sale, can also be considered as transfer and any profit or gain which arises from the transfer of such capital asset is taxable under section 45. Accordingly, the Apex Court held that reduction in share capital results in "transfer" under the provisions of the Income-tax Act, 1961 as there is extinguishment of rights qua such shares. The capital loss arising on proportionate reduction in share capital of the company is admissible even if the overall shareholding of the taxpayer in the company remains unchanged post reduction.
2.	***Seshasayee Steels P. Ltd. v. ACIT (2020) 421 ITR 46 (SC)***	
	Issue	**Analysis & Decision**
	Can any transaction which enables the enjoyment of immovable property be considered as enjoyment as a purported owner thereof for being treated as a "transfer" of a capital asset u/s 2(47)(vi) and levy of tax on capital gains arising therefrom?	Any transaction which has the effect of transferring or enabling the enjoyment of any immovable property would come within the of purview u/s 2(47)(vi). **Section 2(47)(vi) appears to be to bring within its tax net, a *de facto* transfer of any immovable property. The expression 'enabling the enjoyment of' takes colour from the earlier expression 'transferring', so that it is clear that any transaction which enables the enjoyment of immovable property must be enjoyment as a purported owner thereof.** The idea is to bring within the tax net, transactions, where, though title may not be transferred in law, there is, in substance, a transfer of title in fact. In this case, the assessee's rights in the immovable property were extinguished on the receipt of the last cheque. Further, the compromise deed could be stated to be a transaction which had the effect of transferring the immovable property in question. Accordingly, the transaction fell u/s 2(47)(ii) and (vi). Hence, it is a transfer in relation to the capital asset and capital gains tax liability would be attracted.

[6] [1997] 228 ITR 163

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3.	***Balakrishnan v. Union of India & Others (2017) 391 ITR 178 (SC)***	
	Issue	**Analysis & Decision**
	Would receipt of higher compensation after notification of compulsory acquisition change the character of transaction into a voluntary sale, so as to deny exemption u/s 10(37)(iii)?	When proceedings were initiated under the Land Acquisition Act, 1894, even if the compensation is negotiated and fixed, it would continue to remain as compulsory acquisition. **Merely because the compensation amount is agreed upon, the character of acquisition will not change from compulsory acquisition to a voluntary sale.** The claim of exemption from capital gains u/s 10(37)(iii) is, therefore, tenable in law.
4.	***CIT v. V.S. Dempo Company Ltd (2016) 387 ITR 354 (SC)***	
	Issue	**Analysis & Decision**
	In a case where a depreciable asset (building) held for more than 24 months is transferred, can benefit of exemption u/s 54EC be claimed, if the capital gains on sale of such asset are reinvested in long-term specified assets within the specified time?	The assessee cannot be denied exemption u/s 54EC, because firstly, there is nothing in section 50 to suggest that the fiction created therein is not restricted to only sections 48 and 49. Secondly, fiction created by the legislature has to be confined for the purpose for which is created. Thirdly, **section 54EC does not make any distinction between depreciable and non-depreciable asset for the purpose of re-investment of capital gains in long term specified assets for availing the exemption thereunder.** Further, section 54EC specifically provides that when the capital gain arising on the transfer a long-term capital asset (being land or building or both) is invested or deposited in long-term specified assets, the assessee shall not be subject to capital gains to that extent. Therefore, the exemption u/s 54EC cannot be denied to the assessee on account of the fiction created in section 50.
5.	***Fibre Boards (P) Ltd v. CIT (2015) 376 ITR 596 (SC)***	
	Issue	**Analysis & Decision**
	Can advance given for purchase of land, building, plant and machinery tantamount to utilization of	For the purpose of availing exemption, all that was required for the assessee is to "utilise" the amount of capital gain for purchase and acquisition of new machinery or plant and building or land. **Since the entire amount of capital gain, in**

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	capital gain for purchase and acquisition of new machinery or plant and building or land, for claim of exemption u/s 54G?	**this case, was utilized by the assessee by way of advance for acquisition of land, building, plant and machinery, the assessee is entitled to avail exemption/deduction u/s 54G.**
6.	***CIT v. Aditya Kumar Jajodia (2018) 407 ITR 107 (Cal)***	
	Issue	**Analysis & Decision**
	Can the amount incurred by the assessee towards perfecting title of property acquired through will, for making further sale, be included in the cost of acquisition for computing capital gains?	The assessee had inherited the immovable property under a will and the **costs incurred by him for perfection of the title from perpetual leasehold rights to the complete ownership had to be regarded as a cost of acquisition** within the meaning of sections 48 and 55, as the assessee was transferring the complete ownership rights to the transferee, and not the leasehold rights.
7.	***CIT v. Manjula J. Shah (2013) 355 ITR 474 (Bom.)***	
	Issue	**Decision**
	Would indexation benefit in respect of the gifted asset apply from the year in which the asset was first held by the assessee or from the year in which the same was first acquired by the previous owner?	**The indexed cost of acquisition in case of gifted asset has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset**. The benefit of indexation can be opted by a resident individual or HUF while computing tax liability u/s 112 only for long-term capital assets, being land or building or both which are acquired before 23.7.2024.
8.	***Sakthi Metal Depot v. CIT [2021] 436 ITR 1 (SC)***	
	Issue	**Analysis & Decision**
	Would the depreciable asset forming part of block of assets on which depreciation is being	The depreciable asset forming a part of block of assets within the meaning section 2(11) would not cease to be a part of the block of assets so long as the assessee continued business. In this case, the building forming part of the block of assets would

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	allowed since its acquisition change its character if it is not used for business purpose for the last two years, to the effect that gain arising from its transfer be considered as long term capital gain instead of short-term capital gains?	retain its character as such, even if one or two of the assets in the block were not used for the business purposes in the last couple of years. Consequently, the profits arising on sale of such asset would be short-term capital gains.
9.	***CIT v. Syed Ali Adil (2013) 352 ITR 0418 (A.P.)*** ***CIT v. Ananda Basappa (2009) 309 ITR 329*** ***CIT v. K.G. Rukminiamma (2011) 331 ITR 211***	
	Issue	**Decision**
	Would an assessee be entitled to exemption under section 54 in respect of purchase of two flats, adjacent to each other and having a common meeting point?	The assessee is entitled to investment in both the flats purchased by him, since they were adjacent to each other and had a common meeting point, thus, making it a single residential unit. ***Note*** *– Section 54 has been amended by the Finance Act, 2019 to permit claim of deduction in respect of two residential houses purchased/constructed, where long-term capital gains on sale of residential house does not exceed ₹ 2 crores.* *However, this case law will still hold good since the exemption for investment in two residential houses cannot be availed -* - *where long term capital gains > ₹ 2 crores; and* - *where long term capital gains ≤ ₹ 2 crores and exemption of acquiring two properties was already availed once* *Even in these cases, the benefit of treating adjacent flats as one residential house for the purpose of exemption under section 54 would be available as per this High Court ruling.*

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		Furthermore, even in cases where long term capital gains ≤ ₹ 2 crores, the benefit of this case law can be availed and benefit of one time exemption under section 54 can be deferred and availed at a later point of time.
10.	***CIT v. Gurnam Singh (2010) 327 ITR 278 (P&H)***	
	Issue	**Analysis & Decision**
	Can exemption u/s 54B be denied solely on the ground that the new agricultural land purchased is not wholly owned by the assessee, as the assessee's son is a co-owner as per the sale deed?	The agricultural land sold belonged to the assessee and the sale proceeds were also used for purchasing agricultural land. The possession of the said land was also taken by the assessee. **Merely because the assessee's son was shown in the sale deed as co-owner, deduction u/s 54B cannot be denied.** Therefore, the assessee was entitled to deduction u/s 54B.
11.	***CIT v. Kamal Wahal (2013) 351 ITR 4 (Delhi)***	
	Issue	**Analysis & Decision**
	Can exemption u/s 54F be denied solely on the ground that the new residential house is purchased by the assessee exclusively in the name of his wife?	For the purpose of section 54F, a new residential house need not necessarily be purchased by the assessee in his own name nor is it necessary that it should be purchased exclusively in his name. Having regard to the rule of purposive construction and the object of enactment of section 54F, **the assessee is entitled to claim exemption u/s 54F in respect of utilization of sale proceeds of capital asset for investment in residential house property in the name of his wife.**
12.	***CIT v. Ravinder Kumar Arora (2012) 342 ITR 38 (Delhi)***	
	Issue	**Analysis & Decision**
	In case of a house property registered in joint names, can exemption u/s 54F be allowed fully to the co-owner who has paid whole of the purchase	The inclusion of his wife's name in the sale deed was just to avoid any litigation after his death. All the funds invested in the said house were provided by the assessee, including the stamp duty and corporation tax paid at the time of the registration of the sale deed of the said house. This fact was also clearly evident from the bank statement of the assessee.

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	consideration of the house property or will it be restricted to his share in the house property?	**Section 54F mandates that the house should be purchased by the assessee but it does not stipulate that the house should be purchased only in the name of the assessee.** In this case, the house was purchased by the assessee in his name and his wife's name was also included additionally. Therefore, the conditions stipulated in section 54F stand fulfilled and the entire exemption claimed in respect of the purchase price of the house property shall be allowed to the assessee.
13.	***CIT v. Sambandam Udaykumar (2012) 345 ITR 389 (Kar.)***	
	Issue	**Analysis & Decision**
	Can exemption u/s 54F be denied to an assessee in respect of investment made in construction of a residential house, on the ground that the construction was not completed within 3 years after the date on which transfer took place, on account of pendency of certain finishing work like flooring, electrical fittings, fittings of door shutter etc.?	The condition precedent for claiming the benefit u/s 54F is that capital gains realized from sale of capital asset should have been invested either in purchasing a residential house or in constructing a residential house within the stipulated period. If the assessee has invested the money in the construction of a residential house, merely because the construction was not completed in all respects and possession could not be taken within the stipulated period, would not disentitle him from claiming exemption u/s 54F. In fact, in this case, **the assessee has taken possession of the residential building and is living in the said premises despite the pendency of flooring work, electricity work, fitting of door and window shutters**. Therefore, **the assessee is entitled to exemption u/s 54F** in respect of the amount invested in construction within the prescribed period.
14.	***Gouli Mahadevappa v. ITO (2013) 356 ITR 90 (Kar.)***	
	Issue	**Analysis & Decision**
	Where the stamp duty value under section 50C has been adopted as the full value of consideration, can the reinvestment made in acquiring a residential property, which	When capital gain is assessed on notional basis as per the provisions of section 50C, and the higher value i.e., the stamp duty value under section 50C has been adopted as the full value of consideration, the entire amount reinvested in the residential house within the prescribed period should be considered for the purpose of exemption under section 54F, irrespective of the source of funds for such reinvestment.

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	is in excess of the actual net sale consideration, be considered for the purpose of computation of exemption under section 54F, irrespective of the source of funds for such reinvestment?	For eg: if stamp duty value = ₹ 50 lakh, actual consideration = ₹ 40 lakh, capital gains = ₹ 12 lakh, if ₹ 47 lakh is re-invested in residential house, then exemption u/s 54F = ₹ 12 lakh x ₹ 47 lakh/ ₹ 50 lakh = ₹ 11.28 lakh (assuming gross and net consideration are same), irrespective of the source of balance ₹ 7 lakh (₹ 47 lakh - ₹ 40 lakh) over and above actual consideration.
15.	***Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)***	
	Issue	**Analysis & Decision**
	Can exemption u/s 54EC be denied on account of the bonds being issued after six months of the date of transfer even though the payment for the bonds was made by the assessee within the six-month period?	In order to avail the exemption u/s 54EC, the capital gains have to be invested in a long-term specified asset within a period of six months from the date of transfer. **Where the assessee has made the payment within the six month period, and the same is reflected in the bank account and a receipt has been issued as on that date, the exemption u/s 54EC cannot be denied** merely because the bond was issued after the expiry of the six month period or the date of allotment specified therein was after the expiry of the six month period.
16.	***Principal CIT v. Gujarat State Fertilizers and Chemicals Limited (2018) 409 ITR 378 (Guj)***	
	Issue	**Analysis & Decision**
	Would sale of fertilizer bonds (issued in lieu of government subsidy) at loss be treated as a business loss or a loss under the head "Capital gains"?	Fertilizer subsidy given to an assessee to compensate the loss on sale of fertilisers should be treated as business income of the assessee. Due to cash crunch, the Government of India had discharged its dues of paying the subsidy by issue of fertilizer bonds. These bonds are saleable in the open market and the prices of such bonds are varying. In this case also, the assessee received fertilizer bonds (in lieu of subsidy) which were sold at a loss in the open market. Since the subsidy would have been treated as business income, **loss on sale of fertilizer bonds issued is to be allowed as business loss.**

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TEST YOUR KNOWLEDGE

Questions

1. *Hari has acquired a residential house property in Delhi on 15th April, 2002 for ₹ 9,00,000 and decided to sell the same on 3rd May, 2005 to Ms. Pari and an advance of ₹ 25,000 was taken from her. The balance money was not paid by Ms. Pari and Hari has forfeited the entire advance sum. On 3rd June, 2025, he has sold this house to Mr. Suri for ₹ 43,00,000. On 4th April, 2025, he had purchased a residential house in Delhi for ₹ 7,00,000, where he was staying with his family on rent for the last 5 years and paid the full amount as per the purchase agreement. However, Hari does not possess any legal title till 31st March, 2026, as such transfer was not registered with the registration authority.*

   Hari has purchased another old house in Chennai on 14th October, 2025 from Mr. X, an Indian resident, by paying ₹ 5,00,000 and the purchase was registered with the appropriate authority.

   Determine the taxable capital gain arising from above transactions in the hands of Hari for Assessment Year 2026-27.

   [Cost inflation Index - 2002-03: 105; 2005-06: 117; 2025-26: 376]

2. *Mr. Ganesh sold his residential house in Mumbai and earned long term capital gain of ₹ 2.5 crores. He purchased two residential flats adjacent to each other on the same day vide two separate registered sale deeds from two different persons. The builder had certified that he had effected necessary modification to make it one residential apartment. Mr. Ganesh sought exemption under section 54 in respect of the investment made in purchase of the two residential flats. The Assessing Officer, however, gave exemption under section 54 to the extent of purchase of one residential flat only contending that since the long-term capital gain exceeds ₹ 2 crore, sub-section (1) of section 54 clearly restricts the benefit of exemption to purchase one residential house only and the two flats cannot be treated as one residential unit since –*

   (i) the flats were purchased through different sale deeds; and

   (ii) it was found by the Inspector that, before its sale to the assessee, the residential flats were in occupation of two different tenants.

   Examine the correctness of the contention of the Assessing Officer.

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3. *Vijay, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year relevant to the assessment year 2026-27. Within a month from the date of such sale, the four brothers executed a release deed in respect of their shares in the co-owned residential house in favour of Vijay for a monetary consideration.*

   Vijay utilised the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his four brothers. Vijay is not using the house, in respect of which his brothers executed a release deed, for his own residential purposes, but has let it out to another person, who is using it for his residential purposes.

   Is Vijay eligible for exemption under section 54 of the Income-tax Act, 1961 for the assessment year 2026-27 in respect of the long-term capital gain arising from the sale of his residential house, which he utilised for acquiring the shares of his brothers in the co-owned residential house? Will the non-use of the new house for his own residential purposes disentitle him to exemption?

4. *Aries Tubes Private Ltd. went into liquidation on 1.6.2025. The company possessed of the following funds prior to the distribution of assets to the shareholders:*

	₹
Share Capital (issued on 1.4.2013)	*5,00,000*
Reserves prior to 1.6.2025	*3,00,000*
Excess realization in the course of liquidation	*5,00,000*
Total	***13,00,000***

   There are 5 shareholders, each of whom received ₹ 2,60,000 from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital gain in long term specified assets as defined in section 54EC. You are required to examine the various issues and advice the shareholders about their liability to income tax.

5. *Xavier had taken a loan under registered mortgage deed against the house, which was purchased by him on 26.5.2002 for ₹ 5 lakhs. The said property was inherited by his son Abraham in financial year 2009-10 as per Will.*

   For obtaining a clear title thereof, Abraham paid the outstanding amount of loan on 12.2.2010 of ₹ 15 lakhs. The said house property was sold by Abraham on 16.4.2025 for ₹ 55 lakhs. Examine with reasons the amount chargeable to capital gains for A.Y. 2026-27

   (Cost Inflation Index 2002-03: 105, 2009-10: 148 and 2025-26: 376).

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6. *Gama Ltd, located within the corporation limits decided in December, 2025 to shift its industrial undertaking to non-urban area. The company sold some of the assets and acquired new assets in the process of shifting. The relevant details are as follows:*

				(₹ in lakhs)	
	Particulars	**Land**	**Building**	**Plant & Machinery**	**Furniture**
(i)	Sale proceeds (sale effected in March, 2026)	8	18	16	3
(ii)	Cost of acquisition	4	10	12	2
(iii)	WDV in terms of section 50	--	4	5	2
(iv)	Cost of new assets purchased in July, 2026 for the purpose of business in the new place	4	7	17	2

Compute the capital gains of Gama Ltd for the assessment year 2026-27.

7. *The assessee was a company carrying on business of manufacture and sale of art-silk cloth. It purchased machinery worth ₹ 4 lakhs on 1.5.2020 and insured it with United India Assurance Ltd against fire, flood, earthquake etc., The written down value of the asset as on 01.04.2025 was ₹ 1,87,850. The insurance policy contained a reinstatement clause requiring the insurance company to pay the value of the machinery, as on the date of fire etc., in case of destruction of loss. A fire broke out in August, 2025 causing extensive damage to the machinery of the assessee rendering them totally useless. The assessee company received a sum of ₹ 4 lakhs from the insurance company on 15th March, 2026. Examine the issues arising on account on the transactions and their tax treatment.*

(Cost inflation index for financial year 2020-21 and 2025-26 are 301 and 376, respectively)

8. *Tani purchased a land at a cost of ₹ 35 lakhs in the financial year 2004-05 and held the same as her capital asset till 31st May, 2024. Tani started her real estate business on 1st June, 2024 and converted the said land into stock-in-trade of her business on the said date, when the fair market value of the land was ₹ 210 lakhs.*

She constructed 15 flats of equal size, quality and dimension. Cost of construction of each flat is ₹ 10 lakhs. Construction was completed in January, 2026. She sold 10 flats at ₹ 30 lakhs per flat between January, 2026 and March, 2026. The remaining 5 flats were held in stock as on 31st March, 2026.

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She invested ₹ 50 lakhs in bonds issued by National Highway Authority of India on 31st March, 2026 and another ₹ 50 lakhs in bonds of Rural Electrification Corporation Ltd. in April, 2026.

Compute the amount of chargeable capital gain and business income in the hands of Tani arising from the above transactions for Assessment Year 2026-27 indicating clearly the reasons for treatment of each item.

Cost Inflation Index: F.Y. 2004-05: 113; F.Y. 2024-25: 363; F.Y. 2025-26: 376.

9. *Following are the details of income provided by Mr. Singh, the assessee for the financial year ended 31st March, 2026:*

   (i) *Rental income from property at Bangalore - ₹ 3 lakhs, Standard Rent - ₹ 2,50,000, Fair Rent - ₹ 2,80,000.*

   (ii) *Municipal and water tax paid during 2025-26: Current year ₹ 35,000, Arrears - ₹ 1,50,000.*

   (iii) *Interest on loan borrowed towards major repairs to the property: ₹ 1,50,000.*

   (iv) *Arrears of rent of ₹ 30,000 received during the year, which was not charged to tax in earlier years.*

   Further, the assessee furnished following additional information regarding sale of property at Chennai:

   (i) *Mr. Singh's father acquired a residential house in April 2006 for ₹ 1,25,000 and thereafter gifted this property to the assessee, Mr. Singh on 1st March, 2007.*

   (ii) *The property, so gifted, was sold by Mr. Singh on 10th August 2025. The consideration received was ₹ 25,00,000.*

   (iii) *Stamp duty charges paid by the purchaser at the time of registration @ 13% (as per statutory guidelines) was ₹ 3,90,000.*

   (iv) *Out of the sale consideration received:*

      (a) *On 02/01/2026, the assessee had purchased two adjacent flats, in the same building, and made suitable modification to make it as one unit. The investment was made by separate sale deeds, amount being ₹ 8,00,000 and ₹ 7,00,000, respectively.*

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(b) *On 10/l0/2025, ₹ 10 lakhs were invested in bonds issued by National Highways Authority of India, but the allotment of the bonds was made on 1.2.2026.*

Compute Mr. Singh's taxable income for assessment year 2026-27 assuming he has exercised the option to shift out of the default tax regime under section 115BAC.

Cost inflation index: F.Y. 2006-07: 122; F.Y. 2025-26: 376

10. *SS(P) Ltd., an Indian company having two undertakings engaged in manufacture of cement and steel, decided to hive off cement division to RV(P) Ltd., an Indian company, by way of demerger. The net worth of SS(P) Ltd. immediately before demerger was ₹ 40 crores. The net book value of assets transferred to RV(P) Ltd. was ₹ 10 crores. The demerger was made in January 2026. In the scheme of demerger, it was fixed that for each equity share of ₹ 10 each (fully paid up) of SS(P) Ltd., two equity shares of ₹ 10 each (fully paid up) were to be issued.*

One Mr. N.K. held 25,000 equity shares in SS(P) Ltd. which were acquired in the financial year 2004-05 for ₹ 6,00,000. Mr. N.K. received 50,000 equity shares from RV(P) Ltd. consequent to demerger in January 2026. He sold all the shares of RV(P) Ltd. for ₹ 8,00,000 in March, 2026. In this background you are requested to answer the following:

(i) *Does the transaction of demerger attract any income tax liability in the hands of SS(P) Ltd. and RV(P) Ltd.?*

(ii) *Compute the capital gain that could arise in the hands of Mr. N.K. on receipt of shares of RV(P) Ltd.*

(iii) *Compute the capital gain that could arise in the hands of Mr. N.K. on sale of shares of RV(P) Ltd.*

(iv) *Will the sale of shares by Mr. N.K. affect the tax benefits availed by SS(P) Ltd. and/or RV(P) Ltd.?*

(v) *Is Mr. N.K. eligible to avail any tax exemption under any of the provisions of the Income-tax Act, 1961 on the sale of shares of RV(P) Ltd.? If so, mention in brief.*

Note:	***Financial Year***	***Cost inflation index***
	2004-05	*113*
	2025-26	*376*

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11. *PQR Limited has two units - one engaged in manufacture of computer hardware and the other involved in developing software. As a restructuring drive, the company has decided to sell its software unit as a going concern by way of slump sale for ₹ 385 lakhs to a new company called S Limited, in which it holds 74% equity shares.*

The balance sheet of PQR limited as on 31st March 2026, being the date on which software unit has been transferred, is given hereunder –

Balance Sheet as on 31.3.2026

Liabilities	₹ (in lakhs)	Assets	₹ (in lakhs)
Paid up Share Capital	300	Fixed Assets	
General Reserve	150	Hardware unit	170
Share Premium	50	Software unit	200
Revaluation Reserve	120	Debtors	
Current Liabilities (Ascertained liabilities)		Hardware unit	140
Hardware unit	40	Software unit	110
Software unit	90	Inventories	
		Hardware unit	95
		Software unit	35
	750		**750**

Following additional information are furnished by the management:

(i) *The Software unit is in existence since May, 2015.*

(ii) *Fixed assets of Software unit includes land which was purchased at ₹ 40 lakhs in the year 2016 and revalued at ₹ 60 lakhs as on March 31, 2026. The stamp duty value on 31.3.2026 is ₹ 55 lakhs.*

(iii) *Fixed assets of Software unit mirrored at ₹ 140 lakhs (₹ 200 lakhs minus land value ₹ 60 lakhs) is written down value of depreciable assets (Furniture and Plant & machinery) as per books of account. However, the written down value of these assets under section 43(6) of the Income-tax Act, 1961 is ₹ 90 lakhs.*

(a) *Ascertain the tax liability, which would arise from slump sale to PQR Limited, assuming it does not opt for section 115BAA.*

(b) *What would be your advice as a tax-consultant to make the restructuring plan of the company more tax-savvy, without changing the amount of sale consideration?*

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12. *Determine the capital gains/loss on transfer of listed equity shares (STT paid both at the time of acquisition and transfer of shares) and units of equity oriented mutual fund (STT paid at the time of transfer of units) for the A.Y.2026-27 and tax, if any, payable thereon, in the following cases, assuming that these are the only transactions covered under section 112A during the P.Y.2025-26 in respect of these assessees:*

(i) *Mr. Prasun purchased 300 shares in A Ltd. on 20.5.2017 at a cost of ₹ 400 per share. He sold all the shares of A Ltd. on 31.5.2025 for ₹ 1200. The price at which these shares were traded in National Stock Exchange on 31.1.2018 is as follows –*

Particulars	Amount in ₹
Highest Trading Price	700
Average Trading Price	680
Lowest Trading Price	660

(ii) *Mr. Raj purchased 200 units each of equity oriented funds, Fund A and Fund B on 1.2.2017 at a cost of ₹ 550 per unit. The units were not listed at the time of purchase. Subsequently, units of Fund A were listed on 1.1.2018 and units of Fund B were listed on 1.2.2018 on the National Stock Exchange. Mr. Raj sold all the units on 3.8.2025 for ₹ 900 each. The details relating to quoted price on National Stock Exchange and net asset value of the units are given hereunder:*

Particulars	Fund A	Fund B
	Amount in ₹	Amount in ₹
Highest Trading Price	750 (on 31.1.2018)	800 (on 1.2.2018)
Average Trading Price	700 (on 31.1.2018)	750 (on 1.2.2018)
Lowest Trading Price	650 (on 31.1.2018)	700 (on 1.2.2018)
Net Asset Value on 31.1.2018	800	950

13. *Mr. Shyam purchased a house property on February 15, 1979 for ₹ 3,24,000. In addition, he has also paid stamp duty @10% on the stamp duty value of ₹ 3,50,000.*

In April, 2008, Mr. Shyam entered into an agreement with Mr. Mohan for sale of such property for ₹ 14,35,000 and received an amount of ₹ 1,11,000 as advance. However, the sale consideration did not materialize and Mr. Shyam forfeited the advance. In May 2015, he again entered into an agreement for sale of said house for ₹ 20,25,000 to Ms. Deepshikha and received ₹ 1,51,000 as advance. However, as Ms. Deepshikha did not pay the balance amount, Mr. Shyam forfeited the advance. In August, 2015, Mr. Shyam constructed the first floor by incurring a cost of ₹ 3,90,000.

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On November 15, 2025, Mr. Shyam entered into an agreement with Mr. Manish for sale of such house for ₹ 30,50,000 and received an amount of ₹ 1,50,000 as advance through an account payee cheque. Mr. Manish paid the balance entire sum and Mr. Shyam transferred the house to Mr. Manish on February 20, 2026. Mr. Shyam has paid the brokerage @1% of sale consideration to the broker.

On April 1, 2001, fair market value of the house property was ₹ 11,85,000 and Stamp duty value was ₹ 10,70,000. Further, the Valuation as per Stamp duty Authority of such house on 15th November, 2025 was ₹ 39,00,000 and on 20th February, 2026 was ₹ 41,00,000.

Compute the capital gains in the hands of Mr. Shyam for A.Y.2026-27. Also, compute the tax liability under section 112, assuming that the basic exemption limit has been fully exhausted against other income.

CII for F.Y. 2001-02: 100; F.Y. 2008-09: 137; F.Y. 2015-16: 254; F.Y. 2025-26: 376

Answers

1. Computation of taxable capital gain of Mr. Hari for the A.Y.2026-27

Particulars	₹
Sale proceeds	43,00,000
Less: Cost of acquisition **[See Note (i) and (ii)]**	8,75,000
Long Term Capital Gain	34,25,000
Less: Exemption under section 54 in respect of investment in house at Delhi **[See Note (iii)]**	7,00,000
Exemption under section 54 in respect of investment in house at Chennai **[See Note (iv)]**	5,00,000
Taxable long-term capital gain	**22,25,000**

Notes:

(i) Cost of acquisition

Particulars	₹
Cost of acquisition	9,00,000
Less: Advance taken and forfeited	25,000
	8,75,000

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Advance received and forfeited on or after 01.04.2014 is taxable under section 56(2)(ix). Such amount would not be reduced to compute cost of acquisition while determining capital gains on sale of such property.

However, in this case, since the advance was received and forfeited in the year 2005, such advance has to be reduced for calculating cost of acquisition for the purpose of arriving at capital gains.

(ii) Since the house property was acquired before 23.7.2024, while computing tax on such LTCG, Mr. Hari has the option to pay tax under section 112 at lower of 12.5% on LTCG computed without indexation benefit or 20% on LTCG computed with indexation benefit.

(iii) In order to avail exemption of capital gains under section 54, residential house should be purchased within 1 year before or 2 years after the date of transfer or constructed within a period of 3 years after the date of transfer. In this case, Hari has purchased the residential house in Delhi within one year before the date of transfer and paid the full amount as per the purchase agreement, though he does not possess any legal title till 31.3.2026 since the transfer was not registered with the registration authority. However, for the purpose of claiming exemption under section 54, holding of legal title is not necessary. If the taxpayer pays the full consideration in terms of the purchase agreement within the stipulated period, the exemption under section 54 would be available. It was so held in *Balraj v. CIT(2002) 254 ITR 22 (Del.) and CIT v. Shahzada Begum (1988) 173 ITR 397 (A.P.).*

(iv) As per section 54, since the amount of capital gain does not exceed ₹ 2 crore, Mr. Hari can claim exemption thereunder in respect of investment made in two residential houses situated in India.

However, if Mr. Hari exercises the option to claim exemption in respect of two residential houses in Delhi and Chennai in P.Y. 2025-26, he shall not be subsequently entitled to exercise the option for the same or any other assessment year.

2. This issue came up before the Karnataka High Court in *CIT v. D. Ananda Basappa (2009) 309 ITR 329*. The Court observed that the assessee had shown that the flats were situated side by side and the builder had also certified that he had effected modification of the flats to make them one unit by opening the door between the apartments. Therefore, it was immaterial that the flats were occupied by two different tenants prior to sale or that it was

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purchased through different sale deeds. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats as one unit. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one residential house.

Applying the ratio of the above decision to the case on hand, Mr. Ganesh is entitled to exemption under section 54 in respect of purchase of two flats to form **one residential house**. Therefore, the contention of the Assessing Officer is not correct.

3. The long-term capital gain arising on sale of residential house would be exempt under section 54 if it is utilized, *inter alia*, for purchase of one residential house situated in India within one year before or two years after the date of transfer. Release by the other co-owners of their share in co-owned property in favour of Vijay would amount to "purchase" by Vijay for the purpose of claiming exemption under section 54 *[CIT v. T.N. Arvinda Reddy (1979) 120 ITR 46 (SC)].* Since such purchase is within the stipulated time of two years from the date of transfer of asset, Vijay is eligible for exemption under section 54. As Vijay has utilised the entire long-term capital gain arising out of the sale of the residential house for payment of consideration to the other co-owners who have released their share in his favour, he can claim full exemption under section 54.

There is no requirement in section 54 that the new house should be used by the assessee for his own residence. The condition stipulated is that the new house should be utilised for residential purposes and its income is chargeable under the head "Income from house property". This requirement would be satisfied even when the new house is let out for residential purposes.

4. Under section 46(1), where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as transfer in the hands of the company for the purpose of section 45.

However, under section 46(2), where the shareholder, on liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head "capital gains", in respect of the money so received or the market value of the other assets on the date of distribution as reduced by the amount of dividend deemed under section 2(22)(c) [chargeable to tax in the hands of shareholders under the head "Income from other sources"] and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

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As per section 2(22)(c), dividend includes any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not.

In this case, the accumulated profits immediately before liquidation is ₹ 3,00,000. The share of each shareholder is ₹ 60,000 (being one-fifth of ₹ 3,00,000). An amount of ₹ 60,000 is the deemed dividend under section 2(22)(c). The same is taxable in the hands of the shareholder under the head "Income from other sources".

Therefore, ₹ 2,00,000 [i.e. ₹ 2,60,000 minus ₹ 60,000, being the deemed dividend under section 2(22)(c)] is the full value of consideration in the hands of each shareholder as per section 46(2). Against this, the investment of ₹ 1,00,000 by each shareholder is to be deducted to arrive at the capital gains of ₹ 1,00,000 of each shareholder. Since the equity shares are not listed, it would not be liable for securities transaction tax and hence, the capital gain (long term) would be taxable under section 112. Such long-term capital gain would be taxable @12.5%.

Exemption under section 54EC is available only where there is an actual transfer of capital assets and not in the case of deemed capital gain as per the decision rendered in the case of *CIT v. Ruby Trading Co (P) Ltd (2003) 259 ITR 54 (Raj).* Therefore, exemption under section 54EC will not be available in this case since it is deemed transfer and not actual transfer. Furthermore, exemption under section 54EC is available only on transfer of long-term capital asset, being land or building or both.

5. The cost of inherited property to Mr. Abraham shall be the cost to the previous owner as per provisions of section 49(1)(iiia) and therefore, ₹ 5 lakhs, being the cost to his father (amount paid by his father on 26.5.2002 for acquiring the property) shall be the cost to Mr. Abraham, who is the new owner. Payment of outstanding loan of the predecessor by the successor for obtaining a clear title of the property by release of Mortgage Deed shall be the cost of acquisition of the successor under section 48 read with section 55(2) of the Act as held by the Apex Court in case of *RM. Arunachalam v. CIT [1997] 227 ITR 222.*

Computation of Taxable Capital Gain for the A.Y. 2026-27

Particulars		₹
Sale consideration of house property		55,00,000
Less: **Cost of acquisition (See Note below)**		
(i) Cost to previous owner	5,00,000	

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(ii) Loan amount paid by Mr. Abraham	15,00,000	20,00,000
Capital gains		**35,00,000**

Note: Since the property was acquired by Mr. Abraham through inheritance, the cost of acquisition will be cost to the previous owner.

Since the house property was acquired before 23.7.2024, while computing tax on such LTCG, Mr. Abraham has the option to pay tax under section 112 at lower of 12.5% on LTCG computed without indexation benefit or 20% on LTCG computed with indexation benefit.

6. Section 54G deals with deduction in respect of any capital gain that may arise from the transfer of an industrial undertaking situated in an urban area in the course of or in consequence of shifting to a non-urban area.

If the assessee purchases new machinery or plant or acquires a building or land or constructs a new building or shifts the original asset and transfers the establishment to the new area, within 1 year before or 3 years after the date on which the transfer takes place, then, instead of the capital gain being charged to tax, it shall be dealt with as under:

1. If the capital gain is greater than the cost of the new asset, the difference between the capital gain and the cost of the new asset shall be chargeable as income 'under section 45'.
2. If the capital gain is equal to or less than the cost of the new asset, section 45 is not to be applied.

The capital assets referred to in section 54G are machinery or plant or land or building or any rights in building or land. Capital gain arising on transfer of furniture does not qualify for exemption under section 54G. No exemption is therefore available under section 54G in respect of investment of ₹ 2 lakhs in acquiring furniture.

The first step therefore is to determine the capital gain arising out of the transfer and thereafter apply the provisions of section 54G.

	Particulars	₹
(a)	**Land** – Sale proceeds (Non-depreciable asset)	8,00,000
	Less: Cost of acquisition	4,00,000
	Long term capital gain	4,00,000
	Less: Cost of new assets purchased within three year after the date of transfer (under section 54G) **(See Note below)**	3,00,000
	Taxable Long-term capital gain	**1,00,000**

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(b)	**Building** – sale proceeds (depreciable assets)	18,00,000
	Less: W.D.V. is deemed as cost of acquisition under section 50	4,00,000
	Short-term capital gain	**14,00,000**
(c)	**Plant & machinery-** sale proceeds (depreciable asset)	16,00,000
	Less: WDV is deemed cost under section 50	5,00,000
	Short-term capital gain	**11,00,000**
(d)	**Furniture -** sale proceeds (depreciable asset)	3,00,000
	Less: WDV is deemed cost under section 50	2,00,000
	Short-term capital gain (A)	**1,00,000**

Summary	₹
Short term capital gain : Building	14,00,000
Short term capital gain : Plant & machinery	11,00,000
	25,00,000
Less: Section 54G [New assets purchased] **(See Note below)**	25,00,000
Net short term capital gain **(B)**	**Nil**
Total short-term capital gain (A)+(B) = ₹ 1 lakh	

Note – Total exemption available under section 54G is ₹ 28 lakhs (₹ 4 lakhs + ₹ 7 lakhs + ₹ 17 lakhs). The exemption should first be exhausted against short term capital gain as the incidence of tax in case of short-term capital gain is more than in case of long-term capital gain. Therefore, ₹ 25 lakhs is exhausted against short term capital gain and the balance of ₹ 3 lakhs against long term capital gain.

The taxable capital gains would be:

Long-term capital gains	₹ 1,00,000 (taxable @12.5% under section 112)
Short-term capital gains (furniture)	₹ 1,00,000 (taxable at applicable tax rates)
	₹ 2,00,000

7. As per section 45(1A), where any person receives any money or other assets under an insurance from an insurer on account of damage to or destruction of capital asset as a result of, *inter alia*, accidental fire then, any profits and gains arising from the receipt of such money or other assets, shall be chargeable to income tax under the head "Capital Gains" and shall be deemed to be the income of such person of the previous year in which such money or asset was received.

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For the purpose of section 48, the money received or the market value of the asset shall be deemed to be the full value of the consideration accruing as a result of the transfer of such capital asset. Since the asset was destroyed and the money from the insurance company was received in the previous year, there will be a liability to compute capital gains in respect of the insurance moneys received by the assessee.

Under section 45(1A) any profits and gains arising from receipt of insurance moneys is chargeable under the head "Capital gains". For the purpose of section 48, the moneys received shall be deemed to be the full value of the consideration accruing or arising. Under section 50 the capital gains in respect of depreciable assets had to be computed in the following manner (**assuming it was the only asset in the block**).

The computation of capital gain and tax implication is given below:

Full value of the consideration	₹ 4,00,000
Less: Written down value as on April 1st, 2025	₹ 1,87,850
Short term capital gains	₹ 2,12,150

8. Computation of capital gains and business income of Tani for A.Y. 2026-27

Particulars	₹
Capital Gains	
Fair market value of land on the date of conversion deemed as the full value of consideration for the purposes of section 45(2)	2,10,00,000
Less: Indexed cost of acquisition [₹ 35,00,000 × 363/113]	1,12,43,363
	97,56,637
Proportionate capital gains arising during A.Y.2026-27 [₹ 97,56,637 × 2/3]	65,04,425
Less: Exemption under section 54EC	50,00,000
Capital gains chargeable to tax for A.Y.2026-27	**15,04,425**
Business Income	
Sale price of flats [10 × ₹ 30 lakhs]	3,00,00,000
Less: Cost of flats	
Fair market value of land on the date of conversion [₹ 210 lakhs × 2/3]	1,40,00,000
Cost of construction of flats [10 × ₹ 10 lakhs]	1,00,00,000
Business income chargeable to tax for A.Y.2026-27	**60,00,000**

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Notes:

(i) The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock-in-trade.

(ii) However, as per section 45(2), the capital gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock-in-trade is sold.

(iii) The indexation benefit for computing indexed cost of acquisition would, however, be available only up to the year of conversion of capital asset to stock-in-trade and not up to the year of sale of stock-in-trade.

(iv) For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

In this case, since only 2/3rd of the stock-in-trade (10 flats out of 15 flats) is sold in the P.Y.2025-26, only proportionate capital gains (i.e., 2/3rd) would be chargeable in the A.Y.2026-27.

(v) On sale of such stock-in-trade, business income would arise. The business income chargeable to tax would be computed after deducting the fair market value on the date of conversion of the capital asset into stock-in-trade and cost of construction of flats from the price at which the stock-in-trade is sold.

(vi) In case of conversion of capital asset into stock-in-trade and subsequent sale of stock-in-trade, the period of 6 months is to be reckoned from the date of sale of stock-in-trade for the purpose of exemption under section 54EC [*CBDT Circular No.791 dated 2.6.2000]*. In this case, since the investment in bonds of NHAI has been made within 6 months of sale of flats, the same qualifies for exemption under section 54EC. With respect to long-term capital gains arising in any financial year, the maximum deduction under section 54EC would be ₹ 50 lakhs, whether the investment in bonds of NHAI or RECL are made in the same financial year or next financial year or partly in the same financial year and partly in the next financial year.

Therefore, even though investment of ₹ 50 lakhs has been made in bonds of NHAI during the P.Y.2025-26 and investment of ₹ 50 lakhs has been made in bonds of RECL during the P.Y.2026-27, both within the stipulated six month period, the maximum

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deduction allowable for A.Y.2026-27, in respect of long-term capital gain arising on sale of long-term capital asset(s) during the P.Y.2025-26, is only ₹ 50 lakhs.

9. Computation of taxable income of Mr. Singh for A.Y.2026-27

Particulars	₹	₹
Income from house property		
Gross Annual Value [Higher of Expected Rent & Actual Rent]		3,00,000
Expected Rent [lower of Fair Rent and Standard Rent]	2,50,000	
Actual Rent	3,00,000	
Less: Municipal taxes paid by Mr. Singh during the year (including arrears) [₹ 35,000 + ₹ 1,50,000]		1,85,000
Net Annual Value (NAV)		1,15,000
Less: Deductions under section 24		
(a) 30% of NAV	34,500	
(b) Interest on loan borrowed for major repairs	1,50,000	1,84,500
		(69,500)
Arrears of rent taxable under section 25A	30,000	
Less: Deduction@30%	9,000	21,000
		(48,500)
Capital Gains		
Full value of consideration		30,00,000
As per section 50C, the full value of consideration would be the higher of -		
Actual Consideration	25,00,000	
Stamp Duty Value [₹ 3,90,000/13%]	30,00,000	
Since stamp duty value > 110% of actual consideration		
Less: **Cost of acquisition**		
As per section 49(1), cost of acquisition of the residential house gifted by Mr. Singh's father to Mr. Singh would be the cost for which Mr. Singh's father acquired the asset		1,25,000
		28,75,000

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Less: Exemption under section 54 (₹ 8,00,000 + ₹ 7,00,000)		
Purchase of residential house within the stipulated time (within one year before or two years after the date of sale) [Where the flats are situated side by side and the builder had effected the necessary modification to make it as one house, the assessee would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds] *[CIT v. Ananda Basappa (2009) 331 ITR 211 (Kar.)]*	15,00,000	
Note: *Since two adjacent flats are treated as one residential house, Mr. Singh can defer availing exemption under section 54 in respect of two residential houses (where capital gains do not exceed ₹ 2 crores) to a later assessment year.*		
Exemption under section 54EC		
Investment in bonds of NHAI within six months from the date of transfer. Where the payment for bonds has been made within the six months period, exemption under section 54EC would be available even if the allotment of bonds was made after the expiry of the six months *[Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)]*	10,00,000	25,00,000
Long-term capital gains		3,75,000
Total Income		**3,26,500**

Note: It may be noted that since Mr. Singh has transferred residential house property which was acquired before 23.7.2024, he can opt to pay tax @20% on LTCG computed with indexation or 12.5% on LTCG computed without indexation, whichever is beneficial to him.

10. (i) No, the transaction of demerger would not attract any income-tax liability in the hands of SS(P) Ltd. or RV(P) Ltd.

As per section 47(vib), any transfer in a demerger, of a capital asset, by the demerged company to the resulting company would not be regarded as "transfer" for levy of capital gains tax if the resulting company is an Indian company.

Hence, capital gains tax liability would not be attracted in the hands of SS(P) Ltd., the demerged company, in this case, since RV(P) Ltd. is an Indian company.

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(ii) There would be no capital gains tax liability in the hands of Mr. N.K. on receipt of shares of RV (P) Ltd., since as per section 47(vid), any issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company will not be regarded as "transfer" for levy of capital gains tax, if the issue is made in consideration of demerger of the undertaking.

(iii) Yes, capital gains would arise in the hands of Mr. N.K. on sale of shares of RV (P) Ltd.

Sale consideration	8,00,000

Less: Indexed cost of acquisition of shares of RV (P) Ltd.

Cost of acquisition of shares of RV(P) Ltd. as per section 49(2C):

$$\text{Cost of acquisition of shares of SS(P) Ltd. x } \frac{\text{Net book Value of assets transferred in a demerger}}{\text{Net worth of the demerged company immidiately before demerger}}$$

$$₹6,00,000 \times \frac{10\text{ crore}}{40\text{ crore}} = ₹1,50,000$$

Cost of acquisition of shares of RV (P) Ltd.	₹ 1,50,000
Long-term capital gain (since period of holding of shares in demerged company is also to be considered)	**₹ 6,50,000**

(iv) No, sale of shares by Mr. N.K. would not affect the tax benefits availed by SS(P) Ltd. or RV (P) Ltd.

One of the conditions to be satisfied is that the shareholders holding not less than three-fourths in value of the shares in the demerged company become shareholders of the resulting company by virtue of the demerger. It is presumed that the condition is satisfied in this case.

There is no stipulation that they continue to remain shareholders for any period of time thereafter.

(v) Since the resultant capital gain on sale of shares of RV(P) Ltd. is a long-term capital gain (on account of the period of holding of shares in demerged company being considered by virtue of section 2(42A)(g)), Mr. N.K. can avail exemption under section 54F by investing the entire net consideration in purchase (within one year before and two years after the date of transfer) or construction (within three years after the date of transfer) of one residential house in India. If part of the net consideration is invested, only proportionate exemption would be available.

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11. (a) As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability of PQR Limited from slump sale of Software unit

Particulars	₹ (in lakhs)
Full value of consideration for slump sale of Software Unit	385
Less: Cost of acquisition, being the net worth of Software Unit	185
Long term capital gains arising on slump sale	**200**
(The capital gains is long-term as the Software Unit is held for more than 36 months)	
Tax liability on LTCG	
Under section 112 @ 12.5% on ₹ 200 lakhs	25.00
Add: Surcharge@ 7%	1.75
	26.75
Add: Health and Education cess@4%	1.07
	27.82

Working Note:

Computation of Full value of consideration

	₹ (in lakhs)
Fair market value of the capital assets transferred by way of slump sale	
Land, being an immovable property [stamp duty value on 31.3.2026, being the date of slump sale] **[A]**	55
Other Fixed assets (Furniture and Plant & machinery) [Book value as appearing in the books of accounts] [₹ 200 lakhs - ₹ 60 lakhs] **[B]**	140
Debtors [Book value as appearing in the books of accounts] **[C]**	110
Inventories [Book value as appearing in the books of accounts] **[D]**	35
	340

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Less: Liabilities of Software Unit [₹ 750 - ₹ 40] **[L]**			710	
Excluding				
(i)	Paid up share capital	300		
(ii)	General Reserve	150		
(ii)	Share Premium	50		
(iii)	Revaluation reserve	120	620	90
Fair market value of the capital assets transferred by way of slump sale [A+B+C+D- L] **[FMV1]**				250
Fair market value of the consideration received or accruing as a result of transfer by way of slump sale [value of the monetary consideration received] **[FMV2]**				385
Full value of consideration [Higher of FMV1 or FMV2]				**385**

Computation of net worth of Software Unit

		₹ (in lakhs)
(1)	Book value of non-depreciable assets	
	(i) Land (Revaluation not to be considered)	40
	(ii) Debtors	110
	(iii) Inventories	35
(2)	Written down value of depreciable assets under section 43(6) ***(See Note below)***	90
Aggregate value of total assets		275
Less: Current liabilities of Software unit		90
Net worth of software unit		**185**

Note: *For computing net worth, the aggregate value of total assets in the case of depreciable assets shall be the written down value of the block of assets as per section 43(6).*

(b) Tax advice

(i) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempt from capital gains under section 47(iv). Hence, PQR Limited should try to acquire the remaining 26% equity shares in S Limited then make the slump sale in the above said manner, in which case the slump sale shall be exempt from tax. For this exemption, PQR Limited will have to

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keep such 100% holding in S Limited for a period of 8 years from the date of slump sale, otherwise the amount exempt would be deemed to be income chargeable under the head "Capital Gains" of the previous year in which such transfer took place.

(ii) Alternatively, if acquisition of 26% share is not feasible, PQR Limited may think about demerger plan of Software Unit to get benefit of section 47(vib) of the Income-tax Act, 1961.

12. (i) For the purpose of computation of long-term capital gains chargeable to tax under section 112A, the cost of acquisition in relation to the long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust acquired before 1st February, 2018 shall be the higher of

(a) cost of acquisition of such asset, i.e., actual cost; and

(b) lower of

(i) the fair market value of such asset as on 31.1.2018; and

(ii) the full value of consideration received or accruing as a result of the transfer of the capital asset.

The fair market value of listed equity shares as on 31.1.2018 is the highest price quoted on the recognized stock exchange as on that date.

Accordingly, long-term capital gain on transfer of STT paid listed equity shares by Mr. Prasun would be determined as follows:

The FMV of shares of A Ltd. would be ₹ 700, being the highest price quoted on National Stock Exchange on 31.1.2018. The cost of acquisition of each equity share in A Ltd. would be ₹ 700, being higher of actual cost i.e., ₹ 400 and ₹ 700 [being the lower of FMV of ₹ 700 as on 31.1.2018 (i.e., the highest trading price) and actual sale consideration of ₹ 1,200]. Thus, the long-term capital gain would be ₹ 1,50,000 i.e., (₹ 1,200 – ₹ 700) x 300 shares. The long-term capital gain of ₹ 25,000 (i.e., the amount in excess of ₹ 1,25,000) would be subject to tax@12.5% under section 112A (*plus* cess@4%), without benefit of indexation. The tax on capital gain @13% would be ₹ 3,250 (₹ 25,000 x 13%)

(ii) In the case of units listed on recognised stock exchange on the date of transfer, the FMV as on 31.1.2018 would be the highest trading price on recognised stock exchange as on 31.1.2018 (if units are listed on that date), else, it would be the net asset value as on 31.1.2018 (where units are unlisted on that date).

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Accordingly, the FMV of units of Fund A as on 31.1.2018 would be ₹ 750 (being the highest trading price on 31.1.2018, since the units of Fund A are listed on that date) and the FMV of units of Fund B as on 31.1.2018 would be ₹ 950 (being the net asset value as on 31.1.2018, since the units of Fund B are unlisted on that date).

The cost of acquisition of a unit of Fund A would be ₹ 750, being higher of actual cost i.e., ₹ 550 and ₹ 750 (being the lower of FMV of ₹ 750 as on 31.1.2018 and actual sale consideration of ₹ 900). Thus, the long-term capital gains on sale of units of Fund A would be ₹ 30,000 (₹ 900 – ₹ 750) x 200 units.

The cost of acquisition of a unit of Fund B would be ₹ 900, being higher of actual cost i.e., ₹ 550 and ₹ 900 (being the lower of FMV of ₹ 950 as on 31.1.2018 (net asset value) and actual sale consideration of ₹ 900). Thus, the long-term capital gains on sale of units of Fund B would be Nil (₹ 900 – ₹ 900) x 200 units.

Since the long-term capital gains on sale of units is ₹ 30,000, which is less than ₹ 1,25,000, the said sum is not chargeable to tax under section 112A.

13. Computation of Capital gains in the hands of Mr. Shyam for A.Y. 2026-27

Particulars	Amount (₹)	Amount (₹)
Actual sale consideration	30,50,000	
Valuation as per Stamp duty Authority on the date of agreement	39,00,000	
(Where the actual sale consideration is less than the value adopted by the Stamp Valuation Authority for the purpose of charging stamp duty, and such stamp duty value exceeds 110% of the actual sale consideration then, the value adopted by the Stamp Valuation Authority shall be taken to be the full value of consideration as per section 50C. However, where the date of agreement is different from the date of registration, stamp duty value on the date of agreement can be considered, provided the whole or part of the consideration is received by way of account payee cheque/bank draft or by way of ECS through bank account or such other electronic mode as may be prescribed on or before the date of agreement. In the present case, since part of the payment is made by account payee cheque on the date of agreement, the stamp duty value on the date of agreement would be considered as full value of consideration)		

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Deemed Full value of consideration [Since stamp duty value on the date of agreement exceeds 110% of the actual consideration, stamp duty value would be deemed as Full Value of Consideration]		**39,00,000**
Less: Expenses on transfer (Brokerage @1% of ₹ 30,50,000)		30,500
Net sale consideration		**38,69,500**
Less: Cost of acquisition **(Note 1)**	9,59,000	
Less: Cost of improvement	3,90,000	13,49,000
Long term capital gain		**25,20,500**

Computation of tax liability u/s 112

Particulars		Amount (₹)
On LTCG of ₹ 25,20,500 x 12.5%		3,15,063
Add: Health and Education cess @4%		12,603
		3,27,666
On LTCG with indexation benefit		
Net Sale consideration	38,69,500	
Less: Indexed cost of acquisition [₹ 9,59,000 x 376/100]	36,05,840	
Less: Indexed cost of Improvement [₹ 3,90,000 x 376/254]	5,77,323	
Long-term capital loss	(3,13,663)	
Since the computation results in a long term capital loss, if indexation benefit is given, the tax u/s 112 would be Nil. However, this computation is only for determining tax liability, the said loss can neither be set off nor carried forward.		

Notes:

(1) **Computation of cost of acquisition**

Particulars	Amount (₹)	Amount (₹)
Cost of acquisition,		10,70,000
Being the higher of		
(i) lower of Fair market value i.e., ₹ 11,85,000 and Stamp duty value i.e., ₹ 10,70,000, on April 1, 2001	10,70,000	
(ii) Actual cost of acquisition (₹ 3,24,000 + ₹ 35,000, being stamp duty @10% of ₹ 3,50,000)	3,59,000	

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Less: Advance money taken from Mr. Mohan and forfeited		1,11,000
Cost of acquisition		**9,59,000**

(2) Where advance money has been received by the assessee, and retained by him, as a result of failure of the negotiations, section 51 will apply. The advance retained by the assessee will go to reduce the cost of acquisition. Accordingly, cost of acquisition after reducing the advance money forfeited would be ₹ 9,59,000 [i.e. ₹ 10,70,000 – ₹ 1,11,000 (being the advance money forfeited during the P.Y. 2008-09)]. However, where the advance money is forfeited during the previous year 2014-15 or thereafter, the amount forfeited would be taxable under the head "Income from Other Sources" and such amount will not be deducted from the cost of acquisition of such asset while calculating capital gains. Hence, ₹ 1,51,000, being the advance received from Ms. Deepshikha and retained by him, would have been taxable under the head "Income from other sources" in the hands of Mr. Shyam in A.Y.2016-17.

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CHAPTER 5

INCOME FROM OTHER SOURCES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the income which are chargeable to tax under the head "Income from other sources";
- **identify** the admissible/ inadmissible deductions while computing income under this head;
- **examine** the circumstance(s) when amount paid or payable by a closely held company to the shareholder, being a beneficial owner or the concern in which such shareholder has the substantial interest would be deemed as dividend;
- **examine** the circumstances when any sum of money or property transferred without consideration or for inadequate consideration would be taxable in the hands of recipient and the exceptions thereto;
- **compute** the income under the head "Income from Other Sources" after allowing the deductions available thereunder.

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5.1 INTRODUCTION

Any income, profits or gains includible in the total income of an assessee, which cannot be included under any of the preceding heads of income, is chargeable under the head 'Income from other sources'. Thus, this head is the **residuary head of income** and brings within its scope all the taxable income, profits or gains of an assessee which fall outside the scope of any other head. Therefore, when any income, profit or gain does not fall precisely under any of the other specific heads but is chargeable under the provisions of the Act, it would be charged under this head.

5.2 METHOD OF ACCOUNTING [SECTION 145]

Income chargeable under the head "Income from other sources" has to be computed in accordance with the cash or mercantile system of accounting regularly employed by the assessee.

Under section 145(2), the Central Government is empowered to notify in Gazette from time to time, income computation and disclosure standards to be followed by any class of assessees or in respect of any class of income.

Accordingly, Central Government has notified ten ICDSs to be followed by all assessees (other than an individual or a HUF who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB) following the mercantile system of accounting, for the purpose of computation of income chargeable to income-tax under the head "Profits and gains from business or profession" or "Income from other sources".

Text of notified ICDSs is given as an Annexure at the end of this module.

5.3 INCOMES CHARGEABLE UNDER THIS HEAD [SECTION 56]

(1) Income chargeable only under the head 'Income from Other Sources':

(i) Dividend income [Section 56(2)(i)]

Dividend income is always taxable under the head "Income from other sources". The term 'dividend' as used in the Act has a wider scope and meaning than under the general law.

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Dividend [covered by sections 2(22)(a) to (f)]:

According to section 2(22), the following receipts are deemed to be dividend:

(a) **Distribution of accumulated profits, entailing the release of company's assets** - Any distribution of accumulated profits, whether capitalised or not, by a company to its shareholders is dividend if it entails the release of all or any part of its assets.

Note: If accumulated profits are distributed in cash, it is dividend in the hands of the shareholders. Where accumulated profits are distributed in kind, for example by delivery of shares etc. entailing the release of company's assets, the market value of such shares on the date of such distribution is deemed dividend in the hands of the shareholder.

(b) **Distribution of debentures, deposit certificates to shareholders and bonus shares to preference shareholders** - Any distribution to its shareholders by a company of debenture, debenture stock or deposit certificate in any form, whether with or without interest, and any distribution of bonus shares to preference shareholders to the extent to which the company possesses accumulated profits, whether capitalised or not, will be deemed as dividend.

The market value of such bonus shares is deemed as dividend in the hands of the preference shareholder.

In the case of debentures, debenture stock etc., their value is to be taken at the market rate and if there is no market rate they should be valued according to accepted principles of valuation.

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

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

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

(d) **Distribution on reduction of capital** - Any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possessed accumulated profits, whether capitalised or not, shall be deemed to be dividend.

(e) **Advance or loan by a closely held company to its shareholder** – Any payment by a company in which the public are not substantially interested of any sum by way of advance

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or loan to any shareholder who is the beneficial owner of 10% or more of the voting power of the company will be deemed to be dividend to the extent of the accumulated profits. If the loan is not covered by the accumulated profits, it is not deemed to be dividend.

Advance or loan by a closely held company to a specified concern - Any payment by a company in which the public are not substantially interested, to any concern (i.e. HUF/ Firm/ AOP/ BOI/ Company) in which a shareholder, having the beneficial ownership of atleast 10% of the equity shares is a member or a partner and in which he has a substantial interest (i.e. atleast 20% share of the income of the concern) will be deemed to be dividend.

Also, any payments by such a closely held company on behalf of, or for the individual benefit of any such shareholder will also be deemed to be dividend. However, in both cases the ceiling limit of dividend is to the extent of accumulated profits.

Exceptions: The following payments or loan given would not be deemed as dividend:

(i) **Loan granted in the ordinary course of business -** If the loan is granted in the ordinary course of its business and lending of money is a substantial part of the company's business, the loan or advance to a shareholder or to the specified concern is not deemed to be dividend.

(ii) ***Advance or loan between two group entities –*** *Any advance or loan between two group entities, where one of the group entities is a Finance company or a Finance Unit and the parent entity or principal entity of such group is listed on the stock exchange in a country or territory outside India other than the country or territory outside India as notified by the CBDT.*

(iii) **Dividend paid is set off against the deemed dividend -** Where a loan had been treated as dividend and subsequently, the company declares and distributes dividend to all its shareholders including the borrowing shareholder, and the dividend so paid is set off by the company against the previous borrowing, the adjusted amount will not be again treated as a dividend.

Note: Subsequent repayment of loan or charge of interest at market rate does not make any difference in the applicability of section 2(22)(e).

(f) **Amount received by shareholder on buy-back of shares by domestic companies -** In case of buyback of shares (whether listed or unlisted) by a domestic company, any sum paid by the domestic company for purchase of its own shares would be deemed as dividend in the hands of shareholders and shall be charged to income tax at applicable tax rates. No

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deduction for expenses would be available against such dividend income while determining the income from other sources.

Here is the example to understand the provisions of section 46A and section 2(22)(f):

No. of shares of A Ltd. bought in 2020 By Mr. B @₹ 40 per share	100 shares
Total cost of acquisition	₹ 4,000 (100 x ₹ 40)
No. of shares bought back in November 2025 by A Ltd. @₹ 60 per share	20 shares
Income taxable as deemed dividend u/s 2(22)(f) [₹ 60 per share x 20 shares]	₹ 1,200
Long-term capital loss on such buyback as per section 46A (Value of consideration - COA) (Nil - ₹ 40 x 20) [Such LTCL can be set-off against other LTCG or it can be carried forward to the next year for set-off against other LTCG]	₹ 800
No. of shares sold in December 2026 by Mr. B @₹ 70 per share	50 Shares
Long-term capital Gain (₹ 70 x 50 – ₹ 40 x 50)	₹ 1,500
Chargeable long-term capital gain in P.Y. 2026-27 after set-off of long-term capital loss [₹ 1,500 – ₹ 800] would be	₹ 700

Exceptions

The following also do not constitute "dividend" -

(i) **Distribution in respect of non-participating shares issued for full cash consideration –** Any distribution made in accordance with (c) or (d) in respect of any share issued for full cash consideration and the holder of such share is not entitled to participate in the surplus asset in the event of liquidation.

(ii) **Distribution of shares to the shareholders on demerger by the resulting company -** Any distribution of shares on 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).

Meaning of "accumulated profits"

Accumulated profits in point (a), (b), (d) and (e) above include all profits of the company up to the date of distribution or payment of dividend.

Building & Machinery Depreciation fund not to be included in accumulated profits. - *CIT v. Jaldu Rama Rao (1983) 140 ITR 168 (Andhra Pradesh)*

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

In the case of an amalgamated company, the accumulated profits, whether capitalized or not, of the amalgamating company on the date of amalgamation shall be included in the accumulated profits, whether capitalized or not or loss, as the case may be, of the amalgamated company.

Clarification regarding trade advance not to be treated as deemed dividend under section 2(22)(e) – [Circular No. 19/2017, dated 12.06.2017]

Section 2(22)(e) provides that "dividend" includes any payment by a company in which public are not substantially interested, of any sum by way of advance or loan to a shareholder who is the beneficial owner of shares holding not less than 10% 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 or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits.

The CBDT observed that some Courts in the recent past have held that trade advances in the nature of commercial transactions would not fall within the ambit of the provisions of section 2(22)(e) and such views have attained finality. Some illustrations /examples of trade advances/commercial transactions held to be not covered under section 2(22)(e) are as follows:

(i) Advances were made by a company to a sister concern and adjusted against the dues for job work done by the sister concern. It was held that amounts advanced for business transactions do not to fall within the definition of deemed dividend under section 2(22)(e) [*CIT vs. Creative Dyeing & Printing Pvt. Ltd. [NJRS] 2009-LL-0922-2, ITA No. 250 of 2009, Delhi High Court*].

(ii) Advance was made by a company to its shareholder to install plant and machinery at the shareholder's premises to enable him to do job work for the company so that the company could fulfil an export order. It was held that as the assessee proved business expediency, the advance was not covered by section 2(22)(e) [*CIT vs Amrik Singh, [NJRS] 2015-LL-0429-5, ITA No. 347 of 2013, P & H High Court*]

(iii) A floating security deposit was given by a company to its sister concern against the use of electricity generators belonging to the sister concern. The company utilised gas available to it from GAIL to generate electricity and supplied it to the sister concern at concessional rates. It

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was held that the security deposit made by the company to its sister concern was a business transaction arising in the normal course of business between two concerns and the transaction did not attract section 2(22)(e) [*CIT, Agra vs Atul Engineering Udyog, [NJRS] 2014-LL-0926-121, ITA No. 223 of 2011, Allahabad High Court*]

In view of the above, the CBDT has, vide this circular, clarified that it is a settled position that trade advances, which are in the nature of commercial transactions, would not fall within the ambit of the word 'advance' in section 2(22)(e) and therefore, the same would not to be treated as deemed dividend.

Basis of charge of dividend [Section 8]

Dividend declared or distributed or paid by a company is deemed to be the income of the shareholder in the previous year in which it is so declared or distributed or paid, as the case may be.

Deemed dividend u/s 2(22)(a)/(b)/(c)/(d) – Distribution by a company which is deemed as dividend u/s 2(22)(a)/(b)/(c)/(d) would be the income of the previous year in which it is so distributed.

Deemed dividend u/s 2(22)(e) – Payment of advance or loan to a shareholder or a concern, as the case may be, which is deemed as dividend u/s 2(22)(e) will be the income of the previous year in which it is so paid.

Interim dividend – Interim dividend would be deemed to be the income of the previous year in which such dividend is unconditionally made available by the company to the members who are entitled to it.

Tax rate on dividend income - Any income by way of dividend received by a resident from a company, whether domestic or foreign, is taxable in the hands of shareholder at normal rates of tax.

ILLUSTRATION 1

Dhaval is in business of manufacturing customized kitchen equipments. He is also the Managing Director and held nearly 65% of the paid-up share capital of Aarav (P) Ltd. A substantial part of the business of Dhaval is obtained through Aarav (P) Ltd. For this purpose, Aarav (P) Ltd. passed on the advance received from its customers to Dhaval to execute the job work entrusted to him.

The Assessing Officer held that the advance money received by Dhaval is in the nature of loan given by Aarav (P) Ltd. to him and accordingly is deemed dividend within the meaning of provisions of section 2(22)(e) of the Income-tax Act, 1961. The Assessing Officer, therefore, made the addition by treating advance money as deemed dividend.

Examine whether the action of the Assessing Officer is tenable in law.

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SOLUTION

As per section 2(22)(e), in case a company, not being a company in which the public are substantially interested, makes payment of any sum by way of advance or loan to a shareholder holding not less than 10% of voting power/share capital of the company, then, the payment so made shall be deemed to be dividend in the hands of such shareholder to the extent to which the company possesses accumulated profits.

In the present case, Dhaval is holding 65% of the paid-up capital of Aarav (P) Ltd. Aarav (P) Ltd. has passed on advance received from its customers to Dhaval for execution of job work entrusted to Dhaval.

Since Aarav (P) Ltd. is not a company in which public are substantially interested, the applicability of the provisions of section 2(22)(e) in respect of such transaction has to be examined. In *CIT v. Rajkumar (2009) 318 ITR 462 (Del.),* it was held that trade advance given to the shareholder which is in the nature of money transacted to give effect to a commercial transaction, would not amount to deemed dividend under section 2(22)(e). The Delhi High Court ruling in *CIT v. Ambassador Travels (P) Ltd. (2009) 318 ITR 376* also supports the above view.

In the present case, the payment is made to Dhaval by Aarav (P) Ltd. for execution of work is in the course of commercial business transaction and therefore, it cannot be treated as deemed dividend under section 2(22)(e). Hence, the action of the Assessing Officer is not tenable in law.

Note – *This can also be answered on the basis of Circular No. 19/2017, dated 12.06.2017. The CBDT has, in its circular clarified that it is a settled position that trade advances, which are in the nature of commercial transactions, would not fall within the ambit of the word 'advance' in section 2(22)(e) and therefore, the same would not to be treated as deemed dividend. Since, the payment is made to Dhaval by Aarav (P) Ltd. for execution of work is in the course of commercial business transaction and therefore, the advance cannot be treated as deemed dividend under section 2(22)(e). Hence, the action of the Assessing Officer is not tenable in law.*

ILLUSTRATION 2

MNO (P) Ltd. is a company in which the public are not substantially interested. K is a shareholder of the company holding 15% of the equity shares. The accumulated profits of the company as on 1.10.2025 amounted to ₹ 10,00,000. The company lent ₹ 1,00,000 to K by an account payee bank draft on 1.10.2025. The loan was not connected with the business of the company. K repaid the loan to the company by an account payee bank draft on 30.3.2026. Examine the effect of the borrowal and repayment of the loan by K on the computation of his total income for the assessment year 2026-27.

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SOLUTION

As per section 2(22)(e), any payment by a company, in which the public are not substantially interested, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power, shall be treated as dividend to the extent to which the company possesses accumulated profits.

In the instant case, MNO (P) Ltd. is a company in which the public are not substantially interested. The company has accumulated profits of ₹ 10,00,000 on 1.10.2025. The loan given by the company to K was not in the course of its business. K holds more than 10% of the equity shares in the company. Therefore, assuming that K has voting power equivalent to his shareholding, section 2(22)(e) comes into play. Deemed dividend of ₹ 1,00,000 under section 2(22)(e) would be taxable in the hands of Mr. K at normal rates of tax.

Under section 2(22)(e), the liability arises the moment the loan is borrowed by the shareholder and it is immaterial whether the loan is repaid before the end of the accounting year or not. Therefore, the repayment of loan by K to the company on 30.3.2026 will not affect the taxability of the sum of ₹ 1,00,000 as deemed dividend.

(ii) Casual Income [Section 56(2)(ib)]

Casual income means income in the nature of winning from lotteries, crossword puzzles, races including horse races, card games and other games of any sort, gambling, betting etc. Such winnings are chargeable to tax at a flat rate of 30% under the head "Income from Other Sources".

(iii) Interest received on compensation/ enhanced compensation deemed to be income in the year of receipt and taxable under the head "Income from Other Sources" [Section 56(2)(viii)]

(a) As per section 145(1), income chargeable under the head "Profits and gains of business or profession" or "Income from other sources", shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(b) Section 145B(1) provides that notwithstanding anything contained in section 145(1), the interest received by an assessee on compensation or on enhanced compensation shall be deemed to be his income of the previous year in which it is received, irrespective of the method of accounting followed by the assessee.

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(c) Section 56(2)(viii) provides that income by way of interest received on compensation or on enhanced compensation referred to in section 145B(1) shall be assessed as "Income from other sources" in the year in which it is received.

(iv) Advance forfeited due to failure of negotiations for transfer of a capital asset to be taxable as "Income from other sources" [Section 56(2)(ix)]

(a) Prior to A.Y.2015-16, any advance retained or received in respect of a negotiation for transfer which failed to materialise is reduced from the cost of acquisition of the asset or the written down value or the fair market value of the asset, at the time of its transfer to compute the capital gains arising therefrom as per section 51. In case the asset transferred is a long-term capital asset, indexation benefit would be on the cost so reduced.

(b) With effect from A.Y.2015-16, section 56(2)(ix) provides for the taxability of any sum of money, received as an advance or otherwise in the course of negotiations for transfer of a capital asset. Such sum shall be chargeable to income-tax under the head 'Income from other sources', if such sum is forfeited and the negotiations do not result in transfer of such capital asset.

(c) In order to avoid double taxation of the advance received and retained, section 51 was amended to provide that where any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, has been included in the total income of the assessee for any previous year, in accordance with section 56(2)(ix), such amount shall not 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.

(d) It may be noted that advance received and forfeited upto 31.3.2014 has to be reduced from cost of acquisition while computing capital gains, since such advance would not have been subject to tax under section 56(2)(ix). Only the advance received and forfeited on or after 1.4.2014 would be subject to tax under section 56(2)(ix). Hence, such advance would not be reduced from the cost of acquisition for computing capital gains.

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(v) Any sum of money or value of property received without consideration or for inadequate consideration to be subject to tax in the hands of the recipient [Section 56(2)(x)]

In order to prevent the practice of receiving sum of money or the property without consideration or for inadequate consideration, section 56(2)(x) brings to tax any sum of money or the value of any property received by any person without consideration or the value of any property received for inadequate consideration.

(a) **Sum of Money**: If any sum of money is received without consideration and the aggregate value of which exceeds ₹ 50,000, the whole of the aggregate value of such sum is chargeable to tax.

(b) **Immovable property [Land or building or both]:**

I. If an immovable property is received

(a) **Without consideration**: The stamp duty value of such property would be taxed as the income of the recipient, if it exceeds ₹ 50,000.

(b) **For Inadequate consideration:** If consideration is less than the stamp duty value of the property and the difference between the stamp duty value and consideration is more than the higher of –

(i) ₹ 50,000 and

(ii) 10% of consideration,

the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the assessee as "Income from other sources".

It may be noted that the above limit shall be considered for **each property separately.**

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II. **Value of property to be considered where the date of agreement is different from date of registration:** Taking into consideration the possible time gap between the date of agreement and the date of registration, the stamp duty value may be taken as on the date of agreement instead of the date of registration, if the date of the agreement fixing the amount of consideration for the transfer of the immovable property and the date of registration are not the same, provided whole or part of the consideration has been paid by way of an account payee cheque or an account payee bank draft or by use of electronic clearing system (ECS) through a bank account or through such prescribed electronic mode on or before the date of agreement.

The prescribed electronic modes notified are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay as other electronic modes of payment [CBDT Notification No. 8/2020 dated 29.01.2020].

III. **If the stamp duty value of immovable property is disputed by the assessee,** the Assessing Officer may refer the valuation of such property to a Valuation Officer. In such a case, the provisions of section 50C and section 155(15) shall, as far as may be, apply for determining the value of such property. As per section 50C, if such value is less than the stamp duty value, the same would be taken for determining the value of such property, for computation of income under this head in the hands of the buyer.

(c) **Movable Property [Property other than immovable property]:**

If movable property is received

(i) **Without consideration:** The **aggregate fair market value** of such property on the date of receipt would be taxed as the income of the recipient, if it exceeds ₹ 50,000.

(ii) **For inadequate consideration:** If the difference between the **aggregate fair market value** and such consideration exceeds ₹ 50,000, such difference would be taxed as the income of the recipient.

(d) **Applicability of section 56(2)(x):** The provisions of section 56(2)(x) would apply only to the specified property which is the nature of a capital asset of the recipient and not stock-in-trade, raw material or consumable stores of any business of the recipient. Therefore, only

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transfer of a specified capital asset, without consideration or for inadequate consideration would attract the provisions of section 56(2)(x).

(e) **The table below summarizes the scheme of taxability of gifts –**

	Nature of asset	Taxable value
1	**Money**	The whole amount if the same exceeds ₹ 50,000.
2	**Movable property**	**(i) Without consideration:** The aggregate fair market value of the property, if it exceeds ₹ 50,000. **(ii) Inadequate consideration:** The difference between the aggregate fair market value and the consideration, if such difference exceeds ₹ 50,000.
3	**Immovable property**	**(i) Without consideration:** The stamp value of the property, if it exceeds ₹ 50,000. **(ii) Inadequate consideration:** The difference between the stamp duty value and the consideration, if such difference is more than the higher of ₹ 50,000 and 10% of consideration.

(f) **Non-applicability of section 56(2)(x):** However, any sum of money or value of property received in the following circumstances would be outside the ambit of section 56(2)(x) -

(i) from any relative; or

(ii) on the occasion of the marriage of the individual; or

(iii) under a will or by way of inheritance; or

(iv) in contemplation of death of the payer or donor, as the case may be; or

(v) from any local authority as defined in the *Explanation* to section 10(20); or

(vi) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C); or

(vii) from or by any trust or institution registered under section 12A or section 12AA or section 12AB; or

However, where sum of money or property has been received by specified persons under section 13(3), this relaxation is not available and section 56(2)(x) would be applicable.

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(viii) by any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in Section 10(23C)(iv)/(v)/(vi)/(via).

(ix) by way of transaction not regarded as transfer under section 47(i)/(iv)/(v)/(vi)/(via)/(viaa)/(vib)/(vic)/(vica)/(vicb)/(vid)/(vii)/(viiac)/(viiad)/(viiae)/(viiaf).

(x) from an individual by a trust created or established solely for the benefit of relative of the individual.

(xi) by an individual, from any person, in respect of any expenditure actually incurred by him on his medical treatment or treatment of any member of his family, for any illness related to COVID-19 subject to conditions notified by the Central Government.

Accordingly, the Central Government has, *vide Notification No. 91/2022 dated 5.8.2022*, specified the following conditions –

The individual has to keep a record of the following documents, namely:-

(a) the COVID-19 positive report of the individual or his family member, or medical report if clinically determined to be COVID-19 positive through investigations in a hospital or an in-patient facility by a treating physician for a person so admitted;

(b) all necessary documents of medical diagnosis or treatment of the individual or family member due to COVID-19 or illness related to COVID-19 suffered within 6 months from the date of being determined as a COVID-19 positive;

The details of the amount so received in any financial year has to be furnished in Form No. 1 to the Income-tax Department within 9 months from the end of such financial year.

(xii) by a member of the family of a deceased person –

(A) from the employer of the deceased person (without any limit); or

(B) from any other person or persons to the extent that such sum or aggregate of such sums ≤ ₹ 10 lakhs,

where the cause of death of such person is illness related to COVID-19 and the payment is –

(i) received within 12 months from the date of death of such person; and

(ii) subject to such other conditions notified by the Central Government.

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Accordingly, the Central Government has, *vide Notification No. 92/2022 dated 5.8.2022*, specified the following conditions –

1. (i) the death of the individual should be within 6 months from the date of testing positive or from the date of being clinically determined as a COVID-19 case, for which any sum of money has been received by the member of the family;

   (ii) the family member of the individual has to keep a record of the following documents,

      (a) the COVID-19 positive report of the individual, or medical report if clinically determined to be COVID-19 positive through investigations in a hospital or an inpatient facility by a treating physician;

      (b) a medical report or death certificate issued by a medical practitioner or a Government civil registration office, in which it is stated that death of the person is related to corona virus disease (COVID-19).

2. The details of such amount received in any financial year has to be furnished in Form A to the Assessing Officer within 9 months from the end of such financial year.

(xiii) from such class of persons and subject to such conditions, as may be prescribed.

Accordingly, CBDT has inserted Rule 11UAC to notify that the provisions of section 56(2)(x) would not be applicable to the following transactions –

S. No.	Property	Received by	Condition
1.	Any immovable property, being land or building or both	a resident of an unauthorized colony in the National Capital Territory of Delhi	where the Central Government by notification in the Official Gazettee, regularised the transactions of such immovable property based on the latest Power of Attorney, Agreement to Sale, Will, possession letter and other documents including documents evidencing payment of consideration for conferring or recognising right of ownership or transfer or mortgage in regard to such immovable property in favour of such resident.
	Resident means a person having physical possession of property on the basis of a registered sale deed or latest set of Power of Attorney,		

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	Agreement to Sale, Will, possession letter and other documents including documents evidencing payment of consideration in respect of a property in unauthorised colonies and includes their legal heirs but does not include tenant, licensee or permissive user. **Unauthorised colony means** a colony or development comprising of a contiguous area, where no permission has been obtained for approval of layout plan or building plans and has been identified for regularisation of such colony in pursuance to the notification number S.O. 683(E), dated the 24th March, 2008, of the Delhi Development Authority.		
2.	Any movable property, being unquoted shares, of a company and its subsidiary and the subsidiary of such subsidiary	Shareholder	Where, (i) the Tribunal, on an application moved by the Central Government under section 241 of the Companies Act, 2013, has suspended the Board of Directors of such company and has appointed new directors nominated by the Central Government under section 242 of the said Act; and (ii) share of company and its subsidiary and the subsidiary of such subsidiary has been received pursuant to a resolution plan approved by the Tribunal under section 242 of the Companies Act, 2013 after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.
	A company shall be a subsidiary of another company, if such other company holds more than half in nominal value of the equity share capital of the company;		
3.	Any movable property, being equity shares, of the reconstructed bank	Investor or investor bank (SBI)	where the said share has been allotted by the reconstructed bank (Yes Bank) under the Yes Bank Limited Reconstruction Scheme, 2020 at ₹ 10 per share (Face value - ₹ 2 per share; Premium - ₹ 8 per share).
4.	Any movable property, being	a person	It should be received from a public sector company or the Central

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	equity shares, of a public sector company or a company		Government or any State Government under strategic disinvestment.
	Strategic disinvestment - Sale of shareholding by the Central Government or any State Government or a public sector company, in a public sector company or in a company, which results in - reduction of its shareholding to below 51% and - transfer of control to the buyer. The condition of reduction below 51% would apply only in a case where shareholding of the Central Government or the State Government or the public sector company was above 51% before such sale of shareholding. The requirement of transfer of control may be carried out by the Central Government or the State Government or the public sector company or any two of them or all of them.		
5.	Any movable property, being shares or units or interest in the resultant fund	The fund management entity of the resultant fund	It should be received in lieu of shares or units or interest held by the investment manager entity in the original fund, pursuant to the relocation, subject to the following conditions, namely – (i) not less than 90% of shares or units or interest in the fund management entity of the resultant fund are held by the same entity(ies) or person(s) in the same proportion as held by them in the investment manager entity of the original fund; and (ii) not less than 90% of the aggregate of shares or units or interest in the investment manager entity of the original fund was held by such entity(ies) or person(s).

(g) **Meaning of certain terms:**

Term	Meaning
Property	A **capital asset** of the assessee, namely- (a) immovable property being land or building or both, (b) shares and securities,

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	(c) jewellery, (d) archaeological collections, (e) drawings, (f) paintings, (g) sculptures, (h) any work of art or bullion. It also includes virtual digital asset.
Relative	**(a) In case of an individual –** (i) spouse of the individual; (ii) brother or sister of the individual; (iii) brother or sister of the spouse of the individual; (iv) brother or sister of either of the parents of the individual; (v) any lineal ascendant or descendant of the individual; (vi) any lineal ascendant or descendant of the spouse of the individual; (vii) spouse of any of the persons referred to above. **(b) In case of Hindu Undivided Family,** any member thereof**.**
Family	For the purpose of (xi) and (xii), family, in relation to an individual 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 the individual.

SUMMARY

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ILLUSTRATION 3

Mr. A, a dealer in shares, received the following without consideration during the P.Y.2025-26 from his friend Mr. B, -

(1) Cash gift of ₹ 75,000 on his anniversary, 15th April, 2025.

(2) Bullion, the fair market value of which was ₹ 60,000, on his birthday, 19th June, 2025.

(3) A plot of land at Faridabad on 1st July, 2025, the stamp value of which is ₹ 5 lakh on that date. Mr. B had purchased the land in April, 2009.

Mr. A purchased from his friend Mr. C, who is also a dealer in shares, 1000 shares of X Ltd. @ ₹ 400 each on 19th June, 2025, the fair market value of which was ₹ 600 each on that date. Mr. A sold these shares in the course of his business on 23rd June, 2025.

Further, on 1st November, 2025, Mr. A took possession of property (building) booked by him two years back at ₹ 20 lakh. The stamp duty value of the property as on 1st November, 2025 was ₹ 32 lakh and on the date of booking was ₹ 23 lakh. He had paid ₹ 1 lakh by account payee cheque as down payment on the date of booking.

On 1st March, 2026, he sold the plot of land at Faridabad for ₹ 7 lakh.

Compute the income of Mr. A chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2026-27.

SOLUTION

Computation of "Income from other sources" of Mr. A for the A.Y.2026-27

	Particulars	₹
(1)	Cash gift is taxable under section 56(2)(x), since it exceeds ₹ 50,000	75,000
(2)	Since bullion is included in the definition of property, therefore, when bullion is received without consideration, the same is taxable, since the aggregate fair market value exceeds ₹ 50,000	60,000
(3)	Stamp value of plot of land at Faridabad, received without consideration, is taxable under section 56(2)(x)	5,00,000
(4)	Difference of ₹ 2 lakh in the value of shares of X Ltd. purchased from Mr. C, a dealer in shares, is not taxable as it represents the stock-in-trade of Mr. A. Since Mr. A is a dealer in shares and it has been mentioned that the shares were subsequently sold in the course of his business, such shares represent the stock-in-trade of Mr. A.	-

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(5)	Difference between the stamp duty value of ₹ 23 lakh on the date of booking and the actual consideration of ₹ 20 lakh paid is taxable under section 56(2)(x) since the difference exceeds ₹ 2 lakh, being the higher of ₹ 50,000 and 10% of consideration.	3,00,000
Income from Other Sources		**9,35,000**

Computation of "Capital Gains" of Mr. A for the A.Y.2026-27

Particulars	₹
Sale Consideration	7,00,000
Less: Cost of acquisition [deemed to be the stamp value charged to tax under section 56(2)(x) as per section 49(4)]	5,00,000
Short-term capital gains	**2,00,000**

Note *– The resultant capital gains will be short-term capital gains since for calculating the period of holding, the period of holding of previous owner is not to be considered.*

ILLUSTRATION 4

Discuss the taxability or otherwise of the following in the hands of the recipient under section 56(2)(x) of the Income-tax Act, 1961 -

(i) Akhil HUF received ₹ 75,000 in cash from niece of Akhil (i.e., daughter of Akhil's sister). Akhil is the Karta of the HUF.

(ii) Nitisha, a member of her father's HUF, transferred a house property to the HUF without consideration. The stamp duty value of the house property is ₹ 9,00,000.

(iii) Mr. Akshat received 100 shares of A Ltd. from his friend as a gift on occasion of his 25th marriage anniversary. The fair market value on that date was ₹ 100 per share. He also received jewellery worth ₹ 45,000 (FMV) from his nephew on the same day.

(iv) Kishan HUF gifted a car to son of Karta for achieving good marks in XII board examination. The fair market value of the car is ₹ 5,25,000.

SOLUTION

	Taxable/ Non-taxable	Amount liable to tax (₹)	Reason
(i)	Taxable	75,000	Sum of money exceeding ₹ 50,000 received without consideration from a non-relative is taxable under section 56(2)(x). Daughter of Mr. Akhil's sister is not a relative of Akhil HUF, since she is not a member of Akhil HUF.

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(ii)	Non-taxable	Nil	Immovable property received without consideration by a HUF from its relative is not taxable under section 56(2)(x). Since Nitisha is a member of the HUF, she is a relative of the HUF. However, income from such asset would be included in the hands of Nitisha under 64(2).
(iii)	Taxable	55,000	As per provisions of section 56(2)(x), in case the aggregate fair market value of property, other than immovable property, received without consideration exceeds ₹ 50,000, the whole of the aggregate value shall be taxable. In this case, the aggregate fair market value of shares (₹ 10,000) and jewellery (₹ 45,000) exceeds ₹ 50,000. Hence, the entire amount of ₹ 55,000 shall be taxable.
(iv)	Non-taxable	Nil	Car is not included in the definition of property for the purpose of section 56(2)(x), therefore, the same shall not be taxable.

ILLUSTRATION 5

Mr. Hari, a property dealer, sold a building in the course of his business to his friend Mr. Rajesh, who is a dealer in automobile spare parts, for ₹ 90 lakh on 1.1.2026, when the stamp duty value was ₹ 150 lakh. The agreement was, however, entered into on 1.9.2025 when the stamp duty value was ₹ 140 lakh. Mr. Hari had received a down payment of ₹ 15 lakh by a crossed cheque from Mr. Rajesh on the date of agreement. Discuss the tax implications in the hands of Mr. Hari and Mr. Rajesh, assuming that Mr. Hari has purchased the building for ₹ 75 lakh on 12th July, 2024.

Would your answer be different if Hari was a share broker instead of a property dealer?

SOLUTION

Case 1: Tax implications if Mr. Hari is a property dealer

In the hands of Mr. Hari	In the hands of Mr. Rajesh
In the hands of Hari, the provisions of section 43CA would be attracted, since the building represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value; and the stamp duty value exceeds 110% of consideration. Under section 43CA, the option to adopt the stamp duty value on the date of agreement can be exercised only if whole or part of the consideration has been received on or before the date of agreement by way of account payee cheque or	Since Mr. Rajesh is a dealer in automobile spare parts, the building purchased would be a capital asset in his hands. The provisions of section 56(2)(x) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration and the difference between the consideration and stamp duty value exceeds ₹ 9,00,000, being the higher of ₹ 50,000 and **10% of consideration**.

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draft or by use of ECS through a bank account or through credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay on or before the date of agreement. In this case, since the down payment of ₹ 15 lakh is received on the date of agreement by crossed cheque and not account payee cheque, the option cannot be exercised. Therefore, **₹ 75 lakh**, being the difference between the stamp duty value on the date of transfer i.e., ₹ 150 lakh, and the purchase price i.e., ₹ 75 lakh, would be chargeable as **business income** in the hands of Mr. Hari, since stamp duty value exceeds **110% of the consideration**.	Therefore, **₹ 60 lakh**, being the difference between the stamp duty value of the property on the date of registration (i.e., ₹ 150 lakh) and the actual consideration (i.e., ₹ 90 lakh) would be taxable under section 56(2)(x) in the hands of Mr. Rajesh, since the payment on the date of agreement is made by crossed cheque and not account payee cheque/draft or ECS or through credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay.

Case 2: Tax implications if Mr. Hari is a share broker

In the hands of Mr. Hari	In the hands of Mr. Rajesh
In case Mr. Hari is a share broker and not a property dealer, the building would represent his capital asset and not stock-in-trade. In such a case, the provisions of section 50C would be attracted in the hands of Mr. Hari, since building is transferred for a consideration less than the stamp duty value; and the stamp duty value exceeds 110% of consideration. Thus, **₹ 75 lakh, being the difference between the stamp duty value on the date of registration (i.e., ₹ 150 lakh) and the purchase price (i.e., ₹ 75 lakh) would be chargeable as short-term capital gains.** It may be noted that under section 50C, the option to adopt the stamp duty value on the date of agreement can be exercised only if whole or part of the consideration has been received on or before the date of agreement by way of account payee cheque or draft or by use of ECS through a bank account or through credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified	There would be no difference in the taxability in the hands of Mr. Rajesh, whether Mr. Hari is a property dealer or a stock broker, (except where the property transferred in a residential unit fulfilling the stipulated conditions, which is not so in this case). Therefore, the provisions of section 56(2)(x) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration and the difference between the consideration and stamp duty value exceeds ₹ 9,00,000, being the higher of ₹ 50,000 and 10% of consideration. Therefore, **₹ 60 lakh**, being the difference between the stamp duty value of the property on the date of registration (i.e., ₹ 150 lakh) and the actual consideration (i.e., ₹ 90 lakh) would be taxable under section 56(2)(x) in the hands of Mr. Rajesh, since the payment on the date of agreement is made by crossed cheque and not account payee cheque/draft or ECS or through credit card, debit card, net

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Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay on or before the date of agreement. In this case, since the down payment of ₹ 15 lakhs has been received on the date of agreement by crossed cheque and not account payee cheque, the option cannot be exercised.	banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay.

(vi) Compensation or any other payment received in connection with termination of his employment [Section 56(2)(xi)]

Any compensation or any other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto shall be chargeable to tax under this head. However, if it is received from employer, then it is taxable u/s 17(3)(i) under the head "Income from Salaries".

(vii) Any specified sum received by a unit holder from a business trust during the previous year [Section 56(2)(xii)]

Section 56(2)(xii) provides that any specified sum received by a unit holder from a business trust during the previous year with respect to unit held by him at any time during the previous year would be chargeable to tax in the hands of unit holder under the head "Income from other sources".

Specified sum is to be computed in the following manner:

Specified sum = A (-) B (-) C (which shall be zero if sum of B and C is greater than A)	
A	Aggregate of sum distributed by the business trust with respect to such unit, during the previous year or during any earlier previous year or years, to such unit holder, who holds such unit on the date of distribution of sum or to any other unit holder who held such unit at any time prior to the date of such distribution, which is – (a) not in the nature of interest and dividend referred to in section 10(23FC) or rental income referred to in section 10(23FCA); and (b) not chargeable to tax in the hands of the business trust under section 115UA(2)
B	Amount at which such unit was issued by the business trust; and
C	Amount charged to tax under this clause in any earlier previous year;

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(viii) Sum received, including the amount allocated by way of bonus, under a LIP other than under a ULIP and keyman insurance policy, which is not exempt u/s 10(10D) [Section 56(2)(xiii)]

Any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy would be included in the total income of a person if it is not exempt under section 10(10D). The provisions relating to exemption under section 10(10D) have already been discussed in Chapter 4: Capital Gains.

Section 10(10D) provides that in case any difficulty arises in giving effect to the provisions of section 10(10D), the CBDT may issue guidelines for the purpose of removing the difficulty with the previous approval of the Central Government.

Accordingly, the CBDT has, with the approval of the Central Government, vide Circular No. 15/2023, dated 16.08.2023, issued the following guidelines in respect of LIPs (other than ULIPs)–

Situation 1: No sum of any nature including bonus (such sum hereinafter referred as "consideration") is received by the assessee on any LIPs which are issued on or after 1.4.2023 (such LIPs hereinafter referred as "eligible LIPs") during any previous year preceding the current previous year or consideration has been received on such eligible LIPs in an earlier previous year but has not been claimed exempt. In such a situation, the exemption u/s 10(10D) would be determined as under:

I. <u>Where the assessee has received consideration, during the current P.Y., under one eligible LIP only</u>

Circumstance	Eligibility for exemption u/s 10(10D)
If the amount of premium payable on such eligible LIP does not exceed ₹ 5,00,000 for any of the PYs during the term of such eligible LIP and annual premium does not exceed 10% of actual capital sum assured	Such consideration would be eligible for exemption u/s 10(10D). **[Refer Example 1 and 2 given below]**
If the amount of premium payable on such eligible LIP > ₹ 5,00,000 for any of the PYs during the term of such eligible LIP	Such consideration would **<u>not</u>** be eligible for exemption u/s 10(10D). **[Refer Example 3 given below]**

Example 1:

LIP	A
Date of issue	1.4.2014
Annual premium	6,00,000

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Sum assured	60,00,000
Consideration received as on 01.11.2025 on maturity	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2025-26.	

Eligibility for exemption u/s 10(10D) - The consideration received under LIP "A" would be exempt u/s 10(10D) in A.Y. 2026-27 since annual premium does not exceed 10% of the actual capital sum assured. Moreover, as the policy has been issued before 1.4.2023, limit of ₹ 5,00,000 of amount of premium payable is not applicable, since it is not an eligible ULIP.

Example 2:

LIP	A
Date of issue	1.4.2023
Annual premium	5,00,000
Sum assured	50,00,000
Consideration received as on 01.11.2033 on maturity	52,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34.	

Eligibility for exemption u/s 10(10D) - The consideration received would be exempt u/s 10(10D) in A.Y. 2034-35, since the annual premium payable on the policy does not exceed ₹ 5,00,000 and also does not exceed 10% of actual capital sum assured.

Example 3:

LIP	A
Date of issue	1.4.2023
Annual premium	6,00,000
Sum assured	60,00,000
Consideration received as on 01.11.2033 on maturity	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34.	

Eligibility for exemption u/s 10(10D) - The consideration received would **not** be exempt u/s 10(10D) in A.Y. 2034-35 since the annual premium payable on the eligible LIP exceeds ₹ 5,00,000.

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II. Where the assessee has received consideration, during the current P.Y., under more than one eligible LIP

Circumstance	Eligibility for exemption u/s 10(10D)
If the aggregate of the amount of premium payable on such eligible LIPs does not exceed ₹ 5,00,000 for any of the PYs during the term of such eligible LIPs and the annual premium ≤ 10% of actual capital sum assured	Such consideration would be eligible for exemption under u/s 10(10D). **[Refer Example 4 given below]**
If the aggregate of the amount of premium payable on such eligible LIPs > ₹ 5,00,000 for any of the PYs during the term of such eligible LIP	Consideration in respect of any of those eligible LIPs whose aggregate amount of premium payable does not exceed ₹ 5,00,000 for any of the PYs during their term would be eligible for exemption u/s 10(10D), provided their annual premium ≤ 10% of actual capital sum assured. **[Refer Examples 5, 6 and 7 given below]**

Example 4:

LIP	A	B
Date of issue	1.4.2023	1.4.2023
Annual premium	3,00,000	2,00,000
Sum assured	30,00,000	20,00,000
Consideration received as on 01.11.2033 on maturity	32,00,000	21,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34.		

Eligibility for exemption u/s 10(10D) – In this case, the aggregate of the annual premium payable for LIP "A" and LIP "B" does not exceed ₹ 5,00,000 during the term of these policies.

Further, annual premium payable in respect of LIP "A" and LIP "B" does not exceed 10% of actual capital sum assured. Therefore, the consideration received under LIP "A" and "B" would be exempt u/s 10(10D) in A.Y. 2034-35

Example 5:

LIP	A	B
Date of issue	1.4.2023	1.4.2023
Annual premium	4,50,000	5,50,000

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Sum assured	45,00,000	55,00,000
Consideration received as on 01.11.2033 on maturity	52,00,000	60,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34.		

Eligibility for exemption u/s 10(10D) – In this case, the aggregate of the annual premium payable for LIP "A" and LIP "B" exceeds ₹ 5,00,000 during the term of these policies.

However, the consideration received under LIP "A" would be exempt u/s 10(10D) in A.Y. 2034-35, since its annual premium payable does not exceed ₹ 5,00,000 for any previous year during the term of the policy and also does not exceed 10% of actual capital sum assured.

Consequently, the consideration received under LIP "B" alone would **not** be exempt u/s 10(10D) in A.Y. 2034-35.

Example 6:

LIP	A	B	C
Date of issue	1.4.2023	1.4.2023	1.4.2023
Annual premium	1,00,000	3,50,000	6,00,000
Sum assured	10,00,000	35,00,000	60,00,000
Consideration received as on 01.11.2033 on maturity	12,00,000	40,00,000	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34.			

Eligibility for exemption u/s 10(10D) - The aggregate of annual premium payable for LIP "A", LIP "B" and LIP "C" exceeds ₹ 5,00,000 during the term of these policies.

However, the consideration received under LIPs "A" and "B" would be exempt u/s 10(10D) in A.Y. 2034-35, since aggregate of annual premium payable for these two policies does not exceed ₹ 5,00,000 for any previous year during the term of these two policies and annual premium payable in respect of these policies does not exceed 10% of actual capital sum assured.

Consequently, the consideration received under LIP "C" alone would not be exempt u/s 10(10D) in A.Y. 2034-35.

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Example 7:

LIP	X	A	B	C
Date of issue	1.4.2022	1.4.2023	1.4.2023	1.4.2023
Annual premium	5,50,000	1,00,000	3,50,000	6,00,000
Sum assured	55,00,000	10,00,000	35,00,000	60,00,000
Consideration received as on 01.11.2032 on maturity	62,00,000			
Consideration received as on 01.11.2033 on maturity		12,00,000	40,00,000	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2033-34, except LIP X in P.Y. 2032-33.				

Eligibility for exemption u/s 10(10D) - The consideration received under LIP "X" would be exempt u/s 10(10D) in A.Y. 2032-33, since annual premium does not exceed 10% of the actual capital sum assured. Moreover, as the policy has been issued before 1.4.2023, limit of ₹ 5,00,000 on amount of premium payable is not applicable, since LIP "X" is not an eligible LIP.

The aggregate of annual premium payable for LIP "A", LIP "B" and LIP "C" (being LIPs issued on or after 1.4.2023) exceeds ₹ 5,00,000 during the term of these policies.

However, the consideration received under LIPs "A" and "B" would be exempt u/s 10(10D) in A.Y. 2034-35, since aggregate of annual premium payable for these two policies does not exceed ₹ 5,00,000 for any previous year during the term of these two policies and annual premium payable in respect of these policies does not exceed 10% of actual capital sum assured.

Consequently, the consideration received under LIP "C" alone would not be exempt u/s 10(10D) in A.Y. 2034-35.

Situation 2: Consideration has been received by the assessee under any one or more eligible LIPs (i.e., issued on or after 1.4.2023) during any P.Y. preceding the current P.Y. and it has been claimed to be exempt u/s 10(10D). Such eligible LIPs are referred as "Earlier Exempt Eligible LIPs (EEE LIPs)" in this paragraph and corresponding examples and reference to eligible LIPs shall not include EEE LIPs. The exemption u/s 10(10D) would be determined as under:

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I. Where the assessee has received consideration, during the current P.Y., under one eligible LIP only

Circumstance	Eligibility for exemption u/s 10(10D)
If aggregate amount of premium payable on such eligible LIP and EEE LIPs does not exceed ₹ 5,00,000 for any of the PYs during the term of such eligible LIP and annual premium in respect of eligible LIP does not exceed 10% of actual capital sum assured.	Consideration under such eligible LIP would be eligible for exemption u/s 10(10D).
If aggregate amount of premium payable on such eligible LIP and EEE LIPs > ₹ 5,00,000 for any of the PYs during the term of such eligible LIP	Consideration under such eligible LIP would **not** be eligible for exemption u/s 10(10D).

II. Where the assessee has received consideration, during the current P.Y., under more than one eligible LIP

Circumstance	Eligibility for exemption u/s 10(10D)
If aggregate of the amount of premium payable on such eligible LIPs and EEE LIPs does not exceed ₹ 5,00,000 for any of the PYs during the term of such eligible LIPs and annual premium in respect of eligible LIPs also does not exceed 10% of actual capital sum assured.	Consideration received would be eligible for exemption under u/s 10(10D).
If aggregate of the amount of premium payable on such eligible LIPs and EEE LIPs > ₹ 5,00,000 for any of the PYs during the term of such eligible LIPs	Consideration in respect of any of those eligible LIPs (whose aggregate amount of premium along with the aggregate amount of premium of EEE LIPs does not exceed ₹ 5,00,000 for any of the PYs during their term) would be eligible for exemption u/s 10(10D). **[Refer Examples 8, 9 and 10 given below]**

Example 8:

LIP	X	A	B	C
Date of issue	1.4.2023	1.4.2024	1.4.2024	1.4.2024
Annual premium	4,50,000	1,00,000	1,50,000	6,00,000
Sum assured	45,00,000	10,00,000	15,00,000	60,00,000

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Consideration received as on 01.11.2033 on maturity	50,00,000			
Consideration received as on 01.11.2034 on maturity		12,00,000	18,00,000	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2034-35, except LIP X in P.Y. 2033-34.				

Eligibility for exemption u/s 10(10D) - The consideration under LIP "X" would be exempt u/s 10(10D) in P.Y. 2033-34, since the annual premium does not exceed ₹ 5,00,000 and also does not exceed 10% of actual capital sum assured.

In this case, the aggregate of the annual premium payable for LIP "A", LIP "B" and LIP "C" along with the premium for LIP "X" exceeds ₹ 5,00,000 during the term of these policies.

The aggregate of the annual premium payable for LIP "A" and the premium for LIP "X" also exceeds ₹ 5,00,000 during the term of these policies.

Consequently, the consideration received under LIP "A", LIP "B" and LIP "C" would not be exempt u/s 10(10D) in A.Y. 2035-36.

Example 9:

LIP	X	A	B	C
Date of issue	1.4.2023	1.4.2024	1.4.2024	1.4.2024
Annual premium	2,50,000	2,00,000	2,50,000	6,00,000
Sum assured	25,00,000	20,00,000	25,00,000	60,00,000
Consideration received as on 01.11.2033 on maturity	30,00,000			
Consideration received as on 01.11.2034 on maturity		24,00,000	38,00,000	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2034-35, except LIP X in P.Y. 2033-34.				

Eligibility for exemption u/s 10(10D) - The consideration under LIP "X" would be exempt u/s 10(10D) in P.Y. 2033-34, since the annual premium does not exceed ₹ 5,00,000 and also does not exceed 10% of actual capital sum assured.

In this case, the aggregate of the annual premium payable for LIP "A", LIP "B" and LIP "C" along with the premium for LIP "X" exceeds ₹ 5,00,000 during the term of these policies.

However, the consideration received under LIPs "A" or "B" (any one) can be claimed as exempt u/s 10(10D) in A.Y. 2035-36.

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If the consideration received under LIP "A" is claimed to be exempt as aggregate of the annual premium payable for LIP "X" and "A" did not exceed ₹ 5,00,000 for any of the PYs., the consideration received under LIP "B" would not be exempt.

If the consideration received under LIP "B" is claimed to be exempt as aggregate of the annual premium payable for LIP "X" and "B" did not exceed ₹ 5,00,000 for any of the PYs., the consideration received under LIP "A" would not be exempt. Exemption for consideration received under LIP "B" is preferred as it is more beneficial to the assessee.

Alternative treatment: If the consideration under LIP "X" was not claimed to be exempt u/s 10(10D) in A.Y. 2034-35 by the assessee, then, the consideration received under LIP "A" and LIP "B" would be exempt u/s 10(10D) in A.Y. 2035-36 since the aggregate of the annual premium payable for the LIPs "A" and "B" together did not exceed ₹ 5,00,000 for any of the previous years during the term of these two policies. However, the most beneficial treatment is to claim LIP "X" and "B" as exempt.

It may be noted that in every case, the consideration received for LIP "C" would not be exempt u/s 10(10D).

Example 10:

LIP	X	Y	A	B	C
Date of issue	1.4.2023	1.4.2023	1.4.2024	1.4.2024	1.4.2024
Annual premium	2,00,000	2,00,000	2,00,000	3,00,000	6,00,000
Sum assured	20,00,000	20,00,000	20,00,000	30,00,000	60,00,000
Consideration received on surrender as on 1.7.2033	12,00,000				
Consideration received as on 01.11.2034 on maturity		24,00,000			
Consideration received as on 01.11.2035 on maturity			24,00,000	36,00,000	70,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs in earlier P.Y. preceding the P.Y.2035-36, except LIP "X" and "Y".					

Eligibility for exemption u/s 10(10D) - The consideration under LIP "X" would be exempt u/s 10(10D) in A.Y.2034-35, since the annual premium does not exceed ₹ 5,00,000 and also does not exceed 10% of actual capital sum assured.

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The consideration received under LIP "Y" would be exempt u/s 10(10D) in A.Y. 2035-36, since the aggregate of annual premium payable for LIP "X" and "Y" does not exceed ₹ 5,00,000 and annual premium payable for LIP "Y" does not exceed 10% of actual capital sum assured.

The consideration received under LIPs "A", ULIP "B" and ULIP "C" would not be exempt u/s 10(10D) in A.Y. 2036-37, since aggregate of annual premium payable for these three policies and LIP "X" and "Y" exceeds ₹ 5,00,000.

Alternative treatment: If the consideration on surrender under LIP "X" was not claimed to be exempt u/s 10(10D) in A.Y. 2034-35 by the assessee, then the consideration received under LIP "Y" would be exempt and the consideration received under LIP "A" **or** LIP "B" (any one) can be exempt u/s 10(10D) in A.Y. 2036-37. If the consideration received under LIP "A" is claimed to be exempt, as aggregate of the annual premium payable for LIP "Y" and "A" did not exceed ₹ 5,00,000 for any of the PYs., the consideration received under LIP "B" would not be exempt.

If the consideration received under LIP "B" is claimed to be exempt as aggregate of the annual premium payable for LIP "Y" and "B" did not exceed ₹ 5,00,000 for any of the PYs., the consideration received under LIP "A" would not be exempt. Exemption for consideration received under LIP "B" is preferred as it is more beneficial to the assessee.

If the consideration on surrender of LIP "X" and on maturity of LIP "Y" were not claimed to be exempt under section 10(10D) in A.Y.2034-35 and A.Y.2035-36, respectively, then consideration received under both LIP "A" and LIP "B" would be exempt in A.Y.2036-37 (being LIPs issued on or after 1.4.2023, whose aggregate consideration does not exceed ₹ 5,00,000).

It may be noted that, in every case, consideration received under LIP "C" would not be exempt under section 10(10D).

Example 11:

LIP			**A**	**B**	**C**
ULIP	**X**	**Y**			
Date of issue	1.4.2021	1.4.2023	1.4.2023	1.4.2023	1.4.2023
Annual premium	1,00,000	1,00,000	1,00,000	1,50,000	3,00,000
Sum assured	10,00,000	10,00,000	10,00,000	15,00,000	30,00,000
Consideration received on surrender as on 1.7.2033	6,00,000		6,00,000		

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Consideration received as on 01.11.2034 on maturity		12,00,000		18,00,000	34,00,000
Note – The assessee did not receive any consideration under any other eligible LIPs or ULIPs in earlier P.Y. preceding the P.Y.2034-35, except ULIP "X" and LIP "A".					

Eligibility for exemption u/s 10(10D) - The consideration under ULIP "X" would be exempt u/s 10(10D) in A.Y. 2034-35, since the annual premium does not exceed ₹ 2,50,000 and also does not exceed 10% of actual capital sum assured.

The consideration under ULIP "Y" would be exempt u/s 10(10D) in A.Y.2035-36, since the aggregate of annual premium for UIP "X" and ULIP "Y" does not exceed ₹ 2,50,000 and also does not exceed 10% of actual capital sum assured.

The consideration under LIP "A" would be exempt u/s 10(10D) in A.Y.2034-35, since the annual premium does not exceed ₹ 5,00,000 and also does not exceed 10% of actual capital sum assured.

In this case, the aggregate of the annual premium payable for LIP "B" and LIP "C" along with the premium for LIP "A" exceeds ₹ 5,00,000 during the term of these policies.

However, the consideration received under LIPs "B" or "C" (any one) can be claimed as exempt u/s 10(10D) in A.Y. 2035-36.

If the consideration received under LIP "B" is claimed to be exempt as aggregate of the annual premium payable for LIP "A" and "B" did not exceed ₹ 5,00,000 for any of the PYs., the consideration received under LIP "C" would not be exempt.

If the consideration received under LIP "C" is claimed to be exempt as aggregate of the annual premium payable for LIP "A" and "C" did not exceed ₹ 5,00,000 for any of the PYs., the consideration received under LIP "B" would not be exempt. Exemption for consideration received under LIP "C" should be preferred as it is more beneficial to the assessee.

Alternative treatment: If the consideration under LIP "A" was not claimed to be exempt u/s 10(10D) in A.Y. 2034-35 by the assessee, then the consideration received under LIP "B" and LIP "C" would be exempt u/s 10(10D) in A.Y. 2035-36 since the aggregate of the annual premium payable for the LIPs "B" and "C" together did not exceed ₹ 5,00,000 for any of the previous years during the term of these two policies. This would be most beneficial to the assessee.

Clarification on GST Component: It is also clarified by the CBDT that the premium payable/ aggregate premium payable for a life insurance policy/policies, other than a ULIP, issued on or after 1.4.2023, for any previous year, would be exclusive of the amount of GST payable on such premium.

Clarification on premium of Term life insurance policy: It is further clarified by the CBDT that the limit of ₹ 5,00,000 of amount of premium payable would not be applicable in case of a term life

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insurance policy i.e. where sum under a life insurance policy is only paid to the nominee in case of the death of the person insured during the term of the policy and no amount is paid to anyone if the insured person survives the policy tenure.

Hence, any sum received under a term insurance policy shall continue to be exempt under section 10(10D), irrespective of the amount of the premium payable in respect of such policy. Further the premium paid for such policies would not be counted for checking the limit of ₹ 5,00,000 of amount of premium payable.

Summary

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Taxability of sum received under a LIP which is not exempt u/s 10(10D)

Where any sum is received (including the amount allocated by way of bonus) at any time during a previous year, under a life insurance policy, other than the sum

(i) received under a ULIP

(ii) received under a Keyman insurance policy

which is not exempt under section 10(10D), the sum so received as exceeds the aggregate of the premium paid during the term of such life insurance policy, and not claimed as deduction under any other provision of the Act, computed in the prescribed manner, would be chargeable to tax under the head "Income from other sources".

Accordingly, the CBDT has, vide this notification, notified Rule 11UACA to compute the income chargeable to tax under section 56(2)(xiii). Where any person receives at any time during any previous year any sum under such LIP, then, the income chargeable to tax under section 56(2)(xiii) during the previous year in which such sum is received has to be computed in the following manner -

	Situation	Income chargeable to tax during the previous year in which such sum is received
(i)	Where the sum is received for the first time under the LIP during the previous year (first previous year)	**A-B, where** A = the sum or aggregate of sum received under the LIP during the first previous year; and B = the aggregate of the premium paid during the term of the LIP till the date of receipt of the sum in the first previous year that has not been claimed as deduction under any other provision of the Act.
(ii)	where the sum is received under the LIP during the previous year subsequent to the first previous year (subsequent previous year)	**C-D, where** C = the sum or aggregate of sum received under the LIP during the subsequent previous year; and D = the aggregate of the premium paid during the term of the LIP till the date of receipt of the sum in the subsequent previous year not being premium which – (a) has been claimed as deduction under any other provision of the Act; or (b) is included in "B" or "D" in any of the previous year(s).

"Sum received under a LIP" means any amount, by whatever name called, received under such policy which is not exempt under section 10(10D), other than the sum–

(a) received under a ULIP; or

(b) received under a Keyman insurance policy

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(2) Income chargeable under the head "Income from other sources" only if not chargeable under the head "Profits and gains of business or profession" -

(i) Any sum received by an employer-assessee from his employees as contributions to any provident fund, superannuation fund or any other fund for the welfare of the employees.

(ii) Income from letting out on hire, machinery, plant or furniture.

(iii) Where letting out of buildings is inseparable from the letting out of machinery, plant or furniture, the income from such letting.

(iv) Interest on securities

However, the following Interest income arising to certain persons would be exempt under section 10(15):

(a) Income by way of interest, premium on redemption or other payment on notified securities, bonds, annuity certificates or other savings certificates is exempt subject to such conditions and limits as may be specified in the notification.

Interest on Post Office Savings Bank Account would be exempt from tax to the extent of:

(1) ₹ 3,500 in case of an individual account.

(2) ₹ 7,000 in case of a joint account.

(b) Interest payable —

(1) by public sector companies on certain specified bonds and debentures subject to the conditions which the Central Government may specify by notification, including the condition that the holder of such bonds or debentures registers his name and holding with that company;

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

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

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

(i) the manufacture or processing of goods; or

(ii) the manufacture of computer software or recording of programmes on any disc, tape, perforated media or other information device; or

(iii) the business of generation or generation and distribution of electricity or any other form of power; or

(iv) the business of providing telecommunication services; or

(v) mining; or

(vi) construction of ships, or

(vii) the business of ship-breaking; or

(viii) the operation of ships or aircrafts or construction or operation of rail systems.

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

(c) **Bhopal Gas Victims** - Section 10(15)(v) provides exemption in respect of interest on securities held by the Welfare Commissioner, Bhopal Gas Victims, Bhopal, in the Reserve Bank's Account No. SL/DH 048. Recently, in terms of an order of the Supreme Court to finance the construction of a hospital at Bhopal to serve the victims of the gas leak, the shares of the Union Carbide Indian Ltd., have been sold. The scope of the above exemption has been extended to interest on deposits for the benefit of the victims of the Bhopal Gas Leak disaster. Such deposits can be held in such account with the RBI or with a public sector bank as the Central Government may notify in the Official Gazette.

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(d) Interest on Gold Deposit Bond issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetization Scheme, 2015 notified by the Central Government.

(e) Interest on bonds, issued by –

(1) a local authority; or

(2) a State Pooled Finance Entity

and specified by the Central Government by notification in the Official Gazette.

"State Pooled Finance Entity" means such entity which is set up in accordance with the guidelines for the Pooled Finance Development Scheme notified by the Central Government in the Ministry of Urban Development.

Accordingly, the Central Government has specified the "Tax-free Pooled Finance Development Bonds" under Pooled Finance Development Fund Scheme of Government of India, interest from which would be exempt under section 10(15).

(3) Keyman Insurance Policy

Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy is chargeable under the head "Income from other sources" if such income is not chargeable under the head "Profits and gains of business or profession" or under the head "Salaries" i.e. if such sum is received by any person other than the employer who took the policy and the employee in whose name the policy was taken.

(4) Residual Income

Any income chargeable to tax under the Act, but not falling under any other head of income shall be chargeable to tax under the head "Income from other sources" e.g. Salary received by an MPs/MLAs will not be chargeable to income-tax under the head 'Salary' but will be chargeable as "Income from other sources" under section 56.

Exemption from withdrawals from National Savings Scheme (NSS)

Section 80CCA provides for a deduction for any amount deposited in the NSS. No deduction would be allowed in relation to such amount deposited on or after 1.4.1992.

The NSS 1987 accounts are still operational, however due to the notification G.S.R.538E dated 29.8.2024 issued by Ministry of Finance through National Savings Scheme (Amendment) Rules, 2024, the balances at the credit of the subscribers of the National Savings Scheme on or after 1st October, 2024, would not earn any interest.

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Consequent to this notification, depositors who had intended to leave their NSS balances untouched for future use will lose interest benefit and be compelled to withdraw the balances, making these amounts taxable.

Section 80CCA has been amended to provide exemption to the withdrawals made from National Savings Scheme (NSS) on or after 29th August, 2024, for any amount deposited under the scheme and the interest accrued thereon in respect of which a deduction has been allowed.

Interest from non-SLR Securities of Banks: Whether chargeable under the head "Profits and gains of business or profession" or "Income from other sources"? [Circular No. 18, dated 2.11.2015]

The issue addressed by this circular is whether in the case of banks, expenses relatable to investment in non-SLR securities need to be disallowed under section 57(i), by considering interest on non-SLR securities as "Income from other sources."

Section 56(1)(id) provides that income by way of interest on securities shall be chargeable to income-tax under the head "Income from Other Sources", if the income is not chargeable to income-tax under the head "Profits and Gains of Business and Profession".

The CBDT clarified that the **investments made by a banking concern are part of the business of banking**. Therefore, the income arising from such investments is attributable to the business of banking falling **under the head "Profits and Gains of Business and Profession".**

5.4 APPLICABLE RATE OF TAX IN RESPECT OF CASUAL INCOME [SECTION 115BB]

(1) This section provides that income by way of winnings from lotteries, crossword puzzles, races including horse races or card games and other games of any sort or from gambling or betting of any form would be taxed at a flat rate of 30% *plus* surcharge, if applicable, plus health and education cess @4%.

However, income by way of winnings from any online game would not be taxed under this section.

(2) No expenditure or allowance can be allowed from such income.

(3) Deduction under Chapter VI-A is not allowable from such income.

(4) Adjustment of unexhausted basic exemption limit is also not permitted against such income.

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5.5 APPLICABLE RATE OF TAX IN RESPECT OF WINNINGS FROM ONLINE GAMES [SECTION 115BBJ]

(1) This section provides that net winnings from any online game would be taxed at a flat rate of 30% plus surcharge, if applicable, plus health and education cess@4%.

(2) No expenditure or allowance can be allowed from such income.

(3) Deduction under Chapter VI-A is not allowable from such income.

(4) Adjustment of unexhausted basic exemption limit is also not permitted against such income.

(5) **Meaning of certain terms**

S. No.	Term	Meaning
(i)	Internet	The combination of computer facilities and electromagnetic transmission media, and related equipment and software, comprising the interconnected worldwide network of computer networks that transmits information based on a protocol for controlling such transmission
(ii)	Online game	A game that is offered on the internet and is accessible by a user through a computer resource including any telecommunication device

5.6 DEDUCTIONS ALLOWABLE [SECTION 57]

The income chargeable under the head "Income from other sources" shall be computed after making the following deductions:

(1) **In the case of dividend (other than deemed dividend arise on account of buy-back of shares by a domestic company) or income in respect of units of a mutual fund specified under section 10(23D) or income in respect of units of a specified company defined in the Explanation to section 10(35)**: Interest expenditure to earn such income is allowed as deduction subject to a maximum of 20% of such income included in the total income, without deduction under this section.

No deduction in respect of any expenditure is allowed in case of deemed dividend arise on account of buy-back of shares by a domestic company.

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(2) **In the case of interest on securities:** Any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such interest on behalf of the assessee.

(3) **Income consists of recovery from employees as contribution to any provident fund etc. in terms of section 2(24)(x)**: A deduction will be allowed in accordance with the provisions of section 36(1)(va) i.e. to the extent the contribution is remitted before the due date under the respective Acts.

(4) **Where the income to be charged under this head is from letting on hire of machinery, plant and furniture, with or without building:** The following items of deductions are allowable in the computation of such income:

(i) the amount paid on account of any current repairs to the machinery, plant or furniture.

(ii) the amount of any premium paid in respect of insurance against risk of damage or destruction of the machinery or plant or furniture.

(iii) the normal depreciation allowance in respect of the machinery, plant or furniture, due thereon.

(5) **In the case of income in the nature of family pension:** A deduction of a sum equal to 33-1/3 per cent of such income or **₹ 15,000 (in case of option regime) or ₹ 25,000 (in case of default regime)**, whichever is less, is allowable.

This deduction is allowable both under the default tax regime u/s 115BAC and under the optional tax regime i.e., normal provisions of the Act.

For the purposes of this deduction "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.

Exemption in respect of family pension

1. The family pension received by the widow or children or nominated heirs, **of a member of the armed forces (including para-military forces)** of the Union, where the death of such member has occurred in the course of operational duties, in specified circumstances would, however, be exempt under section 10(19).

2. The family pension received by any member of the family of an individual who had been in the service of Central or State Government and had been awarded "Param

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Vir Chakra" or "Vir Chakra" or "Vir Chakra" or other notified gallantry awards would be exempt under section 10(18)(ii).

(6) **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.

(7) **In case of income by way of interest on compensation/ enhanced compensation received chargeable to tax under section 56(2)(viii):** Deduction of 50% of such income. No deduction would be allowable under any other clause of section 57 in respect of such income.

ILLUSTRATION 6

Interest on enhanced compensation received by Mr. G during the previous year 2025-26 is ₹ 5,00,000. Out of this interest, ₹ 1,50,000 relates to the previous year 2020-21, ₹ 1,65,000 relates to previous year 2021-22 and ₹ 1,85,000 relates to previous year 2022-23. Discuss the tax implication, if any, of such interest income for A.Y.2026-27.

SOLUTION

The entire interest of ₹ 5,00,000 would be taxable in the year of receipt, namely, P.Y.2025-26.

Particulars	₹
Interest on enhanced compensation taxable u/s 56(2)(viii)	5,00,000
Less: Deduction under section 57(iv) @50%	2,50,000
Interest chargeable under the head "Income from other sources"	**2,50,000**

Chart summarising the taxability of compensation/enhanced compensation (including interest) received on compulsory acquisition:

Initial Compensation will be taxable in the year in which first instalment is received under the head 'Capital Gains'

Enhanced Compensation will be taxable as & when received under the head 'Capital Gains'

Interest on compensation/ enhanced compensation is taxable in year of receipt under the head 'Income from Other Sources' after deduction of 50% of such interest

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5.7 DEDUCTIONS NOT ALLOWABLE [SECTION 58]

No deduction shall be made in computing the "Income from other sources" of an assessee in respect of the following items of expenses:

(1) **In the case of any assessee:**

(i) any personal expense of the assessee;

(ii) any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source.

(iii) any payment taxable in India as salaries, if it is payable outside India unless tax has been paid thereon or deducted at source.

(2) **Any expenditure in respect of which a payment is made to a related person or made in cash in excess of ₹ 10,000:** In addition to these disallowances, section 58(2) specifically provides that the disallowance of any expenditure in respect of which a payment is made to a related person, to the extent the same is considered excessive or unreasonable by the Assessing Officer, having regard to the FMV. and disallowance of payment or aggregate of payments exceeding ₹ 10,000 made to a person during a day otherwise than by account payee cheque or draft or ECS through bank account or through such other prescribed electronic mode such as credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay covered by section 40A will be applicable to the computation of income under the head 'Income from other sources' as well.

(3) **Disallowance of 30% of expenditure:** 30% of expenditure shall not be allowed, in respect of a sum which is payable to a resident and on which tax is deductible at source, if

- such tax has not been deducted or;
- such tax after deduction has not been paid on or before the due date of return specified in section 139(1).

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such payee –

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

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(iii) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed,

it would be deemed that the assessee has deducted and paid the tax on such sum.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the payee.

(4) **No deduction in respect of any expenditure incurred in connection with casual income:** No deduction in respect of any expenditure or allowance in connection with income by way of earnings from lotteries, cross word puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever shall be allowed in computing the said income.

The prohibition will not, however, apply in respect of the income of an assessee, being the owner of race horses, from the activity of owning and maintaining such horses. In respect of the activity of owning and maintaining race horses, expenses incurred shall be allowed even in the absence of any stake money earned. Such loss shall be allowed to be carried forward in accordance with the provisions of section 74A.

5.8 DEEMED INCOME CHARGEABLE TO TAX [SECTION 59]

The provisions of section 41(1) are made applicable, so far as may be, to the computation of income under this head. Accordingly, where a deduction has been made in respect of a loss, expenditure or liability and subsequently any amount is received or benefit is derived in respect of such expenditure incurred or loss or trading liability allowed as deduction, then it shall be deemed as income in the year in which the amount is received or the benefit is accrued.

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SIGNIFICANT SELECT CASES

S. No.	Case Law	
1.	***PCIT v. Dr. Ranjan Pai (2021) 431 ITR 250 (Karn)***	
	Issue	**Analysis & Decision**
	Can bonus shares received by shareholders be taxable under the head 'Income from other sources' as per the provisions of section 56(2)(x), as they are received without consideration?	**The issue of bonus shares by capitalization of reserves is merely a reallocation of the company's funds. There is no inflow of fresh funds or increase in the capital employed, which remains the same.** Thus, there is no addition or alteration to the profit-making apparatus and the total funds available with the company remain the same. On the other hand, when a shareholder gets bonus shares, the value of the original shares held by him goes down and the market value as well as intrinsic value of the two shares put together will be the same or nearly the same as the value of original share before the issue of bonus shares. **Thus, any profit derived by the assessee shareholder on account of receipt of bonus shares is adjusted by depreciation in the value of equity shares originally held by him**. Hence, **the provisions of section 56(2)(x) would not be attracted in the hands of the recipient shareholders on receipt of bonus shares.** ***Note -*** *This decision was rendered in the context of section 56(2)(vii); however, the underlying principle emanating therefrom applies with equal force in the context of the present provisions contained in section 56(2(x). Accordingly, the issue and decision has been presented with reference to section 56(2)(x).*
2.	***CIT v. Sree Rama Multi Tech Ltd. (2018) 403 ITR 426 (SC)***	
	Issue	**Analysis & Decision**
	Is interest income from share application money deposited in bank eligible for set-off against public issue expenses or should such interest be subject to tax under the head 'Income from Other Sources'?	The assessee-company was statutorily required to keep share application money in a separate account till the allotment of shares was completed. Part of the share application money would normally have to be returned to unsuccessful applicants, and therefore, the entire share application money would not ultimately be appropriated by the company. **The interest earned was inextricably linked with the requirement of raising share capital.**

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		Any surplus money deposited in the bank for the purpose of earning interest is liable to be taxed as "Income from Other Sources". Here, the share application money was deposited with the bank not to make additional income but to comply with the statute. The interest accrued on such deposit is merely incidental. Moreover, the issue of shares relates to capital structure of the company and hence, expenses incurred in connection with the issue of shares are to be capitalized. **Accordingly, the accrued interest is not liable to be taxed as "Income from Other Sources"; the same is eligible to be set-off against public issue expenses.**
3.	***Movaliya Bhikhubhai Balabhai v. ITO (TDS) (2016) 388 ITR 343 (Guj)***	
	Issue	**Analysis & Decision**
	Is interest on enhanced compensation u/s 28 of the Land Acquisition Act, 1894 assessable as capital gains or as income from other sources?	The assessee **has received interest u/s 28 of the Land Acquisition Act, 1894 which represents enhanced value of land and thus, partakes the character of compensation and not interest. Hence, interest u/s 28 is liable to be taxed under the head of 'Capital Gains'** and not under 'Income from Other Sources'. On the other hand, interest u/s 34 of the Land Acquisition Act, 1894 is for the delay in making payment after the compensation amount is determined. Such amount is liable to be taxed under the head 'Income from Other Sources'. ***Note:*** *The Land Acquisition Act, 1894 has now been repealed and replaced by the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. Section 72 and Section 80 of the new legislation have similar provisions regarding award of interest.*
4.	***CIT v. Parle Plastics Ltd. (2011) 332 ITR 63 (Bom.)***	
	Issue	**Analysis & Decision**
	What are the tests for determining "substantial part of business" of lending company for the purpose of application of exclusion provision u/s 2(22)?	U/s 2(22), "dividend" does not include, *inter alia,* any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company. **Percentage of turnover in relation to the whole as also the percentage of the profit in relation to the whole and sometimes even percentage of manpower**

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		used for a particular part of the business in relation to the total manpower or work force of the company would be required to be taken into consideration for determining the substantial part of business. **The capital employed for a specific division of a company in comparison to total capital employed** would also be relevant to determine whether the part of the business constitutes a substantial part.
5.	***CIT v. Vir Vikram Vaid (2014) 367 ITR 365 (Bom)***	
	Issue	**Analysis & Decision**
	Can repair and renovation expenses incurred by a company in respect of premises leased out by a shareholder having substantial interest in the company, be treated as deemed dividend?	The expenditure incurred by virtue of repairs and renovation on the premises cannot be brought within the definition of advance or loan given to the shareholder having substantial interest in the company, though he is the owner of the premises. It cannot be treated as payment by the company on behalf of the shareholder or for the individual benefit of such shareholder. Accordingly, **the repair and renovation expenses in respect of premises owned by the shareholder having substantial interest in the company and occupied by the company cannot be treated as deemed dividend**.
6.	***Pradip Kumar Malhotra v. CIT (2011) 338 ITR 538 (Cal.)***	
	Issue	**Analysis & Decision**
	Can the loan or advance given to a shareholder by the company, in return for an advantage conferred on the company by the shareholder, be deemed as dividend under section 2(22)(e)?	The phrase "by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans which a shareholder enjoys simply on account of being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power. In case such loan or advance is given to such shareholder as a consequence of any further consideration which is beneficial to the company received from such a shareholder, such advance or loan cannot be deemed as dividend within the meaning of the Act. Thus, only gratuitous loan or advance given by a company to a shareholder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) but not

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		cases where the loan or advance is given in return for an advantage conferred upon the company by such shareholder.
7.	***CIT v. Ambassador Travels (P) Ltd. (2009) 318 ITR 376 (Del.)***	
	Issue	**Analysis & Decision**
	Would the provisions of deemed dividend u/s 2(22)(e) be attracted in respect of financial transactions entered into in the normal course of business?	U/s 2(22)(e), loans and advances made out of accumulated profits of a company in which public are not substantially interested to a beneficial owner of shares holding not less than 10% of the voting power or to a concern in which such shareholder has substantial interest is deemed as dividend. However, this provision would not apply in the case of advance made in the course of the assessee's business as a trading transaction. **The assessee was involved in booking of resorts for the customers of these companies and entered into normal business transactions as a part of its day-to-day business activities. Such financial transactions cannot under any circumstances be treated as loans or advances received by the assessee from these concerns for the purpose of application of section 2(22)(e).**
8.	***CIT v. Manjoo and Co. (2011) 335 ITR 527 (Kerala)***	
	Issue	**Analysis & Decision**
	Can winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets be assessed as business income and be subject to normal rates of tax instead of the rates prescribed u/s 115BB?	The receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source. Further, **winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls.**

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TEST YOUR KNOWLEDGE

Questions

1. *Parimal, Managing Director of Heavens Engg. Pvt. Ltd. holds 70% of its paid up capital of ₹ 20 lakhs. The balance as at 31.03.2025 in General Reserve was ₹ 6 lakhs. The company on 1.04.2025 gave an interest-free loan of ₹ 5 lakhs to its Supervisor having salary of ₹ 4,000 p.m., who in turn on 15.4.2025 advanced the said amount of loan so taken from the company to Shri Parimal. The Assessing Officer had treated the amount of advance as deemed dividend. Is the action of Assessing Officer correct?*

2. *Mr. Santhanam holding 25% voting power in VKS Manufacturing Private Limited permitted his own land to be mortgaged to a bank for enabling the company to obtain a loan. Mr. Santhanam requested the company to release the property from the mortgage. The company failed to do so, but for retaining the benefit of bank loan it gave an advance of ₹ 10 lakhs to Mr. Santhanam, which was authorized by a resolution passed by the Board of Directors. The company's accumulated profit on the date of payment of advance was ₹ 50 lakhs. The Assessing Officer proposes to treat the amount of ₹ 10 lakhs as deemed dividend by invoking the provision of section 2(22)(e).*

   Is the proposition of the Assessing Officer correct in law?

3. *An enterprise engaged in manufacturing of steel balls discontinued its activities and decided to lease out its factory building, plant and machinery and furniture from 1.4.2025 on a consolidated lease rent of ₹ 50,000 per month. Compute the income for Assessment Year 2026-27 of the assessee from following information:*

		₹
(i)	Interest received on deposits	1,00,000
(ii)	Brokerage paid on hundi loan taken	2,000
(iii)	Interest paid on hundi and other loans which were given as deposits on interest to others	75,000
(iv)	Expenses incurred on repairs of building, plant and machinery	15,000
(v)	Fire insurance premium of plant and machinery and furniture	12,000
(vi)	Depreciation for the year	1,47,500
(vii)	Legal fees paid to an advocate for drafting and registering the lease agreement	1,500

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(viii) Factory licence fees paid for the year 1,000

(ix) There is unabsorbed depreciation of ₹ 2,75,000 of the Assessment Years 2024-25 and 2025-26.

(x) Interest paid in (iii) above includes an amount of ₹ 25,000 remitted to a non-resident outside India on which tax was not deducted at source.

4. In July 2025, Mr. Pervez employed as Marketing Manager in a Pharma company, received a Maruti car as gift from a distributor of the company. The value of the gifted car is estimated at ₹ 2,60,000. Is the value of car taxable as income? If so, under what head it is taxable?

Answers

1. The company had advanced a loan to an employee who in turn had advanced the same to the Managing Director of the company holding 70% of its capital. By virtue of the provisions of section 2(22)(e), the same shall be treated as the payment by a company in which public are not substantially interested, on behalf of, or for individual benefit of any such share holder (who holds not less than 10% of the voting power), to the extent to which the company possesses accumulated profits.

In this case, the company has reserves of ₹ 6 lakhs on 31st March of the preceding year and the amount of loan advanced on 1st April is ₹ 5 Lakhs. Therefore, the payment is to be treated as deemed dividend. The amount of interest-free loan of ₹ 5 lakhs given by the company to the supervisor who in turn had given the same to Mr. Parimal, shall be construed as the amount given for the benefit of Mr. Parimal and would be treated as deemed dividend. This has been held by the Supreme Court in the case of *L. Alagusundaram Chettiar v. CIT (2001) 252 ITR 893.*

2. The issue under consideration is whether loan or advance given to a shareholder by the company, in return of an advantage or benefit conferred on the company by the shareholder, can be deemed as dividend under section 2(22)(e) of the Income-tax Act, 1961 in the hands of the shareholder

The facts of the case are similar to the facts in *Pradip Kumar Malhotra v. CIT (2011) 338 ITR 538*, wherein the above issue came up before the Calcutta High Court.

The High Court observed that the phrase "by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans which a shareholder enjoys simply on account of being a person who is the beneficial owner of shares (not being

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shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power.

In case such loan or advance is given to such shareholder as a consequence of any further consideration received from such a shareholder which is beneficial to the company, such advance or loan cannot be a deemed dividend within the meaning of the Act.

Thus, gratuitous loan or advance given by a company to a shareholder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) to the extent of accumulated profits of the company but not the cases where the loan or advance is given in return for an advantage conferred upon the company by such shareholder.

In this case, advance of ₹ 10 lakhs was given by VKS Manufacturing (P) Ltd. to Mr. Santhanam holding 25% of voting power in lieu of non-release of his personal property from mortgage thereby enabling the company to retain the benefit of loan obtained from bank. Therefore, applying the rationale of the Calcutta High Court ruling in *Pradip Kumar Malhotra's* case, such advance cannot be brought within the purview of section 2(22)(e), since it was not in the nature of gratuitous advance but was given to protect the interest of the company.

The proposition of the Assessing Officer to treat the amount of ₹ 10 lakhs as deemed dividend by invoking the provisions of section 2(22)(e) in this case is, therefore, **not correct**.

3. The income derived from leased assets shall be chargeable to tax as 'Income from other sources' under section 56(2)(iii) but the computation thereof shall be made after allowing deductions specified under sections 30, 31 and 32 subject to section 38. This is as per the provisions of section 57(ii) and 57(iii).

Computation of income under the head "Income from other sources"

Particulars	₹	₹
(A) Lease Rent for 12 months @ ₹ 50,000 p.m.		6,00,000
Less: Expenses and deductions allowable under section 57(ii) & 57(iii):		
Repairs	15,000	
Fire Insurance Premium	12,000	
Legal expenses for drafting of lease agreement	1,500	
Factory Licence fee	1,000	
Depreciation for the year	1,47,500	

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Unabsorbed depreciation of earlier assessment years – eligible for deduction **(Note 1)**		2,75,000	4,52,000
			1,48,000
(B) Interest on Deposits		1,00,000	
Less: Expenses allowable under section 57(i)			
Brokerage	₹ 2,000		
Interest on hundi loans **(Note 2)**	₹ 50,000	52,000	48,000
Total Income			**1,96,000**

Notes:

1. Unabsorbed depreciation of ₹ 2,75,000 pertains to earlier assessment years. The unabsorbed depreciation shall form part of the current year depreciation and can be set off against any other head of income. Accordingly, the amount of ₹ 2,75,000 is adjustable/ allowed to be set off against 'Income from other sources'.

2. Since deposits are made by investing amount received on hundi and other loans, the interest on hundi and other loans would be eligible for deduction from the income arising on such deposits.

   However, interest paid to non-resident is not eligible for deduction as the tax has not been deducted at source.

4. Mr. Pervez, an employee of a Pharma company, has received a car as a gift from a distributor of the company. Since there is no employer-employee relationship in this case between the distributor and Mr. Pervez, the value of gift is **not** a perquisite chargeable to tax under the head “Salaries”.

   Section 56(2)(x) brings within its scope the value of any property received by any person. For this purpose, “property” means immovable property being land or building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or bullion.

   Therefore, for the purpose of attracting the provisions of section 56(2)(x) for chargeability under the head “Income from Other Sources”, an individual should be in receipt of property as defined therein. Since, car is not included in the definition of “property”, the provisions of section 56(2)(x) would not be attracted in the hands of Mr. Pervez.

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CHAPTER 6

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **examine** the cases where clubbing provisions would be attracted;
- **examine** the circumstances when income of minor child, has to be included in the hands of parent and exemption available in respect of such included income;
- **examine** the circumstances when the income of HUF has to be included in the hands of its member(s);
- **apply** the clubbing provisions to determine the amount of income which need to be included in the hands of another person;
- **examine** the cases of cross transfers to determine the person in whose hands the income arising from assets transferred has to be included and the portion of income that has to be included;
- **compute** the income under different heads of income after applying the clubbing provisions.

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CHAPTER OVERVIEW

* In case of transfer of house property to spouse without adequate consideration, transferor will be deemed as owner of such property as per section 27(i). In such a case, section 64(1)(iv) will not apply.

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6.1 CLUBBING OF INCOME – AN INTRODUCTION

Under the Income-tax Act, 1961, an assessee is generally taxed in respect of his own income. However, there are certain cases where an assessee has to pay tax in respect of income of another person. The provisions for the same are contained in sections 60 to 65 of the Act. These provisions have been enacted to counteract the tendency on the part of the tax-payers to dispose off their property or transfer their income in such a way that their tax liability can be avoided or reduced.

These provisions can be categorized as follows:

- Income of other persons included in an assessee's total income [Sections 60-63]
- Income of other persons included in an Individual's total income [Section 64]

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

6.2 INCOME OF OTHER PERSONS INCLUDIBLE IN ASSESSEE'S TOTAL INCOME

(1) Transfer of income without transfer of asset [Section 60]

(i) If any person transfers the income from any asset without transferring the asset itself, such income is to be included in the total income of the transferor.

(ii) It is immaterial whether the transfer is revocable or irrevocable and whether it was made before the commencement of this Act or after its commencement.

Example: *Mr. A confers the right to receive rent in respect of his house property on his wife, Mrs. A, without transferring the house itself to her. In this case, the rent received by Mrs. A will be clubbed with the income of Mr. A.*

(2) Income arising from revocable transfer of assets [Section 61]

All income arising to any person by virtue of a revocable transfer of assets is to be included in the total income of the transferor.

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Meaning of revocable transfer [Section 63]

Transfer is deemed to be revocable if—

(i) it contains any provision for the retransfer, directly or indirectly, of the whole or any part of the income or assets to the transferor, or

(ii) it gives, in any way to the transferor, a right to reassume power, directly or indirectly, over the whole or any part of the income or the assets.

This clubbing provision will operate even if only part of income of the transferred asset had been applied for the benefit of the transferor. Once the transfer is revocable, the entire income from the transferred asset is includible in the total income of the transferor.

Exception where clubbing provisions are not attracted even in case of revocable transfer [Section 62]

Section 61 will not apply to any income arising to any person if there is -

(i) a transfer by way of trust which is not revocable during the life time of the beneficiary; and

(ii) any other transfer, which is not revocable during the life time of the transferee.

In the above cases, the income from the transferred asset is not includible in the total income of the transferor, provided the transferor derives no direct or indirect benefit from such income.

If the transferor receives direct or indirect benefit from such income, such income is to be included in his total income even though the transfer may not be revocable during the life time of the beneficiary or transferee, as the case may be.

As and when the power to revoke the transfer arises, the income arising by virtue of such transfer will be included in the total income of the transferor.

6.3 INCOME OF OTHER PERSONS INCLUDIBLE IN AN INDIVIDUAL'S TOTAL INCOME

(1) Clubbing of income arising to spouse

(I) **Income by way of remuneration from a concern in which the individual has substantial interest [Section 64(1)(ii)]**

(i) **Remuneration in cash or kind to spouse from a concern in which the individual has a substantial interest is to be clubbed:** In computing the total income of any individual, all

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such income which arises, directly or indirectly, to the spouse of such individual by way of salary, commission, fees or any other form of remuneration, whether in cash or in kind, from a concern in which such individual has a substantial interest shall be included.

The term **'relative'** in relation to an individual means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual [Section 2(41)].

(ii) **Clubbing provisions will not apply where remuneration is received on account of technical or professional qualifications:** Clubbing provisions, however, does not apply where the spouse of the said individual possesses technical or professional qualifications and the income to the spouse is solely attributable to the application of his/her technical or professional knowledge or experiences. In such an event, the income arising to such spouse is to be assessed in his/her hands.

(iii) **Both husband and wife have substantial interest in a concern:** Where both husband and wife have substantial interest in a concern and both are in receipt of income by way of salary etc. from the said concern, such income will be includible in the hands of that spouse, whose total income, excluding such income is higher.

Where any such income is once included in the total income of either spouse, income arising in the succeeding year shall not be included in the total income of the other spouse unless the Assessing Officer is satisfied, after giving that spouse an opportunity of being heard, that it is necessary to do so.

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ILLUSTRATION 1

Mr. Arun holds shares carrying 55% voting power in MNO (P) Ltd. Mrs. Anamika, wife of Mr. Arun is working as a computer software programmer in MNO (P) Ltd. at a salary of ₹ 35,000 p.m. She is, however, not qualified for the job. The other income of Mr. Arun & Mrs. Anamika are ₹ 7,30,000 & ₹ 4,20,000, respectively. Compute the gross total income of Mr. Arun and Mrs. Anamika for the A.Y.2026-27 if they are paying tax under default tax regime.

SOLUTION

Mr. Arun holds shares carrying 55% voting power in MNO (P) Ltd i.e., a substantial interest in the company. His wife is working in the same company without any professional qualifications for the same. Thus, by virtue of the clubbing provisions of the Act, the salary received by Mrs. Anamika from MNO (P) Ltd. will be clubbed in the hands of Mr. Arun.

Computation of Gross total income of Mr. Arun

Particulars	₹	₹
Salary received by Mrs. Anamika (₹ 35,000 × 12)	4,20,000	
Less: Standard deduction under section 16(ia)	75,000	3,45,000
Other Income		7,30,000
Gross total income		**10,75,000**

The gross total income of Mrs. Anamika is ₹ 4,20,000.

ILLUSTRATION 2

Will your answer be different if Mrs. Anamika was qualified for the job?

SOLUTION

If Mrs. Anamika possesses professional qualifications for the job, then the clubbing provisions shall not be applicable.

Gross total income of Mr. Arun = ₹ 7,30,000 (other income)

Gross total income of Mrs. Anamika = Salary received by Mrs. Anamika [₹ 35,000×12] *less* ₹ 75,000, being the standard deduction under section 16(ia) *plus* other income [₹ 4,20,000] = ₹ 7,65,000

ILLUSTRATION 3

Mr. Binu holds shares carrying 33% voting power in Yamma (P) Ltd. Mrs. Babita is working as an accountant in Yamma (P) Ltd. getting income under the head salary (computed) of ₹ 3,60,000 without any qualification in accountancy. Mr. Binu also receives ₹ 32,000 as interest on securities.

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Mrs. Babita owns a house property which she has let out. Rent received from tenants is ₹ 6,500 p.m. Compute the gross total income of Mr. Binu and Mrs. Babita for the A.Y. 2026-27.

SOLUTION

Since Mrs. Babita is not professionally qualified for the job, the clubbing provisions shall be applicable.

Computation of Gross total income of Mr. Binu

Particulars	₹
Income from salary of Mrs. Babita (Computed)	3,60,000
Income from other sources	
- Interest on securities	32,000
	3,92,000

Computation of gross total income of Mrs. Babita

Particulars	₹	₹
Income from Salary		Nil
[clubbed in the hands of Mr. Binu]		
Income from house property		
Gross Annual Value [₹ 6,500 × 12]	78,000	
Less: Municipal taxes paid	-	
Net Annual Value (NAV)	**78,000**	
Less: 30% of NAV [deduction under section 24(b)]	23,400	54,600
Gross total income		**54,600**

(II) **<u>Income arising to the spouse from an asset transferred without adequate consideration [Section 64(1)(iv)]</u>**

(i) **Transfer of asset (other than house property):** Where there is a transfer of an asset (other than house property), directly or indirectly, from one spouse to the other, otherwise than for adequate consideration or in connection with an agreement to live apart, any income arising to the transferee-spouse from the transferred asset, either directly or indirectly, shall be included in the total income of the transferor-spouse.

(ii) **Transfer of house property:** In the case of transfer of house property, the provisions are contained in section 27. If an individual transfers a house property to his spouse, without adequate consideration or otherwise than in connection with an agreement to live apart, the

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transferor shall be deemed to be the owner of the house property and its annual value will be taxed in his hands.

(iii) **Income from accretion of the transferred asset:** It may be noted that any income from the accretion of the transferred asset is not to be clubbed with the income of the transferor i.e., the income arising on transferred assets alone has to be clubbed. However, income earned by investing such income (arising from transferred asset) cannot be clubbed.

(iv) **Meaning of adequate consideration:** It is also to be noted that natural love and affection do not constitute adequate consideration. Therefore, where an asset is transferred without adequate consideration, the income from such asset will be clubbed in the hands of the transferor.

(v) **Transferred asset invested in business:** Where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the business, proportionate income arising to the transferee from such investment is to be included in the total income of the transferor. If the investment is in the nature of contribution of capital, proportionate interest receivable by the transferee from the firm will be clubbed with the income of the transferor.

Such proportion has to be computed by taking into account the value of the aforesaid investment **as on the first day of the previous year** to the total investment in the business or by way of capital contribution in a firm as a partner, as the case may be, by the transferee as on that day.

ILLUSTRATION 4

Mr. Rahul started a proprietary business on 01.04.2024 with a capital of ₹ 6,00,000. He incurred a loss of ₹ 3,00,000 during the year 2024-25. To overcome the financial position, his wife Mrs. Radha, a software engineer, gave a gift of ₹ 7,00,000 on 01.04.2025, which was immediately invested in the business by Mr. Rahul. He earned a profit of ₹ 5,00,000 during the year 2025-26. Compute the amount to be clubbed in the hands of Mrs. Radha for the Assessment Year 2026-27. If Mrs. Radha gave the said amount as loan, what would be the amount to be clubbed?

SOLUTION

Section 64(1)(iv) of the Income-tax Act, 1961 provides for the clubbing of income in the hands of the individual, if the income earned is from the assets (other than house property) transferred directly or indirectly to the spouse of the individual, otherwise than for adequate consideration or in connection with an agreement to live apart.

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In this case, Mr. Rahul received a gift of ₹ 7,00,000 on 1.4.2025 from his wife Mrs. Radha, which he invested in his business immediately. The income to be clubbed in the hands of Mrs. Radha for the A.Y. 2026-27 is computed as under:

Particulars	Mr. Rahul's capital contribution (₹)	Capital contribution out of gift from Mrs. Radha (₹)	Total (₹)
Capital as on 1.4.2025	3,00,000 (6,00,000 – 3,00,000)	7,00,000	10,00,000
Profit for P.Y.2025-26 to be apportioned on the basis of capital employed on the first day of the previous year i.e. as on 1.4.2025 (3:7)	1,50,000 $\left(5,00,000\times\frac{3}{10}\right)$	3,50,000 $\left(5,00,000\times\frac{7}{10}\right)$	5,00,000

Therefore, the income to be clubbed in the hands of Mrs. Radha for the A.Y.2026-27 is ₹ 3,50,000.

In case, Mrs. Radha gave the said amount of ₹ 7,00,000 as a *bona fide* loan, then, clubbing provisions would not be attracted.

Note: *The provisions of section 56(2)(x) would not be attracted in the hands of Mr. Rahul, since he has received a sum of money exceeding ₹ 50,000 without consideration from a relative i.e., his wife.*

(III) <u>Transfer of assets for the benefit of spouse [Section 64(1)(vii)]</u>

All income arising directly or indirectly to any person or association of persons, from the assets transferred, directly or indirectly, to such person or association of persons by an individual without adequate consideration is includible in the income of the individual to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's spouse.

(2) Clubbing of income arising to son's wife

(I) <u>Income arising to son's wife from the assets transferred without adequate consideration by the father-in-law or mother-in-law [Section 64(1)(vi)]</u>

(i) Asset transferred without adequate consideration: Where an asset is transferred, directly or indirectly, by an individual to his or her son's wife without adequate consideration, the income from such asset is to be included in the total income of the transferor.

(ii) Asset transferred invested in the business: For this purpose, where the assets transferred directly or indirectly by an individual to his or her son's wife are invested by the transferee in the business, proportionate income arising from such investment is to be included in the total

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income of the transferor. If the investment is in the nature of contribution of capital, the proportionate interest receivable from firm will be clubbed with the income of the transferor.

Such proportion has to be computed by taking into account the value of the aforesaid investment **as on the first day of the previous year** to the total investment in the business or by way of capital contribution in a firm as a partner, as the case may be, by the transferee as on that day.

(II) Transfer of assets for the benefit of son's wife [Section 64(1)(viii)]

All income arising directly or indirectly, to any person or association of persons from the assets transferred, directly or indirectly, without adequate consideration, to such person or association of persons by an individual will be included in the total income of the individual to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's son's wife.

Note: *Where any asset is transferred by a person to any other person without consideration or for inadequate consideration, the provisions of 56(2)(x) would get attracted in the hands of transferee, if conditions specified thereunder are satisfied.*

ILLUSTRATION 5

Mrs. Komal transferred her immovable property to TPS Co. Ltd. subject to a condition that out of the rental income, a sum of ₹ 42,000 per annum shall be utilized for the benefit of her son's wife.

Mrs. Komal claims that the amount of ₹ 42,000 (utilized by her son's wife) should not be included in her total income as she no longer owned the property.

Examine with reasons whether the contention of Mrs. Komal is valid in law.

SOLUTION

The clubbing provisions under section 64(1)(viii) are attracted in case of transfer of any asset, directly or indirectly, otherwise than for adequate consideration, to any person to the extent to which the income from such asset is for the immediate or deferred benefit of son's wife. Such income shall be included in computing the total income of the transferor-individual.

Therefore, income of ₹ 42,000 meant for the benefit of daughter-in-law is chargeable to tax in the hands of transferor i.e., Mrs. Komal in this case.

Hence, the contention of Mrs. Komal is not valid in law.

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Note - *In order to attract the clubbing provisions under section 64(1)(viii), the transfer should be otherwise than for adequate consideration. In this case, it is presumed that the transfer is otherwise than for adequate consideration and therefore, the clubbing provisions are attracted. Moreover, the provisions of section 56(2)(x) will also get attracted in the hands of TPS Co Ltd., if the conditions specified thereunder are satisfied.*

If it is presumed that the transfer was for adequate consideration, the provisions of section 64(1)(viii) and section 56(2)(x) would not be attracted.

(3) Clubbing of minor's income

(i) All income of a minor is to be included in the income of his parent.

(ii) However, the income derived by the minor from manual work or from any activity involving his skill, talent or specialized knowledge or experience will not be included in the income of his parent.

(iii) The income of the minor will be included in the income of that parent, whose total income is greater.

(iv) Once clubbing of minor's income is done with that of one parent, it will continue to be clubbed with that parent only, in subsequent years. The Assessing Officer, may, however, club the minor's income with that of the other parent, if, after giving the other parent an opportunity to be heard, he is satisfied that it is necessary to do so.

(v) Where the marriage of the parents does not subsist, the income of the minor will be includible in the income of that parent who maintains the minor child in the relevant previous year.

(vi) However, the income of a minor child suffering from any disability of the nature specified in section 80U shall not be included in the hands of the parent but shall be assessed in the hands of the child.

(vii) It may be noted that the clubbing provisions are attracted even in respect of income of minor married daughter.

Exemption in respect of clubbed income of minor [Section 10(32)]

In case the income of an individual (i.e., the parent) includes the income of his/her minor child in terms of section 64(1A), such parent shall be entitled to exemption of ₹ 1,500 in respect of each minor child. However, if income of any minor so includible is less than ₹ 1,500, then the entire income shall be exempt.

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Exemption under section 10(32) would be available to the parent only if he/she exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). The same would not be available to him/her under the default tax regime where he/she computes his/her total income as per section 115BAC and pays tax at the concessional rates provided thereunder.

(viii) In case the asset transferred to a minor child (not being a minor married daughter) without consideration or for inadequate consideration is a house property, then, by virtue of section 27(i), the transferor-parent will be the deemed owner of the house property. Therefore, the income from house property will be taxable in the hands of the transferor-parent, being the deemed owner and not in the hands of the minor child. Consequently, clubbing provisions under section 64(1A) would not be attracted in respect of such income, due to which the benefit of exemption u/s 10(32) (discussed above) cannot be availed against such income.

However, if the house property is transferred by a parent to his or her minor married daughter, without consideration or for inadequate consideration, then, section 27(i) is **not** attracted. In such a case, the income from house property will be included u/s 64(1A) in the hands of that parent, whose total income before including minor child's income is higher; and benefit of exemption u/s 10(32) can be availed by that parent in respect of the income so included if he/she exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).

Child in relation to an individual includes a step-child and an adopted child of that individual. [Section 2(15B)]

ILLUSTRATION 6

Mr. Arvind has three minor children – two twin daughters, aged 12 years, and one son, aged 16 years. Income of the twin daughters is ₹ 2,500 p.a. each and that of the son is ₹ 1,200 p.a. Mrs. Avani (wife of Mr. Arvind) has transferred her flat to her minor son on 1.4.2025 out of natural love and affection. The flat was let out on the same date and the rental income from the flat is ₹ 10,000 p.m. Compute the income, in respect of minor children, to be included in the hands of Mr. Arvind and Mrs. Avani under section 64(1A) assuming that Mr. Arvind's total income is higher than Mrs. Avani's total income, before including income of minor children and both Mr. Arvind and Mrs. Avani exercise the option of shifting out of the default tax regime provided under section 115BAC(1A).

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SOLUTION

Taxable income, in respect of minor children, in the hands of Mr. Arvind is

Particulars	₹	₹
Twin minor daughters [₹ 2,500 × 2]	5,000	
Less: Exempt under section 10(32) [₹ 1,500 × 2]	3,000	2,000
Minor son	1,200	
Less: Exemption under section 10(32) would be lower of ₹ 1200, being the income of minor son or ceiling limit of ₹ 1500	1,200	Nil
Income to be clubbed in the hands of Mr. Arvind		**2,000**

Note *– As per section 27(i), Mrs. Avani is the deemed owner of house property transferred to her minor son. Natural love and affection do not constitute adequate consideration for this purpose. Accordingly, the income from house property of ₹ 84,000 [i.e., ₹ 1,20,000 (-) ₹ 36,000, being 30% of ₹ 1,20,000) would be taxable directly in her hands as the deemed owner of the said property. Consequently, clubbing provisions under section 64(1A) would not be attracted in respect of income from house property, owing to which exemption u/s 10(32) cannot be availed by her.*

6.4 CROSS TRANSFERS

In the case of cross transfers also (e.g., A making gift of ₹ 50,000 to the wife of his brother B for the purchase of a house by her and a simultaneous gift by B to A's minor son of shares in a foreign company worth ₹ 50,000 owned by him), the income from the assets transferred would be assessed in the hands of the deemed transferor if the transfers are so intimately connected that they form part of a single transaction, and each transfer constitutes consideration for the other by being mutual or otherwise. Thus, in the instant case, the transfers have been made by A and B to persons who are not their spouse or minor child so as to circumvent the provisions of this section, showing that such transfers constituted consideration for each other.

The Supreme Court, in case of *CIT* v. *Keshavji Morarji [1967] 66 ITR 142,* observed that if two transactions are inter-connected and are parts of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. Accordingly, the income arising to Mrs. B from the house property should be included in the total income of B and the dividend from shares transferred to A's minor son would be taxable in the hands of A, assuming that Mr. A's income is higher than that of Mrs. A. This is because A and B are the indirect transferors to their minor child and spouse, respectively, of income-yielding assets, so as to reduce their burden of taxation.

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ILLUSTRATION 7

Mr. Madan gifted a sum of ₹ 6.5 lakhs to his brother's wife on 14-6-2025. On 12-7-2025, his brother gifted a sum of ₹ 5.2 lakhs to Mr. Madan's wife. The gifted amounts were invested as fixed deposits in banks by Mrs. Madan and wife of Mr. Madan's brother on 01-8-2025 at 9% interest. Examine the consequences of the above under the provisions of the Income-tax Act, 1961 in the hands of Mr. Madan and his brother.

SOLUTION

In the given case, Mr. Madan gifted a sum of ₹ 6.5 lakhs to his brother's wife on 14.06.2025 and simultaneously, his brother gifted a sum of ₹ 5.2 lakhs to Mr. Madan's wife on 12.07.2025. The gifted amounts were invested as fixed deposits in banks by Mrs. Madan and his brother's wife. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

If two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted. It was so held by the Apex Court in *CIT vs. Keshavji Morarji (1967) 66 ITR 142.*

Accordingly, the interest income arising to Mrs. Madan in the form of interest on fixed deposits would be included in the total income of Mr. Madan and interest income arising in the hands of his brother's wife would be taxable in the hands of Mr. Madan's brother as per section 64(1), to the extent of amount of cross transfers i.e., ₹ 5.2 lakhs.

This is because both Mr. Madan and his brother are the indirect transferors of the income to their respective spouses with an intention to reduce their burden of taxation.

However, the interest income earned by his spouse on fixed deposit of ₹ 5.2 lakhs alone would be included in the hands of Mr. Madan's brother and not the interest income on the entire fixed deposit of ₹ 6.5 lakhs, since the cross transfer is only to the extent of ₹ 5.2 lakhs.

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6.5 CONVERSION OF SELF-ACQUIRED PROPERTY INTO THE PROPERTY OF A HINDU UNDIVIDED FAMILY [SECTION 64(2)]

Section 64(2) deals with the case of conversion of self-acquired property into property of a Hindu undivided family.

(1) Where an individual, who is a member of the HUF, converts at any time after 31-12-1969, his individual property into property of the HUF of which he is a member or throws such property into the common stock of the family or otherwise transfers such individual property, directly or indirectly, to the family otherwise than for adequate consideration, the income from such property shall continue to be included in the total income of the individual.

(2) Where the converted property has been partitioned, either by way of total or partial partition, the income derived from such converted property as is received by the spouse on partition will be deemed to arise to the spouse from assets transferred indirectly by the individual to the spouse and consequently, such income shall also be included in the total income of the individual who effected the conversion of such property.

(3) Where income from the converted property is included in the total income of an individual under section 64(2), it will be excluded from the total income of the family or, as the case may be, of the spouse of the individual.

6.6 INCOME INCLUDES LOSS

It is significant to note that as per the *Explanation 2* to section 64, 'income' would include 'loss'. Accordingly, where the specified income to be included in the total income of the individual is a loss, such loss will be taken into account while computing the total income of the individual. It is significant to note that this *Explanation* applies to clubbing provisions under both sections 64(1) and 64(2).

6.7 DISTINCTION BETWEEN SECTION 61 AND SECTION 64

It may be noted that the main distinction between the two sections is that section 61 applies only to a revocable transfer made by any person while section 64 applies to revocable as well as irrevocable transfers made only by individuals.

Note - *Clubbing provisions are attracted in respect of income arising from the assets transferred, however, income arising on accretion of income arising from transferred asset, would not be clubbed except in case of minor child.*

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6.8 LIABILITY OF PERSON IN RESPECT OF INCOME INCLUDED IN THE INCOME OF ANOTHER PERSON [SECTION 65]

Sections 61 to 64 provide for clubbing of income of one person in the hands of the other in circumstances specified therein. However, service of notice of demand (in respect of tax on such income) may be made upon the person to whom such asset is transferred (i.e., the transferee). In such a case, the transferee is liable to pay that portion of tax levied on the transferor which is attributable to the income so clubbed.

Similar provision will be applicable in case of deemed ownership of house property under section 27 i.e., transfer of house property otherwise than for adequate consideration to spouse, not being in connection with agreement to live apart or to minor child not being a minor married daughter.

ILLUSTRATION 8

Mr. Ravi has gifted his only house property to his wife, Mrs. Ravi, and his married daughter, Mrs. Divya. The Assessing Officer has served a notice of demand on Mr. Ravi for payment of tax for the income derived from the said house property. Examine the validity of the Assessing Officer's action.

SOLUTION

As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, or to a minor child not being a married daughter shall be deemed to be the owner of the house property so transferred.

Mr. Ravi, in this case, would be the deemed owner only in respect of the share of house property transferred to his wife Mrs. Ravi without consideration and not for the share of the house property transferred to his married daughter Mrs. Divya.

Since Mr. Ravi is the deemed owner of the share of house property transferred to his wife without consideration, the income derived from the house property, to the extent attributable to the share of property transferred to his wife without consideration, would be taxable in his hands under the head "Income from house property".

However, as per section 65, the notice of demand can be served on Mrs. Ravi for payment of that portion of tax levied on Mr. Ravi attributable to the income derived [by virtue of section 27(i)], from the share of house property transferred to Mrs. Ravi, and standing in her name.

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However, the income derived from house property, attributable to the share of property transferred to his married daughter without consideration, would be taxable in the hands of his daughter. Such income would not be taxable in the hands of Mr. Ravi. Mr. Ravi will not be responsible for the payment of tax attributable to aforesaid share of income of daughter from house property.

Thus, the action of the Assessing Officer in serving notice of demand on Mr. Ravi for payment of tax for the entire income derived from the said house property is not valid.

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TEST YOUR KNOWLEDGE

Questions

1. *Mrs. E, wife of Mr. F, is a partner in a firm. Her capital contribution to the firm as on 01-04-2025 was ₹ 5 lakhs, out of which ₹ 3 lakhs was contributed out of her own sources and ₹ 2 lakhs was contributed out of gift from her husband.*

   As further capital was needed by the firm, she further invested ₹ 2 lakhs on 01.05.2025 out of the funds gifted by her husband. The firm paid interest on capital of ₹ 80,000 and share of profit of ₹ 60,000 for the financial year 2025-26.

   Advise Mr. F as to the applicability of the provisions of section 64(1)(iv) and the manner thereof in respect of the above referred transactions.

2. *Mr. A has gifted a house property valued at ₹ 50 lakhs to his wife, Mrs. B, who in turn has gifted the same to Mrs. C, their daughter-in-law. The house was let out at ₹ 25,000 per month throughout the year. Compute the total income of Mr. A and Mrs. C.*

   Will your answer be different if the said property was gifted to his son, husband of Mrs. C?

3. *Mr. Korani transferred 2,000 debentures of ₹ 100 each of Wild Fox Ltd. to his wife Mrs. Rekha Korani on 03.10.2024 without consideration. The company paid interest of ₹ 30,000 in September, 2025 which was deposited by Mrs. Korani with Kartar Finance Co. in October, 2025. Kartar Finance Co. paid interest of ₹ 3,000 upto March, 2026. How would both the interest income be charged to tax in A.Y. 2026-27?*

4. *Mr. Rose, out of his own funds, had taken an FDR for ₹ 10,00,000 bearing interest @10% p.a. payable half-yearly in the name of his wife, Lilly. The interest earned during the financial year 2025-26 of ₹ 1,00,000 was invested by Mrs. Lilly in the business of packed spices which resulted in a net profit of ₹ 55,000 for the year ended 31.03.2026. How shall the interest on FDR and income from business be taxed for the Assessment Year 2026-27?*

5. *Naresh is a fashion designer having lucrative business. His wife is a model. Naresh pays her monthly salary of ₹ 10,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of Naresh had applied the provisions of section 64(1) and had clubbed the income (salary) of his wife in Naresh hands.*

   Discuss the correctness of the action of the Assessing Officer.

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Answers

1. As per section 64(1)(iv), in computing the total income of any individual, there shall be included all such income as arises, directly or indirectly, subject to the provisions of section 27(i), to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

In this instant case, Mr. F has gifted money to his wife, Mrs. E. Mrs. E, in turn, invested such gifted money in the capital of a partnership firm, of which she is a partner. Mrs. E has also contributed a sum of ₹ 3 lakhs out of her own resources to the capital of the firm.

As per *Explanation 3* to section 64(1), for the purpose of clubbing under section 64(1)(iv), where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the nature of contribution of capital as a partner in a firm, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the **first day of the previous year** to the total investment by way of capital contribution as a partner in the firm as on that day.

In view of the above provision, interest received by Mrs. E from the firm shall be included in total income of Mr. F to the extent of ₹ 32,000 i.e., ₹ 80,000 x ₹ 2,00,000/ ₹ 5,00,000.

Share of profit amounting to ₹ 60,000 is exempt from income-tax under the provisions of section 10(2A). The provisions of section 64 will not apply, if the income from the transferred asset itself is exempt from tax.

Note: *It is assumed that rate of interest on capital contributed by Mrs. E does not exceed 12% p.a.*

2. As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, shall be deemed to be the owner of the house property so transferred.

Therefore, in this case, Mr. A would be the deemed owner of the house property transferred to his wife Mrs. B without consideration.

As per section 64(1)(vi), income arising to the son's wife from assets transferred, directly or indirectly, to her by an individual otherwise than for adequate consideration would be included in the total income of such individual.

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Income from let-out property is ₹ 2,10,000 [i.e., ₹ 3,00,000, being the actual rent calculated at ₹ 25,000 per month *less* ₹ 90,000, being deduction under section 24 @30% of ₹ 3,00,000]

In this case, income of ₹ 2,10,000 from let-out property arising to Mrs. C, being Mr. A's son's wife, would be included in the income of Mr. A, applying the provisions of section 27(i) and section 64(1)(vi). Such income would, therefore, not be taxable in the hands of Mrs. C.

In case the property was gifted to Mr. A's son, the clubbing provisions under section 64 would not apply, since the son is not a minor child. Therefore, the income of ₹ 2,10,000 from letting out of property gifted to the son would be taxable in the hands of the son.

It may be noted that the provisions of section 56(2)(x) would not be attracted in the hands of the recipient of house property, since the receipt of property in each case was from a "relative" of such individual. Therefore, the stamp duty value of house property would not be chargeable to tax in the hands of the recipient of immovable property, even though the house property was received by her or him without consideration.

Note - *The first part of the question can also be answered by applying the provisions of section 64(1)(vi) directly to include the income of ₹ 2,10,000 arising to Mrs. C in the hands of Mr. A. [without first applying the provisions of section 27(i) to deem Mr. A as the owner of the house property transferred to his wife Mrs. B without consideration], since section 64(1)(vi) speaks of clubbing of income arising to son's wife from indirect transfer of assets to her by her husband's parent, without consideration. Gift of house property by Mr. A to Mrs. C, via Mrs. B, can be viewed as an indirect transfer by Mr. A to Mrs. C.*

3. As per section 64(1)(iv), income arising from assets transferred without adequate consideration by an individual to his spouse is liable to be clubbed in the hands of the individual. It may be noted that income on the asset transferred has to be clubbed but if there is accretion to the asset, any further income derived on such accretion should not be clubbed.

Therefore, applying the provisions of section 64(1)(iv), ₹ 30,000, being the interest on debentures received by Mrs. Rekha Korani in September, 2025 will be clubbed with the income of Mr. Korani, since he had transferred the debentures of the company without consideration to her in October, 2024.

However, the interest of ₹ 3,000 upto March, 2026 earned by Mrs. Rekha Korani on the interest on the debentures deposited by her with Kartar Finance Company shall be taxable in her individual capacity and will not be clubbed with the income of Mr. Korani.

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4. Section 64(1)(iv) specifies that the income derived by the spouse of an assessee from the assets transferred directly or indirectly without adequate consideration or intention to live apart shall be clubbed with the income of the transferor. Therefore, the interest income of ₹ 1 lakh on the FDR of ₹ 10 lakhs for the F.Y.2025-26 shall be clubbed with the income of Mr. Rose.

When Mrs. Lilly invested the interest income in a business and earned profits therefrom, such profits shall not be clubbed with the income of her husband but shall be taxable in her individual capacity. This is so because the income from the accretion of the transferred assets is not to be clubbed with the income of the transferor *[CIT v. M. S. S. Rajan (2001) 252 ITR 126 (Mad)]*.

5. This question is based on the principles laid down by Madras High Court in the case of *CIT v. Smt. R. Bharati (1999) 240 ITR 697* where the interpretation of the terms "professional qualifications" and "knowledge" came up for consideration as per proviso to section 64(1).

These words do not necessarily connote a qualification conferred by a recognized university after examining the candidate who has undergone a course of study in a technical subject or course of study preparing him for a profession of law, accountancy etc. Accordingly, the term "qualification" must be given a wide meaning as referring to the qualities which are required to be possessed by a person performing the work that he does, so long as that work is capable of being regarded as technical or professional.

The word "professional" is a term capable of very broad meaning and would encompass a variety of occupations. A large number of occupations are being practiced which form a source of livelihood and are capable of being regarded, as professions as long as they require certain degree of skill. A person having skill, experience and competence in a line of work can be regarded as professionally qualified for the purpose of section 64(1)(ii).

Applying the rationale of the Madras High Court ruling, a model, having skill, competence and experience in her line can be considered as a professional. Hence, the action of the Assessing Officer is not correct.

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CHAPTER 7

AGGREGATION OF INCOME, SET OFF OR CARRY FORWARD OF LOSSES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the permissible inter-source and inter-head adjustments for set-off of losses and the restrictions in inter-source and inter-head set-off of losses;
- **determine** the unabsorbed losses which can be carried forward to the subsequent assessment year for set-off against income of that year and the maximum period of carry forward of such losses;
- **appreciate** the provisions regarding carry forward and set-off of losses in case of closely held companies and eligible start-ups as also in case of change in constitution of firms;
- **appreciate** the conditions which are required to be satisfied by the amalgamating company and the amalgamated company for carry forward and set-off of loss of the amalgamating company by the amalgamated company;
- **appreciate** the special provisions for carry forward and set-off of losses of a banking company against the profits of a banking institution under a scheme of amalgamation;
- **compute** the gross total income of an assessee after applying the provisions relating to set-off and carry forward and set-off of losses.

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CHAPTER OVERVIEW

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Notes - Following brought forward losses/ depreciation is not allowed to be set off while computing total income under the special concessional tax regimes under section 115BAA/115BAB/115BAC/115BAD/115BAE -

1. Brought forward business loss of specified business u/s 35AD
2. Brought forward business loss on account of deduction u/s 35(1)(ii)/(iia)/(iii) or u/s 35(2AA) [or u/s 35(2AB), in case of computation of total income under sections 115BAA/115BAB, applicable to companies].
3. Unabsorbed depreciation attributable to additional depreciation u/s 32(1)(iia).

This is because deductions u/s 35AD, u/s 35(i)(ii)/(iia)/(iii), u/s 35(2AA), u/s 35(2AB) and additional depreciation u/s 32(1)(iia) are not allowable under the special concessional tax regimes.

In addition, in case of persons covered under section 115BAC, loss from house property cannot be set off against income under other head and the same cannot be carried forward. Also, brought forward loss from self-occupied house property is not allowed to be set-off while computing total income for A.Y.2026-27 under the default tax regime thereunder.

7.1 AGGREGATION OF INCOME

In certain cases, some amounts are deemed as income in the hands of the assessee though they are actually not in the nature of income. These cases are contained in sections 68, 69, 69A, 69B, 69C and 69D. These are discussed in detail in Chapter 1. The Assessing Officer may require the assessee to furnish explanation in such cases. If the assessee does not offer any explanation or the explanation offered by the assessee is not satisfactory, the amounts referred to in these sections would be deemed to be the income of the assessee. Such amounts have to be aggregated with the assessee's income.

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7.2 CONCEPT OF SET OFF AND CARRY FORWARD OF LOSSES

Specific provisions have been made in the Income-tax Act, 1961 for the set-off and carry forward of losses. In simple words, "Set-off" means adjustment of losses against the profits from another source/head of income in the same assessment year. If losses cannot be set-off in the same year due to inadequacy of eligible profits, then such losses are carried forward to the next assessment year for adjustment against the eligible profits of that year. The maximum period for which different losses can be carried forward for set-off has been provided in the Act.

7.3 INTER SOURCE ADJUSTMENTS [SECTION 70]

(1) Inter-source set-off of losses

Under this section, the losses incurred by the assessee in respect of one source shall be set-off against income from any other source under the same head of income, since the income under each head is to be computed by grouping together the net result of the activities of all the sources covered by that head. In simpler terms, loss from one source of income can be adjusted against income from another source, both the sources being under the same head.

Example: *Loss from one house property can be set off against the income from another house property.*

Example: *Loss from one business, say textiles, can be set off against income from any other business, say printing, in the same year as both these sources of income fall under one head of income. Therefore, the loss in one business may be set off against the profits from another business in the same year.*

(2) Impermissible inter-source set-off

Inter-source set-off, however, is not permissible in the following cases -

(i) Long-term capital loss [Section 70(3)]

Short-term capital loss is allowed to be set off against both short-term capital gain and long-term capital gain. However, long-term capital loss can be set off only against long-term capital gain and not against short-term capital gain.

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(ii) Speculation loss [Section 73(1)]

A loss in speculation business can be set off only against the profits of any other speculation business and not against any other business or professional income.

However, losses from other business can be adjusted against profits from speculation business.

(iii) Loss from the activity of owning and maintaining race horses [Section 74A(3)]

Such loss can be set off only against income from the activity of owning and maintaining race horses.

(iv) Losses from specified business [Section 73A(1)]

A loss in any specified business referred in section 35AD can be set off only against any other specified business, whether eligible for deduction under 35AD or not.

However, losses from other business can be set off against profits from specified business

It must be noted that **loss from an exempt source** cannot be set off against profits from a taxable source of income. For example, share of loss from a partnership firm cannot be set off against business income, since share of income of the firm is exempt under section 10(2A).

7.4 INTER HEAD ADJUSTMENTS [SECTION 71]

Loss under one head of income can be adjusted or set off against income under another head. However, the following points should be considered:

(1) Loss under any head other than capital gains: Where the net result of the computation under any head of income (other than 'Capital Gains') is a loss, the assessee can set off such loss against his income assessable for that assessment year under any other head, including 'Capital Gains'.

(2) Loss under the head "Profits and gains from business or profession: Where the net result of the computation under the head "Profits and gains of business or profession" is a loss, such loss cannot be set off against income under the head "Salaries". It shall be allowed to set off from income under any other head except "Salaries".

(3) Loss under the head "Capital Gains": Where the net result of computation under the head 'Capital Gains' is a loss, whether short term or long term, such capital loss cannot be set off against income under any other head.

(4) Loss under the head "Income from house property": Where the net result of the computation under the head "Income from house property" is a loss and the assessee has

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income assessable under any other head of income, the amount of such loss exceeding ₹ 2 lakhs would not be allowable to be set off against income under the other head. In other words, the maximum loss from house property which can be set off against income from any other head is ₹ 2 lakhs.

Note - *The loss under the head "Income from house property" would not be allowable to be set off against income under the other head if an assessee [Individual/HUF/AOP(other than Co-operative Society)/BOI/Artificial Juridical Person] pays tax at concessional rate u/s 115BAC. However, if the assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A) and there is a loss under the head "Income from house property" and the assessee has income assessable under any other head of income, the maximum loss from house property which can be set off against income from any other head is ₹ 2 lakhs. In other words, in such case, the amount of such loss exceeding ₹ 2 lakhs would not be allowable to be set off against income under the other head.*

(5) **Speculation loss and loss from the activity of owning and maintaining race horses** cannot be set off against income under any other head.

(6) **Losses from Specified business u/s 35AD:** In case of an assessee exercising the option of shifting out of the default tax regime provided under section 115BAC(1A), loss from specified business referred to in section 35AD can be set off only against income from any other specified business. Such loss cannot be set off against income under any other head.

However, losses from other business can be set off against profits from specified business.

If the income from a source is exempt from tax, loss from that exempt source cannot be set off against taxable income from a different source or taxable income under a different head.

7.5 CARRY FORWARD AND SET OFF OF LOSS FROM HOUSE PROPERTY [SECTION 71B]

(1) **Set-off and Carry Forward & Set-off of losses:**

(a) **If the assessee, being an individual, HUF, AoP (other than Co-operative Society), Bol or Artificial Juridical Person, exercises the option of shifting out of the default tax regime provided under section 115BAC(1A):** In any assessment year, if there is a loss under the head "Income from house property", such loss will first be set-off against income from any other head to the extent of

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₹ 2,00,000 during the same year. The unabsorbed loss will be carried forward to the following assessment year to be set off against income under the head "Income from house property".

(b) **If such assessee referred to in (a) above pays tax at concessional rate u/s 115BAC:** The loss under the head "Income from house property" would not be allowable to be set off against income under any other head. The unabsorbed loss cannot be carried forward to the following assessment year.

(c) **In case of other assessees (Companies/Firms/Co-operative Societies):** In any assessment year, if there is a loss under the head "Income from house property", such loss will first be set off against income from any other head to the extent of ₹ 2,00,000 during the same year. The unabsorbed loss will be carried forward to the following assessment year to be set off against income under the head "Income from house property".

This is irrespective of whether or not the company opted for section 115BAA/115BAB and whether or not the co-operative society opted for section 115BAD/115BAE.

(2) **Maximum period for carry forward & set-off of losses:** The loss under this head is allowed to be carried forward upto 8 assessment years immediately succeeding the assessment year in which the loss was first computed.

Note - It is to be remembered that once a particular loss is carried forward, it can be set off only against the income from the same head in the forthcoming assessment years.

ILLUSTRATION 1

Mr. Kamal (aged 35 years) submits the following particulars pertaining to the A.Y.2026-27:

Particulars	*₹*
Income from salary (computed)	*4,20,000*
Loss from let-out property	*(-) 2,30,000*
Business loss	*(-)1,20,000*
Bank interest (FD) received	*85,000*

Compute the total income of Mr. Kamal for the A.Y.2026-27, assuming that

(i) He has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

(ii) He pays tax under the default tax regime.

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SOLUTION

(i) **Computation of total income of Mr. Kamal for the A.Y.2026-27 under the normal provisions of the Act**

Particulars	Amount (₹)	Amount (₹)
Income from salary	4,20,000	
Less: Loss from house property of ₹ 2,30,000 to be restricted to ₹ 2 lakhs by virtue of section 71(3A)	(-) 2,00,000	2,20,000
Balance loss of ₹ 30,000 from house property to be carried forward to next assessment year		
Income from other sources (interest on fixed deposit with bank)	85,000	
Less: Business loss of ₹ 1,20,000 set-off to the extent of ₹ 85,000	(-) 85,000	-
(Business loss of ₹ 35,000 to be carried forward for set-off against business income of the next assessment year)		
Gross total income [See Note below]		**2,20,000**
Less: Deduction under Chapter VI-A		Nil
Total income		**2,20,000**

Notes:

(i) Gross Total Income includes salary income of ₹ 2,20,000 after adjusting loss of ₹ 2,00,000 from house property. The balance loss of ₹ 30,000 from house property to be carried forward to next assessment year for set-off against income from house property of that year.

(ii) Business loss of ₹ 1,20,000 is set off to the extent of bank interest of ₹ 85,000 and remaining business loss of ₹ 35,000 will be carried forward as it cannot be set off against salary income.

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(ii) Computation of total income of Mr. Kamal for the A.Y.2026-27 under default tax regime

Particulars	Amount (₹)	Amount (₹)
Income from salary		4,20,000
Income from other sources (interest on fixed deposit with bank)	85,000	
Less: Business loss of ₹ 1,20,000 set-off to the extent of ₹ 85,000	(-) 85,000	-
(Business loss of ₹ 35,000 to be carried forward for set-off against business income of the next assessment year)		
Gross total income/ Total Income		**4,20,000**

Notes:

(i) Under the default tax regime, loss from house property cannot be set off against income under any other head and cannot be carried forward to next assessment year.

(ii) Business loss of ₹ 1,20,000 is set off to the extent of bank interest of ₹ 85,000 and remaining business loss of ₹ 35,000 will be carried forward as it cannot be set off against salary income.

7.6 CARRY FORWARD AND SET OFF OF BUSINESS LOSSES [SECTION 72]

Under the Act, the assessee has the right to carry forward the losses under the head of business and profession in cases where such loss cannot be set-off due to the absence or inadequacy of income under any other head in the same year. The loss so carried forward can be set off against the profits of subsequent previous years.

Section 72 covers the carry forward and set off of losses arising from a business or profession.

Conditions

The assessee's right to carry forward business losses under this section is, however, subject to the following conditions:-

(1) The loss should have been incurred in business, profession or vocation.

(2) The loss should not be in the nature of a loss in the business of speculation.

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(3) **Loss from one business can be carried forward & set off against the income from any other business:** The loss may be carried forward and set-off against the income from business or profession though not necessarily against the profits and gains of the same business or profession in which the loss was incurred.

However, a loss carried forward cannot, under any circumstances, be set off against the income from any head other than "Profits and gains of business or profession".

(4) **Person who incurred the loss alone is entitled to carry forward & set-off the loss:** The loss can be carried forward and set off only against the profits of the assessee who incurred the loss. That is, only the person who has incurred the loss is entitled to carry forward or set off the same. Consequently, the successor of a business cannot carry forward or set off the losses of his predecessor except in the case of succession by inheritance.

(5) **Maximum period for carry forward & set-off of losses:** A business loss can be carried forward for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

(6) **Rehabilitation of business [Proviso to section 72(1)]**

If there is a loss sustained in a business which is discontinued in the circumstances mentioned under section 33B and such business is re-established, reconstructed or revived by the assessee within 3 years from the end of previous year of discontinuation, the loss attributable to such business

(i) shall be allowed to be set off against the profits and gains, if any, of that business or any other business carried on by him and assessable for that assessment year, and

(ii) if the loss cannot be wholly so set off, the amount of balance loss to be carried to the following assessment year and so on for 7 assessment years immediately succeeding provided such re-established business is continued to be carried by the assessee.

Note: Circumstances referred to in section 33B

The business is formed as re-establishment, reconstruction or revival by the assessee of the business of such industrial undertaking which is discontinued by reason of extensive damage to or destruction of any building, machinery, plant or furniture owned by the assessee and used for the purpose of such business.

Such damage or destruction should be affected as a direct result of flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature or riot or civil disturbance or accidental fire or explosion or action by an enemy or action taken in combating an enemy.

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ILLUSTRATION 2

Mr. Vikas, a resident individual, furnishes the following particulars for the P.Y.2025-26:

Particulars	*₹*
Income from salary (computed)	*8,50,000*
Income from house property	*(24,000)*
Income from non-speculative business	*(24,000)*
Income from speculative business	*(6,000)*
Short-term capital losses	*25,000*
Long-term capital gains taxable u/s 112	*21,000*

What is the total income chargeable to tax for the A.Y.2026-27, assuming that he pays tax under section 115BAC?

SOLUTION

Total income of Mr. Vikas for the A.Y. 2026-27

Particulars	Amount (₹)	Amount (₹)
Income from salaries		8,50,000
Income from house property		
Loss from house property can neither be set off nor can be carried forward, since Mr. Vikas is paying tax under the default tax regime u/s 115BAC	Nil	
Profits and gains of business and profession		
Business loss to be carried forward **[Note (i)]**	(24,000)	
Speculative loss to be carried forward **[Note (ii)]**	(6,000)	
Capital Gains		
Long term capital gain taxable u/s 112	21,000	
Short term capital loss of ₹ 25,000 set-off against long-term capital gains to the extent of ₹ 21,000 **[Note (iii)]**	(21,000)	
	Nil	
Balance short term capital loss of ₹ 4,000 to be carried forward **[Note (iii)]**		
Taxable income		**8,50,000**

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Notes:

(i) Business loss cannot be set off against salary income. Therefore, loss of ₹ 24,000 from the non-speculative business cannot be set off against the income from salaries. Hence, such loss has to be carried forward to the next year for set off against business profits, if any.

(ii) Loss of ₹ 6,000 from the speculative business can be set off only against the income from the speculative business. Hence, such loss has to be carried forward.

(iii) Short term capital loss can be set off against both short term capital gain and long term capital gain. Therefore, short term capital loss of ₹ 25,000 can be set off against long term capital gains to the extent of ₹ 21,000. The balance short term capital loss of ₹ 4,000 cannot be set-off against any other income and has to be carried forward to the next year for set off against capital gains, if any.

7.7 CARRY FORWARD AND SET OFF OF ACCUMULATED BUSINESS LOSSES AND UNABSORBED DEPRECIATION IN CERTAIN CASES OF AMALGAMATION/ DEMERGER, ETC. [SECTION 72A]

(1) Amalgamation

Applicability: This section applies where there has been an amalgamation of –

(i) a company owning an industrial undertaking or a ship or a hotel with another company; or

(ii) a banking company with a specified bank; or

(iii) one or more public sector company or companies with one or more public sector company or companies; or

(iv) erstwhile public sector company (i.e., a company which was a public sector company in earlier previous years and ceases to be a public sector company by way of strategic disinvestment by the Government) with one or more company or companies, if the share purchase agreement entered into under strategic disinvestment restricted immediate amalgamation of the said public sector company and the amalgamation is carried out within five year from the end of the previous year in which the restriction on amalgamation in the share purchase agreement ends.

Strategic disinvestment means sale of shareholding by the Central Government or any State Government or a public sector company, in a public sector company or in a company,

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which results in reduction of its shareholding to below 51% and transfer of control to the buyer.

However, the condition of reduction of shareholding below 51% would apply only in a case where shareholding of the Central Government or the State Government or the public sector company was above 51% before such sale of shareholding.

Further, the requirement of transfer of control to the buyer may be carried out by the Central Government or the State Government or the public sector company or any two of them or all of them.

As per section 2(27) of the Companies Act, 2013, control shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

Allowability of carry forward and set off of accumulated loss and unabsorbed loss by amalgamated company in case of amalgamation: It provides that the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation, as the case may be, of the amalgamated company for the previous year in which the amalgamation took place. Other provisions of the Act relating to set off and carry forward shall also apply accordingly.

However, in case of an amalgamation of erstwhile public sector company, with one or more company or companies, the accumulated loss and the unabsorbed depreciation of the amalgamating company, which is deemed to be the loss or the allowance for unabsorbed depreciation, as the case may be, of the amalgamated company, shall not be more than the accumulated loss and unabsorbed depreciation of the public sector company as on the date on which the public sector company ceases to be a public sector company as a result of strategic disinvestment.

Conditions for availing benefit under this section

(i) Conditions to be fulfilled by the amalgamating company

(a) The amalgamating company should have been **engaged in the business**, in which the accumulated loss occurred or depreciation remains unabsorbed, **for 3 or more years**.

(b) The amalgamating company has held continuously as on the date of amalgamation, **at least 3/4th of the book value of the fixed assets held by it, 2 years prior** to the date of amalgamation.

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(ii) Conditions to be fulfilled by the amalgamated company

(a) The amalgamated company should **hold at least 3/4th of the book value of fixed assets** of the amalgamating company acquired as a result of amalgamation **for a minimum period of 5 years** from the effective date of amalgamation.

(b) The amalgamated company **continues the business** of the amalgamating company for **at least 5 years**.

(c) The amalgamated company must also fulfill such other conditions prescribed under Rule 9C for the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose -

(1) The amalgamated company, owning an industrial undertaking of the amalgamating company by way of amalgamation, shall achieve the level of production of at least 50% of the installed capacity (capacity of production as on the date of amalgamation) of the said undertaking before the end of 4 years from the date of amalgamation and continue to maintain the said minimum level of production till the end of 5 years from the date of amalgamation. Central Government has the power to modify this requirement on an application made by the amalgamated company.

(2) The amalgamated company shall furnish to the Assessing Officer a certificate in the prescribed form verified by a Chartered Accountant in this regard.

Consequences of non-fulfillment of specified conditions: In case the above specified conditions are not fulfilled, that part of carry forward of loss and unabsorbed depreciation remaining to be utilized by the amalgamated company shall lapse and such loss or depreciation as has been set off shall be treated as the income of the amalgamated company in the year in which there is a failure to fulfill the conditions.

(2) Re-organisation of business

Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by company in case of succession: In case of re-organisation of business, whereby

- a firm is succeeded by a company as per the provisions of section 47(xiii), or
- a sole proprietary concern is succeeded by a company as per the provisions of section 47(xiv),

then the accumulated business loss and the unabsorbed depreciation of the firm/proprietary concern, as the case may be, shall be deemed to be the loss or depreciation allowance of the

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successor company for the previous year in which the business re-organisation took place. Other provisions of the Act relating to set off and carry forward will apply accordingly.

Consequences of non-fulfillment of specified conditions: If it is found that any of the conditions laid down in the corresponding sub-sections (xiii) or (xiv) of section 47 have not been 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 the conditions have been violated.

(3) Conversion of a company into LLP [Section 72A(6A)]

Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by LLP in case of conversion: In case of re-organisation of business, whereby a private company or unlisted company is succeeded by a LLP as per the provisions of section 47(xiiib), then the accumulated business loss and the unabsorbed depreciation of the company shall be deemed to be the loss or depreciation allowance of the successor LLP for the previous year in which the business re-organisation took place. Other provisions of the Act relating to set off and carry forward will apply accordingly.

Consequences of non-fulfillment of specified conditions: If the entity fails to fulfill the conditions specified in section 47(xiiib), the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions.

(4) Carry forward of accumulated loss in case of amalgamation or business re-organisation effected on or after 1.4.2025

In case of an amalgamation or business re-organisation as per point (1), (2) and (3) above took place on or after 01.04.2025, any accumulated loss of predecessor entity, being -

a) the amalgamating company; or

b) the firm or proprietary concern; or

c) the private company or unlisted public company,

which is deemed to be the loss of successor entity, being-

i) the amalgamated company; or

ii) the successor company; or

iii) the successor LLP,

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shall be carried forward in the hands of the successor entity for not more than eight assessment years immediately succeeding the assessment year for which such loss was first computed for original predecessor entity.

(5) Demerger

Allowability of carry forward and set off of accumulated loss and unabsorbed loss by resulting company in case of demerger: Where there has been a demerger of an undertaking,

- the accumulated loss and the unabsorbed depreciation directly relatable to the undertaking transferred by the demerged company to the resulting company shall be allowed to be carried forward and set off in the hands of the resulting company.
- if the accumulated loss or unabsorbed depreciation is not directly relatable to the undertaking, the same will be apportioned between the demerged company and the resulting company in the same proportion in which the value of the assets retained by the demerged company and have been transferred to the resulting company.

Conditions for availing benefit under this section: The Central Government is empowered to notify such conditions as it considers necessary to ensure that the demerger is for genuine business purpose.

(6) Meanings of certain terms

Term	Particulars
Accumulated loss	It means so much of the loss of - the predecessor firm or - the proprietary concern or - the private company or unlisted public company or - the amalgamating company or - the demerged company, as the case may be, under the head "Profit and gains of business or profession" **(not being a loss sustained in a speculation business)** which such predecessor firm or the proprietary concern or 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 re-organisation be of business or amalgamation or demerger had not taken place.
Industrial undertaking	It means any undertaking which is engaged in - (i) the manufacture or processing of goods; (ii) the manufacture of computer software;

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	(iii) the business of generation or distribution of electricity or any other form of power; (iv) providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broad band network and internet services. (v) mining; (vi) the construction of ships, aircraft or rail systems.
Original predecessor entity	*It means predecessor entity in respect of first amalgamation or first business reorganization, as the case may be.*
Unabsorbed depreciation	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 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 re-organisation of business or amalgamation or demerger had not taken place
Specified bank	It means the State Bank of India or a subsidiary bank as defined in the SBI (Subsidiary Banks) Act, 1959 or a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

7.8 CARRY FORWARD AND SET OFF OF ACCUMULATED BUSINESS LOSSES AND UNABSORBED DEPRECIATION IN A SCHEME OF AMALGAMATION IN CERTAIN CASES [SECTION 72AA]

(1) **Applicability:** This section provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance where there has been an amalgamation of -

(i) one or more banking company with

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- any other banking institution under a scheme sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949; or
- any other banking institution or a company subsequent to a strategic disinvestment, wherein the amalgamation is carried out within 5 years from the end of the previous year during which such strategic disinvestment is carried out; or

(ii) one or more corresponding new bank or banks with any other corresponding new bank under a scheme brought into force by the Central Government under section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, or both, as the case may be, or

(ii) one or more Government company or companies with any other Government company under a scheme sanctioned and brought into force by the Central Government under section 16 of the General Insurance Business (Nationalisation) Act, 1972.

(2) Allowability of carry forward and set-off of accumulated loss and unabsorbed depreciation in case of amalgamation: The accumulated loss and unabsorbed depreciation of such banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies shall be deemed to be the loss or the allowance for depreciation of such banking institution or company or amalgamated corresponding new bank or amalgamated Government company for the previous year in which the scheme of amalgamation is brought into force. Accordingly, all the provisions contained in the Income-tax Act, 1961, relating to set off and carry forward of loss and unabsorbed depreciation would be applicable.

(3) Carry forward of accumulated loss in case of amalgamation effected on or after 1.4.2025

In case of an amalgamation took place on or after 01.04.2025, any accumulated loss of predecessor entity, being -

a) the banking company or companies; or

b) the amalgamating corresponding new bank or banks; or

c) the amalgamating Government company or companies,

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which is deemed to be the loss of successor entity, being-

i) the banking institution or company; or

ii) the amalgamated corresponding new bank or banks; or

iii) the amalgamated Government company or companies,

shall be carried forward in the hands of the successor entity for not more than eight assessment years immediately succeeding the assessment year for which such loss was first computed for original predecessor entity.

(4) Meaning of certain terms:

Term	Meaning
Accumulated loss	So much of the loss of the amalgamating banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies, would have been entitled to carry forward and set off under the provisions of section 72, if the amalgamation had not taken place
Government company	It means a Government company as defined in section 2(45) of the Companies Act, 2013, which is engaged in the general insurance business and which has come into existence by operation of section 4 or section 5 or section 16 of the General Insurance Business (Nationalisation) Act, 1972
Unabsorbed depreciation	It means so much of the allowance for depreciation of the amalgamating banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies which remains to be allowed and which would have been allowed to such banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies, if the amalgamation had not taken place.
Original predecessor entity	*It means predecessor entity in respect of first amalgamation.*

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7.9 CARRY FORWARD AND SET OFF OF ACCUMULATED LOSS AND UNABSORBED DEPRECIATION IN BUSINESS REORGANISATION OF CO-OPERATIVE BANKS [SECTION 72AB]

(1) Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by a co-operative bank in case of reorganisation: Under this section, in a case where the amalgamation has taken place during the previous year, set off of accumulated loss and the unabsorbed depreciation of the predecessor co-operative bank will be allowed in the hands of the successor co-operative bank as if the amalgamation had not taken place. All the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation would apply accordingly.

(2) Conditions for availing benefit under this section

(i) <u>Conditions to be fulfilled by the predecessor co-operative bank</u>

(a) It should have been engaged in the business of banking for three or more years; and

(b) It has held at least 3/4thof the book value of fixed assets as on the date of the business reorganisation, continuously for 2 years prior to the date of business reorganisation;

(ii) <u>Conditions to be fulfilled by the successor co-operative bank</u>

(a) It should hold at least 3/4thof the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of 5 years immediately succeeding the date of business reorganisation;

(b) It continues the business of the predecessor co-operative bank for a minimum period of 5 years from the date of business reorganisation; and

(c) It fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.

(3) Quantum allowed of accumulated loss and unabsorbed depreciation: The amount of set-off of the accumulated loss and unabsorbed depreciation allowable to the resulting co-operative bank has to be calculated in the following manner -

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(i) **In a case where the whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting co-operative bank** - the entire accumulated loss or unabsorbed depreciation of the demerged co-operative bank is allowed to be set-off.

(ii) **In a case where the accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting co-operative bank** - the amount which bears the same proportion to the accumulated loss or unabsorbed depreciation of the demerged co-operative bank as the assets of the undertaking transferred to the resulting co-operative bank bears to the assets of the demerged co-operative bank.

Example:

If A Co-op Bank is the demerged co-operative bank and B Co-op Bank is the resulting co-operative bank, the amount of set-off of the accumulated loss and unabsorbed depreciation allowable to B Co-op. bank would be –

$$\text{Unabsorbed business loss/depreciation of A Co-op bank} \times \frac{\text{Assets of the undertaking transferred to B Co-op bank}}{\text{Assets of A Co-op bank}}$$

(4) Additional conditions for availing benefit under this section: The Central Government may specify other conditions by notification in the Official Gazette as it considers necessary, to ensure that the business reorganisation is for genuine business purposes.

(5) Period before and after business reorganization to constitute two different previous years: The period commencing from the beginning of the previous year and ending on the date immediately preceding the date of business reorganisation, and the period commencing from the date of such business reorganisation and ending with the previous year shall be deemed to be two different previous years for the purposes of set off and carry forward of loss and allowance for depreciation.

Example:

If the date on which business re-organisation took place is 1.11.2025, then the period between 1.4.2025 and 31.10.2025 and the period between 1.11.2025 and 31.3.2025 would be deemed to be two different previous years for the purposes of set off and carry forward of unabsorbed business losses and depreciation.

(6) Consequences of non-fulfillment of specified conditions: In a case where the conditions specified in (2) above or notified under (4) above are not complied with, the set-

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off of accumulated loss or unabsorbed depreciation allowed in any previous year to the successor co-operative bank shall be deemed to be the income of the successor co-operative bank chargeable to tax for the year in which the conditions are not complied with.

(7) Meaning of certain terms

Term	Particulars
Accumulated loss	It means so much of loss of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating co-operative bank or the demerged co-operative bank, would have been entitled to carry forward and set-off under the provisions of section 72 as if the business reorganisation had not taken place.
Unabsorbed depreciation	It means so much of the allowance for depreciation of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, which remains to be allowed and which would have been allowed to such bank as if the business reorganisation had not taken place.

7.10 LOSSES IN SPECULATION BUSINESS [SECTION 73]

The meaning of the expression 'speculative transaction' as defined in section 43(5) and the treatment of income from speculation business has already been discussed under the head "Profits and gains of business or profession".

(1) Set-off and Carry forward & set-off of loss from speculation business: Since speculation is deemed to be a business distinct and separate from any other business carried on by the assessee, the losses incurred in speculation can be neither set off in the same year against any other non-speculation income nor be carried forward and set off against other income in the subsequent years.

Therefore, if the losses sustained by an assessee in a speculation business cannot be set-off in the same year against any other speculation profit, they can be carried forward to subsequent years and set-off only against income from any speculation business carried on by the assessee. Loss from the activity of trading in derivatives, however, is not to be treated as speculative loss.

(2) Maximum period for carry forward & set-off of losses: The loss in speculation business can be carried forward only for a **maximum period of 4 years** from the end of the relevant assessment year in respect of which the loss was computed. Loss from the activity of trading in derivatives, however, is not to be treated as speculative loss.

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(3) When a business of a company deemed to be carrying on a speculation business: The *Explanation* to this section provides that where any part of the business of a company consists in the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

However, this deeming provision does not apply to the following companies –

(i) A company whose gross total income consists of mainly income chargeable under the heads "Income from house property", "Capital gains" and "Income from other sources";

(ii) A company, the principal business of which is –

(a) the business of trading in shares; or

(b) the business of banking; or

(c) the granting of loans and advances.

Thus, these companies would be exempted from the operation of this *Explanation*. Accordingly, if these companies carry on the business of purchase and sale of shares of other companies, they would not be deemed to be carrying on speculation business.

7.11 CARRY FORWARD & SET OFF OF LOSSES BY SPECIFIED BUSINESSES [SECTION 73A]

(1) Set-off and Carry forward & set-off of losses of specified business: Any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on.

Note *- The loss of an assessee claiming deduction under section 35AD in respect of a specified business can be set-off against the profit of another specified business under section 73A, irrespective of whether the latter is eligible for deduction under section 35AD. An assessee can, therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April, 2010 and which is eligible for deduction under section 35AD, against the profits of the existing business of operating a hospital (with atleast 100 beds for patients) or a hotel (of two-star or above category), even if the latter is not eligible for deduction under section 35AD.*

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(2) **Loss can be set-off indefinitely:** There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against income from specified business.

Notes:

(i) Companies who has opted for section 115BAA/115BAB and Co-operative societies who has opted for section 115BAD/115BAE are **not** eligible for deduction under section 35AD.

(ii) An assessee, being an Individual/HUF/AOP/BOI, paying tax under the default tax regime under section 115BAC(1A) would **not** be entitled to deduction under section 35AD. However, such person exercising the option of shifting out of the default tax regime provided under section 115BAC(1A) and carrying on specified business, can claim deduction u/s 35AD in respect of capital expenditure (other than land, goodwill and financial instruments) incurred in respect of such business, subject to fulfillment of specified conditions. Any loss computed in respect of the specified business referred to in section 35AD can, however, be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on.

7.12 LOSSES UNDER THE HEAD 'CAPITAL GAINS' [SECTION 74]

Carry forward & set-off of losses: Section 74 provides that where for any assessment year, the net result under the head 'Capital gains' is short term capital loss or long term capital loss, the loss shall be carried forward to the following assessment year to be set off in the following manner:

(1) **Short-term capital loss:** Where the loss so carried forward is a short-term capital loss, it shall be set off against any capital gains, short term or long term, arising in that year.

(2) **Long-term capital loss:** Where the loss so carried forward is a long-term capital loss, it shall be set off only against long term capital gain arising in that year.

(3) **Loss under head capital gains:** Net loss under the head capital gains cannot be set off against income under any other head.

(4) **Maximum period for carry forward & set-off of loss**: Any unabsorbed loss shall be carried forward to the following assessment year up to a maximum of 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

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Note *- Long-term capital gain exceeding ₹ 1,25,000 arising on sale of equity shares or units of equity oriented fund or unit of business trust on which STT is paid*

- *in respect of equity shares, both at the time of acquisition and sale and*
- *in respect of units of equity oriented fund or unit of business trust, at the time of sale*

is taxable under section 112A @12.5%. Long-term capital loss on sale of such shares/units can, therefore, be set-off and carried forward for set-off against long-term capital gains by virtue of section 70(3) and section 74.

ILLUSTRATION 3

During the P.Y. 2025-26, Mr. Chetan has the following income and the brought forward losses:

Particulars	*₹*
Short term capital gains on sale of shares	*1,75,000*
Brought forward Long-term capital loss of A.Y.2024-25	*(96,000)*
Short term capital loss of A.Y.2025-26	*(42,000)*
Long term capital gain u/s 112	*85,000*

What is the capital gain taxable in the hands of Mr. Chetan for the A.Y.2026-27?

SOLUTION

Taxable capital gains of Mr. Chetan for the A.Y. 2026-27

Particulars	₹	₹
Short term capital gains on sale of shares	1,75,000	
Less: Brought forward short-term capital loss of the A.Y.2025-26	(42,000)	1,33,000
Long term capital gain	85,000	
Less: Brought forward long-term capital loss of A.Y.2024-25 of ₹ 96,000 set-off to the extent of ₹ 85,000 **[See Note below]**	(85,000)	Nil
Taxable short-term capital gains		**1,33,000**

Note: Long-term capital loss cannot be set off against short-term capital gain. Hence, the unadjusted long term capital loss of A.Y.2024-25 of ₹ 11,000 (i.e., ₹ 96,000 – ₹ 85,000) has to be carried forward to the next year to be set-off against long-term capital gains of that year.

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7.13 LOSSES FROM THE ACTIVITY OF OWNING AND MAINTAINING RACE HORSES [SECTION 74A(3)]

(1) Set-off and Carry forward & set-off of loss: According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses.

(2) Maximum period for carry forward & set-off of losses: Such loss can be carried forward for a maximum period of 4 assessment years immediately succeeding the assessment year for which the loss was first computed, for being set-off against the income from the activity of owning and maintaining race horses.

(3) Meaning of certain terms

Term	Meaning
Amount of loss incurred by the assessee in the activity of owning and maintaining race horses	(i) **In case assessee has no income by way of stake money** – amount of revenue expenditure incurred by the assessee wholly & exclusively for the purpose of maintaining race horses. (ii) **In case assessee has income by way of stake money -** The amount by which such income by way of stake money falls short of the amount of revenue expenditure incurred by the assessee wholly & exclusively for the purpose of maintaining race horses. i.e. Loss = Stake money – revenue expenditure for the purpose of maintaining race horses.
Horse race	A horse race upon which wagering or betting may be lawfully made.
Income by way of stake money	The gross amount of prize money received on a race horse or race horses by the owner thereof on account of the horse or horses or any one or more of the horses winning or being placed second or in any lower position in horse races.

ILLUSTRATION 4

Mr. Dinesh has the following income for the P.Y.2025-26-

Particulars	*₹*
Income from the activity of owning and maintaining the race horses	*75,000*

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Income from textile business	*95,000*
Brought forward textile business loss (relating to A.Y. 2025-26)	*50,000*
Brought forward loss from the activity of owning and maintaining the race horses (relating to A.Y.2023-24)	*96,000*

What is the total income in the hands of Mr. Dinesh for the A.Y. 2026-27?

SOLUTION

Total income of Mr. Dinesh for the A.Y. 2026-27

Particulars	₹	₹
Income from the activity of owning and maintaining race horses	75,000	
Less: Brought forward loss of ₹ 96,000 from the activity of owning and maintaining race horses set-off to the extent of ₹ 75,000	75,000	
	Nil	
Balance loss of ₹ 21,000 (₹ 96,000 – ₹ 75,000) from the activity of owning and maintaining race horses to be carried forward to A.Y.2027-28		
Income from textile business	95,000	
Less: Brought forward business loss from textile business	50,000	45,000
Total income		**45,000**

Note: Loss from the activity of owning and maintaining race horses cannot be set-off against any other source/head of income.

7.14 CARRY FORWARD AND SET OFF OF LOSSES IN CASE OF CHANGE IN CONSTITUTION OF FIRM OR SUCCESSION [SECTION 78]

(1) **Change in constitution of firm:** Where there is a change in the constitution of a firm, so much of the loss proportionate to the share of a retired or deceased partner remaining unabsorbed (i.e. 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), shall not be allowed to be carried forward by the firm. However, unabsorbed depreciation can be carried forward without such restriction.

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(2) **Succession otherwise by inheritance:** Where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, such other person shall not be allowed to carry forward and set off against his income, any loss incurred by the predecessor.

(3) **Succession by inheritance:** Where there is a succession by inheritance, the legal heirs are entitled to set-off the business loss of the predecessor. Such carry forward and set-off is possible even if the legal heirs constitute themselves as a partnership firm. In such a case, the firm can carry forward and set-off the business loss of the predecessor.

7.15 CARRY FORWARD AND SET OFF OF LOSSES IN CASE OF CLOSELY HELD COMPANIES [SECTION 79]

(1) **Carry forward and set-off of losses in case of closely held company not being an eligible start-up referred to in section 80-IAC**

In the case of a company in which the public are not substantially interested and not being an eligible start-up referred to in section 80-IAC, 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

- on the last day of the previous year, the shares of the company carrying not less than 51% of the voting power were beneficially held by persons
- who beneficially held shares of the company carrying not less than 51% of the voting power on the last day of the year or years in which the loss was incurred.

(2) **Carry forward and set-off of losses in case of closely held company being an eligible start-up referred to in section 80-IAC**

In case of a company in which the public are not substantially interested but being an eligible start-up as referred to in section 80-IAC, any unabsorbed loss of the company shall be allowed to be carried forward and set off against the income of the previous year if either of the conditions are satisfied –

(a) on the last day of the previous year, the shares of the company carrying not less than 51% of the voting power were beneficially held by persons who beneficially held

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shares of the company carrying not less than 51% of the voting power on the last day of the year or years in which the loss was incurred; or

(b) all the shareholders of such company who held shares carrying voting power on the last day of the previous year or years in which the loss was incurred continue to hold those shares on the last day of such previous year in which the loss is to be set-off and such loss has been incurred during the period of ***10 years*** beginning from the year of incorporation of such company.

(3) Non-applicability of restriction

This restriction shall, however, not apply:

(i) where a change in the voting power and shareholding 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;

(ii) where any change in shareholding takes place in an Indian company, being a subsidiary of a foreign company, as a result of amalgamation or demerger of the foreign company. However, this is subject to the condition that 51% of the shareholders of the amalgamating/ demerged company continue to be shareholders of the amalgamated/ resulting foreign company.

(iii) where a change in shareholding takes place in a previous year pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

(iv) to a company, and its subsidiary and the subsidiary of such subsidiary, where

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

(b) a change in shareholding of a company, and its subsidiary and the subsidiary of such subsidiary, has taken place in a previous year pursuant to a resolution plan approved by the Tribunal under section 242 of the Companies Act, 2013 after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

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(v) to a company to the extent that a change in the shareholding has taken place during the previous year on account of

(a) relocation of a capital asset by the original fund to the resulting fund; and

(b) consequent transfer of a capital asset, being a share or unit or interest held by a shareholder or unitholder or interest holder in the original fund, in consideration for the share or unit or interest in the resultant fund [For the meaning of the terms "relocation", "original fund" and "resultant fund", please refer Chapter 4: Capital Gains]

(vi) to an erstwhile public sector company which has become so as a result of strategic disinvestment by the Government (discussed in detail at 7.7) subject to the condition that the ultimate holding company of such erstwhile public sector company immediately after completion of the strategic disinvestment, continues to hold, directly or through its subsidiary or subsidiaries, 51% of the voting power of the erstwhile public sector company in aggregate.

However, if the above condition is not complied with in any previous year after the completion of strategic disinvestment, the restriction mentioned in (1) or (2) above shall apply for such previous year and subsequent previous year.

(4) Meaning of eligible start-up:

(5) Meaning of eligible business:

A business carried out by an eligible start-up engaged in –

- Innovation, development or improvement of products or processes or services or
- a scalable business model with a high potential of employment generation or wealth creation

(6) A company shall be a subsidiary of another company, if such other company holds more than half in nominal value of the equity share capital of the company.

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7.16 NO SET OFF OF LOSSES AGAINST UNDISCLOSED INCOME BROUGHT TO TAX CONSEQUENT TO SEARCH, REQUISITION AND SURVEY [SECTION 79A]

(1) **No set-off of losses or unabsorbed depreciation against undisclosed income:** No loss (whether brought forward or otherwise) or unabsorbed depreciation under section 32(2) can be set-off against undisclosed income included in the total income of any previous year of an assessee [consequent to a search under section 132 or a requisition under section 132A or a survey under section 133A (other than a survey conducted for TDS verification under section 133A(2A))] while computing his total income for such previous year.

(2) **Meaning of undisclosed income:** Undisclosed income means -

(i) **Income represented by any money, bullion, jewellery or other valuable article or thing or any entry in the books of account:** Any income of the previous year represented, either wholly or partly, by any money, bullion, jewellery or other valuable article or thing or any entry in the books of account or other documents or transactions found in the course of a search under section 132 or a requisition under section 132A or a survey under section 133A [other than under section 133A(2A)], which has -

(A) **not been recorded on or before the date of search or requisition or survey,** as the case may be, in the books of account or other documents maintained in the normal course relating to such previous year; or

(B) **not been disclosed** to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner before the date of search or requisition or survey, as the case may be; or

(ii) **Income represented by any entry in respect of an expense:** Any income of the previous year represented, either wholly or partly, by any entry in respect of an expense recorded in the books of account or other documents maintained in the normal course relating to the previous year **which is found to be false** and which would not have been found to be so, had the search not been initiated or the survey not been conducted or the requisition not been made.

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7.17 ORDER OF SET OFF OF LOSSES

As per the provisions of section 72(2), brought forward business loss is to be set-off before setting off unabsorbed depreciation. Therefore, the order in which set-off will be effected is as follows -

(1) Current year depreciation under section 32(1)

(2) Current year capital expenditure on scientific research and current year expenditure on family planning, to the extent allowed.

(3) Brought forward loss from business/profession [Section 72(1)]

(4) Unabsorbed depreciation [Section 32(2)]

(5) Unabsorbed capital expenditure on scientific research [Section 35(4)]

(6) Unabsorbed expenditure on family planning [Section 36(1)(ix)].

ILLUSTRATION 5

Mr. Varun has furnished his details for the A.Y.2026-27 as under:

Particulars	*₹*
Income from salaries (computed)	*1,70,000*
Income from speculation business	*60,000*
Loss from non-speculation business	*(40,000)*
Short term capital gain	*90,000*
Long term capital loss of A.Y.2024-25	*(30,000)*
Winning from lotteries (gross)	*20,000*

What is the taxable income of Mr. Varun for the A.Y.2026-27?

SOLUTION

Computation of taxable income of Mr. Varun for the A.Y.2026-27

Particulars	₹	₹
Income from salaries		1,70,000
Income from speculation business	60,000	
Less: Loss from non-speculation business	(40,000)	20,000
Short-term capital gain		90,000
Winnings from lotteries		20,000
Taxable income		**3,00,000**

Note: Long term capital loss can be set off only against long term capital gain. Therefore, long term capital loss of ₹ 30,000 has to be carried forward to the next assessment year.

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ILLUSTRATION 6

Compute the gross total income of Mr. Fadnis for the A.Y.2026-27 from the information given below –

Particulars	*₹*
Income from house property (computed)	*1,25,000*
Income from business (before providing for depreciation)	*1,35,000*
Short-term capital gains on sale of shares	*56,000*
Long-term capital loss from sale of property (brought forward from A.Y.2023-24)	*(90,000)*
Income from tea business	*1,20,000*
Dividend from Indian companies carrying on agricultural operations (Gross)	*1,20,000*
Current year depreciation	*26,000*
Brought forward business loss (loss incurred six years ago)	*(45,000)*

SOLUTION

Gross Total Income of Mr. Fadnis for the A.Y. 2026-27

Particulars	₹	₹
Income from house property		1,25,000
Income from business		
Profits before depreciation	1,35,000	
Less: Current year depreciation	26,000	
	1,09,000	
Add: Income from tea business (40% is business income)	48,000	
	1,57,000	
Less: Brought forward business loss	45,000	1,12,000
Income from the capital gains		
Short-term capital gains		56,000
Income from Other Sources		
Dividend from Indian companies is chargeable to tax in the hands of shareholders		1,20,000
Gross Total Income		**4,13,000**

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Notes:

(1) Dividend from Indian companies of ₹ 1,20,000 is taxable in the hands of shareholders at normal rate of tax.

(2) 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax.

(3) Long-term capital loss can be set off only against long-term capital gains. Therefore, long-term capital loss of ₹ 90,000 brought forward from A.Y.2023-24 cannot be set-off in the A.Y.2026-27. It has to be carried forward for set-off against long-term capital gains, if any, during A.Y.2027-28.

7.18 SUBMISSION OF RETURN OF LOSSES [SECTION 80]

As per section 80,

- business loss to be carried forward under section 72(1)
- speculation business loss to be carried forward under section 73(2)
- loss from specified business to carried forward under section 73A(2)
- loss under the head "Capital Gains" to be carried forward under section 74(1) and
- loss incurred in the activity of owning and maintaining race horses to be carried forward under section 74A(3).

which has not been determined in pursuance of a return filed under section 139(3) cannot be carried forward and set off. Thus, the assessee must have filed a return of loss under section 139(3) in order to carry forward and set off of such losses. Such a return of loss should be filed within the time allowed under section 139(1).

In other words, the non-filing of a return of loss disentitles the assessee from carrying forward the above specified losses sustained by him. Such a return should be filed within the time allowed under section 139(1).

This condition does not apply to a loss from house property carried forward under section 71B and unabsorbed depreciation carried forward under section 32(2).

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SIGNIFICANT SELECT CASES

Sl. No.	Case Law	
1.	***CIT v. KBD Sugars and Distilleries Ltd. [2023] 454 ITR 800 (SC)***	
	Issue	**Relevant provision of Law, analysis & decision**
	Can a resulting entity set off and carry forward the losses of the dysfunctional unit of demerged entity?	**Relevant Provision of Law:** Clause (vi) of Section 2(19AA) lays down a condition that demerger in relation to companies means the transfer, pursuant to a scheme of arrangement under section 230 to 232 of the Companies Act, 2013 by a demerged company of its one or more undertakings to any resulting company in such a manner that the transfer of the undertaking is on a going concern basis. **Assessing Officer's Contentions:** The Assessing Officer contented that the assessee was ineligible to the benefit of brought forward loss under section 72A(4) for the reason that the demerged company was dysfunctional since 1999 and, therefore, does not qualify to be a 'going concern'. Since the undertaking not being a 'going concern', the condition laid down in subclause (vi) of section 2(19AA) for demerger stands violated. **Analysis and Decision:** The Tribunal opined that the words used 'on a going concern basis' in subclause (vi) of section 2 (19AA) only means that the transfer should be based on a 'going concern', and it does not mean that the undertaking being transferred should be a 'going concern' as on the date of transfer. The 'scheme of demerger', which stands approved by the High Courts and the jurisdictional Court, clearly establishes the fact that the transfer of the undertaking is indeed on a 'going concern basis'. The assets, liabilities, employees, debts, obligations, rights, etc., of the undertaking, immediately prior to the demerger, stand entirely vested with the assessee upon 'demerger'. This amounts to 'transfer of the undertaking on a going concern basis'. A simple reading of the same makes it very clear that the assessee is eligible for the benefits under section 72A(4). The Act does not state that the undertaking being demerged ought to be a going concern at the time of demerger. It only states that the undertaking being demerged should stand

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		transferred in a manner similar to the manner in which a 'going concern' is transferred. Accordingly, the High Court held that if a unit were running and profitable, the same would not be available for demerger. It would be incongruous to construe sub-clause (vi) of section 2(19AA) to mean a running unit. The scheme of demerger had been approved by the High Courts. Therefore, the assessee was entitled to set off the brought forward losses under section 72A(4). The Apex Court affirmed the decision of the High Court.
2.	***Pramod Mittal v. CIT (2013) 356 ITR 456 (Delhi)***	
	Issue	**Analysis & Decision**
	Can the loss suffered by an erstwhile partnership firm, which was dissolved, be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance?	The partnership firm was dissolved and the take over of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor for set-off against his income is not allowed. ***Note*** *- In CIT v. Madhukant M. Mehta (2001) 247 ITR 805 (SC), the sole proprietor had expired and after his death, the heirs succeeded the business as a partnership concern. Therefore, the losses suffered by the deceased proprietor was allowed to be set-off by the partnership firm since the case falls within the exception mentioned u/s 78(2), i.e., a case of succession by inheritance.* *Also, in Saroj Aggarwal v. CIT (1985) 156 ITR 497 (SC), upon death of a partner, his legal heirs were inducted as partners in the partnership firm. The partnership firm was not dissolved on the death of the partner. The partnership firm which suffered the losses continued with induction of the legal heirs of the deceased partner. This, being a case of succession by inheritance, the benefit of carry forward of losses was given to the re-constituted partnership firm.* *In the present case, however, the partnership firm was dissolved and the take over of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor was not allowed in this case.*

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TEST YOUR KNOWLEDGE

Questions

1. *X carrying on a business as sole proprietor, died on 31st March, 2026. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2026, a determined business loss of ₹ 5 lakhs is to be carried forward under the Income-tax Act, 1961.*

   Does the firm consisting of all legal heirs of Mr. X, get a right to have this loss adjusted against its current income?

2. *ABC Limited owning an industrial undertaking was amalgamated with XYZ Limited on 01.04.2025. All the conditions of section 2(1B) were satisfied.*

   ABC Limited has the following losses as assessed in the Assessment Year 2025-26 which is carried forward to A.Y. 2026-27:

	Particulars	₹ (in lakhs)
(i)	Speculative Loss	4
(ii)	Unabsorbed Depreciation	18
(iii)	Unabsorbed expenditure of capital nature on scientific research	2
(iv)	Business Loss	120

   XYZ Limited has computed a profit of ₹ 140 lakhs for the financial year 2025-26 before setting off the eligible losses of ABC Limited but after providing depreciation at 15% per annum on ₹ 150 lakhs, being the consideration at which plant and machinery were transferred to XYZ Limited. The written down value as per Income-tax record of ABC Limited as on 1st April, 2025 was ₹ 100 lakhs.

   The above profit of XYZ Limited includes speculative profit of ₹ 10 lakhs.

   Compute the total income of XYZ Limited for Assessment Year 2026-27 and indicate the losses/ other allowances to be carried forward by it.

3. *Examine in brief about the treatment to be given in the following case under the Income-tax Act, 1961, for A.Y.2026-27:*

   A loss of ₹ 85,000 was sustained by Simran in the activity of owning and maintaining camels for races.

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4. *M/s. JKLM, a firm, consists of four partners namely, J, K, L and M. They shared profits and losses equally during the year ended 31.3.2025. The assessed business loss of the firm for the assessment year 2025-26 which it is entitled to carry forward amounts to ₹ 3,60,000. A new deed of partnership was executed among J, K, L and M on 1.4.2025 in terms of which they agreed to share profits and losses in the ratio of 15:15:20:50 respectively.*

   Compute the amount of business loss relating to the assessment year 2025-26, which the firm is entitled to set off against its business income for the assessment year 2026-27. The business income of the firm for the assessment year 2026-27 is ₹ 3,30,000. Your answer should be supported by reasons.

5. *An assessee sustained an unabsorbed depreciation in the previous year relevant to the assessment year 2025-26, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed under section 139(4). Can the assessee carry forward such unabsorbed depreciation for set off against income of the assessment year 2026-27?*

Answers

1. Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case *CIT v. Madhukant M. Mehta (2001) 247 ITR 805*, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In this case, the business of X was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of ₹ 5 lakhs of X.

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2. Computation of total income of XYZ Limited for the A.Y. 2026-27

Particulars		(₹ in lakhs)
Business income before setting off brought forward losses of ABC Ltd.		140.00
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Limited with XYZ Limited.		
Value at which assets are transferred by ABC Ltd.	150	
WDV in the books of ABC Ltd.	100	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of XYZ Ltd. [₹ 50 lacs × 15%] [*Explanation 2* to section 43(6)]		7.50
		147.50
Set off of brought forward business loss of ABC Ltd. **(See Notes 2 & 4)**		(120.00)
Set off of unabsorbed depreciation under section 32(2) read with section 72A **(See Notes 2 & 4)**		(18.00)
Set off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) **(See Note 5)**		(2.00)
Business income		7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income-tax Act, 1961.

2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company i.e., ABC Limited shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company i.e., XYZ Limited for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by XYZ Limited for a period of 8 years immediately succeeding the A.Y. in which such loss was first computed for ABC Ltd. and indefinitely, respectively.

3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of ₹ 4 lacs of ABC Limited cannot be carried forward by XYZ Limited.

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4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.

5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set off and carried forward in the same manner as unabsorbed depreciation.

6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set off against profits of a speculative business.

   Consequently, there is no loss or allowance to be carried forward by XYZ Limited to the F.Y. 2026-27.

3. Section 74A(3) lays down the provisions for set-off and carry forward of loss from the activity of owning and maintaining race horses. According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses. Since the scope of this section is confined to the activity of owning and maintaining race horses only, therefore, set-off and carry forward of loss from the activity of owning and maintaining camels is not covered under section 74A(3).

It is possible to take a view that the loss from the activity of owning and maintaining camels for races may be governed by section 72 provided such activity amounts to business. Accordingly, the loss from the activity of owning and maintaining of camels for races can be set-off against any income (other than income from salary) of current year and unadjusted amount shall be carried forward for set off against any business income for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

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4. The firm is entitled to set off its brought forward business loss amounting to ₹ 3,60,000 relating to the assessment year 2025-26 to the extent of ₹ 3,30,000 against its business income of ₹ 3,30,000 for the assessment year 2026-27, as per the provisions of section 72(1).

The balance unabsorbed business loss of ₹ 30,000 relating to the assessment year 2025-26 will be carried forward to assessment year 2027-28.

Section 78(1) which deals with carry forward and set-off of losses in the case of change in constitution of firm is applicable only where there is retirement or death of a partner. **It is not applicable to a case where there is a change in the ratio of sharing profits and losses amongst the existing partners.** Therefore, section 78(1) is not applicable to the case of M/s. JKLM.

5. Section 139(3) stipulates that an assessee claiming carry forward of loss under the heads "Profits and gains of business or profession" or "Capital gains" should furnish the return of loss within the time stipulated under section 139(1). There is no reference to "unabsorbed depreciation" in section 139(3). The assessee, in the instant case, has filed the return showing unabsorbed depreciation within the time prescribed under section 139(4). The assessee is, therefore, entitled to carry forward such unabsorbed depreciation for set off against the income of the subsequent assessment year.

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CHAPTER 8

DEDUCTIONS FROM GROSS TOTAL INCOME

LEARNING OUTCOMES

After studying this chapter, you would be able to:

- **appreciate** the general provisions contained in "A – General" of Chapter VI-A relating to deductions to be made in computing total income;
- **analyse and apply** the provisions of Chapter VI-A contained in "B – Deductions in respect of certain payments" in problem solving and addressing related issues;
- **appreciate** the provisions of Chapter VI-A contained in "C – Deductions in respect of certain incomes" and "CA – Deductions in respect of other incomes", and **analyse and apply** the provisions in problem solving and addressing related issues;
- **compute** the deduction allowable in the case of a person with disability under section 80U;
- **compute** the aggregate deduction available under Chapter VI-A to an assessee, if available, and thereafter, arrive at the total income of the assessee;
- **compute** the deduction available under section 10AA for units established in SEZs considering the conditions specified thereunder.

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CHAPTER OVERVIEW

8.1 GENERAL PROVISIONS

As we have seen earlier, section 10 exempts certain incomes. Such income are excluded from the total income and do not enter into the computation process at all. On the other hand, Chapter VI-A contains deductions from gross total income. Section 10AA also provides for a deduction in respect of units established in SEZ from the total income of the assessee. The important point to be noted here is that if there is no gross total income, then no deductions will be permissible.

This Chapter contains deductions in respect of certain payments, deductions in respect of certain incomes, deductions in respect of other income and other deductions. It also includes deduction under section 10AA.

Section 80A

(1) Section 80A(1) provides that in computing the total income of an assessee, there shall be allowed from his gross total income, the deductions specified in sections 80C to 80U.

(2) According to section 80A(2), the aggregate amount of the deductions under this chapter shall not, in any case, exceed the gross total income of the assessee. Therefore, the total income after deductions will either be positive or nil. It cannot be negative due to deductions.

An assessee cannot have a loss as a result of the deduction under Chapter VI-A and claim to carry forward the same for the purpose of set-off against his income in the subsequent year.

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(3) Section 80A(3) provides that in the case of AOP/BOI, if any deduction is admissible under section 80G/80GGA/80GGC/80-IA/80-IB/80-ID/80-IE, no deduction under the same section shall be made in computing the total income of a member of the AOP or BOI in relation to the share of such member in the income of the AOP or BOI.

(4) The profits and gains allowed as deduction under section 10AA or under any provision of Chapter VI-A under the heading "C.-Deductions in respect of certain incomes" in any assessment year, shall not be allowed as deduction under any other provision of the Act for such assessment year [Section 80A(4)];

(5) The deduction, referred to in (4) above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be [Section 80A(4)];

(6) No deduction under any of the provisions referred to in (4) above, shall be allowed if the deduction has not been claimed in the return of income [Section 80A(5)];

(7) The transfer price of goods and services between such undertaking or unit or enterprise or eligible business and any other business of the assessee shall be determined at the market value of such goods or services as on the date of transfer. This is notwithstanding anything to the contrary contained in section 10AA or in any provision of Chapter VI-A under the heading “C- Deductions in respect of certain incomes” [Section 80A(6)].

(8) For this purpose, the expression "market value" has been defined to mean,-

(a) in relation to any goods or services sold or supplied, the price that such goods or services would fetch if these were sold by the undertaking or unit or enterprise or eligible business in the open market, subject to statutory or regulatory restrictions, if any;

(b) in relation to any goods or services acquired, the price that such goods or services would cost if these were acquired by the undertaking or unit or enterprise or eligible business from the open market, subject to statutory or regulatory restrictions, if any;

(c) if it is a specified domestic transaction referred to in section 92BA, - in relation to any goods or services sold, supplied or acquired means the arm’s length price as defined in section 92F(ii) of such goods or services.

(9) Where a deduction under any provision of this Chapter under the heading “C – Deductions in respect of certain incomes” is claimed and allowed in respect of the profits of such specified business for any assessment year, no deduction under section 35AD is permissible in relation to such specified business for the same or any other assessment year.

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In short, once the assessee has claimed the benefit of deduction under section 35AD for a particular year in respect of a specified business, he cannot claim benefit under Chapter VI-A under the heading "C.-Deductions in respect of certain incomes" for the same or any other year and *vice versa*.

Section 80AB

This section provides that for the purpose of calculation of deductions specified in Chapter VI-A under the heading "C - Deductions in respect of certain incomes", the income computed in accordance with the provisions of the Act (before making any deduction under Chapter VI-A) shall alone be regarded as income received by the assessee and which is included in his gross total income. Accordingly, the deductions specified in the aforesaid sections will be calculated with reference to the net income as computed in accordance with the provisions of the Act (before making deduction under Chapter VI-A) and not with reference to the gross amount of such income. This is notwithstanding anything contained in the respective sections of Chapter VI-A.

Section 80AC: Furnishing return of income on or before due date mandatory for claiming deduction under Chapter VI-A under the heading "C.- Deductions in respect of certain incomes"

(1) Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1), as a pre-condition for availing benefit of deductions under any provision of Chapter VI-A under the heading "C. – Deductions in respect of certain incomes".

Table showing the deductions contained in Chapter VI-A under the heading "C. – Deductions in respect of certain income"

Section	Deduction
80-IA	Deductions in respect of profits and gains from undertakings or enterprises engaged in infrastructure development/generation/ transmission/ distribution of power etc.
80-IAB	Deduction in respect of profits and gains derived by an undertaking or enterprise engaged in development of SEZ
80-IAC	Deduction in respect of profits and gains derived by an eligible start-up from an eligible business
80-IB	Deduction in respect of profits and gains from the business of processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains
80-IBA	Deduction in respect of profits and gains from housing projects/rental housing projects

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80-IE	Deduction in respect of profits and gains from manufacture or production of eligible article or thing, substantial expansion to manufacture or produce any eligible article or thing or carrying on of eligible business in North-Eastern States
80JJA	Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste
80JJAA	Deduction in respect of employment of new employees
80LA	Deduction in respect of certain income of Offshore Banking Units and International Financial Services Centre
80M	Deduction in respect of certain inter-corporate dividends
80P	Deduction in respect of income of co-operative societies
80QQB	Deduction in respect of royalty income, etc., of authors of certain books other than text books
80RRB	Deduction in respect of royalty on patents

(2) The effect of this provision is that in case of failure to file return of income on or before the stipulated due date, the undertakings would lose the benefit of deduction under these sections.

ILLUSTRATION 1

Examine the following statements with regard to the provisions of the Income-tax Act, 1961:

(a) For grant of deduction u/s 80-IB, filing of audit report in prescribed form is must for a corporate assessee; filing of return within the due date laid down in section 139(1) is not required.

(b) Filing of belated return under section 139(4) of the Income-tax Act, 1961 will debar an assessee from claiming deduction under section 80-IE.

SOLUTION

(a) **The statement is not correct.** Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1), as a pre-condition for availing the benefit of deduction, *inter alia*, under section 80-IB.

(b) **The statement is correct.** As per section 80AC, the assessee has to furnish his return of income on or before the due date specified under section 139(1), to be eligible to claim deduction, *inter alia,* under section 80-IE.

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Section 80B(5)

"Gross total income" means the total income computed in accordance with the provisions of the Act without making any deduction under Chapter VI-A. "Computed in accordance with the provisions of the Act" implies —

(1) that deductions under appropriate computation section have already been given effect to;

(2) that income of other persons, if includible under sections 60 to 64, has been included;

(3) the intra head and/or inter head losses have been adjusted; and

(4) that unabsorbed business losses, unabsorbed depreciation etc., have been set off.

Two types of deductions are allowable from Gross Total Income - Deductions under Chapter VI-A and Deduction under section 10AA which are discussed in this chapter.

Let us first consider the deductions allowable in respect of certain payments.

8.2 DEDUCTIONS IN RESPECT OF PAYMENTS

(1) Deduction in respect of investment in specified assets [Section 80C]

Section 80C provides for a deduction from the Gross Total Income, of savings in specified modes of investments. The deduction under section 80C is available only to an individual or HUF.

Note - *The deduction under section 80C is available only to an individual or HUF exercising the option of shifting out of the default tax regime provided under section 115BAC(1A). It is not available under the default tax regime under section 115BAC.*

The maximum permissible deduction under section 80C is ₹ 1,50,000. The following are the investments/contributions eligible for deduction –

(i) Contribution in Unit-linked Insurance Plan 1971

Contributions in the name of the individual, his or her spouse or any child of the individual for participation in the Unit-linked Insurance Plan 1971. In case of a HUF, the contribution can be in the name of any member.

(ii) Contribution in Unit-linked Insurance Plan of LIC Mutual Fund

Contributions in the name of the individual, his or her spouse or any child of the individual for participation in any Unit linked Insurance Plan of the LIC Mutual Fund. In case of a HUF, the contribution can be in the name of any member.

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(iii) Premium paid in respect of life insurance policy

Premium paid for insurance on the life of the individual, spouse or any child (minor or major) and in the case of HUF, any member thereof. This will include a life policy and an endowment policy.

The following is a tabular summary of the deduction allowable under section 80C *vis-à-vis* the date of issue of such policies –

		Deduction u/s 80C
In respect of policies issued before 31.3.2012		Premium paid to the extent of 20% of "actual capital sum assured"
In respect of policies issued on or after 1.4.2012 but before 1.4.2013		Premium paid to the extent of 10% of "actual capital sum assured"
In respect of policies issued on or after 1.4.2013	**(a)**	**Where the insurance is on the life of a person with disability or severe disability as referred to in section 80U or a person suffering from disease or ailment as specified under section 80DDB.**
		Premium paid to the extent of 15% of "actual capital sum assured"
	(b)	**Where the insurance is on the life of any person, other than mentioned in (a) above**
		Premium paid to the extent of 10% of "actual capital sum assured"
Meaning of actual capital sum assured - 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.		

ILLUSTRATION 2

Compute the eligible deduction under section 80C for A.Y.2026-27 in respect of life insurance premium paid by Mr. Hari during the P.Y.2025-26, the details of which are given hereunder, if Mr. Hari has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A) -

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	Date of issue of policy	*Person insured*	*Actual capital sum assured (₹)*	*Insurance premium paid during P.Y. 2025-26 (₹)*
(i)	*30/3/2012*	*Self*	*9,00,000*	*48,000*
(ii)	*1/5/2019*	*Spouse*	*1,50,000*	*20,000*
(iii)	*1/6/2022*	*Handicapped son (section 80U disability)*	*4,00,000*	*80,000*

SOLUTION

	Date of issue of policy	Person insured	Actual capital sum assured (₹)	Insurance premium paid during P.Y. 2025-26 (₹)	Deduction u/s 80C for A.Y. 2026-27 (₹)	Remark (restricted to % of actual capital sum assured)
(i)	30/3/2012	Self	9,00,000	48,000	48,000	20%
(ii)	1/5/2019	Spouse	1,50,000	20,000	15,000	10%
(iii)	1/6/2022	Handicapped son (section 80U disability)	4,00,000	80,000	60,000	15%
Total					**1,23,000**	

ILLUSTRATION 3

What would your answer if Mr. Hari pays tax under default tax regime under section 115BAC?

SOLUTION

If Mr. Hari pays tax under default tax regime under section 115BAC, he would not be eligible for deduction under section 80C.

(iv) Premium paid in respect of a contract for deferred annuity

Premium paid to effect and keep in force a contract for a deferred annuity on the life of the individual and/or his or her spouse or any child, provided such contract does not contain any provision for the exercise by the insured of an option to receive cash payments in lieu of the payment of the annuity.

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It is pertinent to note here that a contract for a deferred annuity need not necessarily be with an insurance company. It follows therefore that such a contract can be entered into with any person.

(v) Any sum deducted from the salary payable of a Government employee for securing a deferred annuity

Amount deducted by or on behalf of the Government from the salary of a Government employee in accordance with the conditions of his service for securing a deferred annuity or making provisions for his spouse or children. The excess, if any, over one-fifth of the salary is to be ignored.

(vi) Contribution to SPF/PPF/RPF

Contributions to any provident fund to which the Provident Funds Act, 1925 applies and recognized provident fund qualifies for deduction under section 80C.

Contribution made to any Provident Fund set up by the Central Government and notified in his behalf (i.e., the Public Provident Fund established under the Public Provident Fund Scheme, 1968) also qualifies for deduction under section 80C. Such contribution can be made in the name of the individual, his spouse and any child of the individual, and any member of the family, in case of a HUF. The maximum limit for deposit in PPF is ₹ 1,50,000 in a year.

ILLUSTRATION 4

An individual assessee, resident in India, has made the following deposit/payment during the previous year 2025-26:

Particulars	*₹*
Contribution to the public provident fund	*1,50,000*
Insurance premium paid on the life of the spouse (policy taken on 1.4.2019) (Assured value ₹ 3,00,000)	*36,000*

What is the deduction allowable under section 80C for A.Y.2026-27 if the assessee has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)?

SOLUTION

Computation of deduction under section 80C for A.Y.2026-27

Particulars	₹
Deposit in public provident fund	1,50,000

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Insurance premium paid on the life of the spouse (Maximum 10% of the assured value ₹ 3,00,000, as the policy is taken after 31.3.2012)	30,000
Total	**1,80,000**
However, the maximum permissible deduction u/s 80C is restricted to	1,50,000

(vii) Contribution to approved superannuation Fund

Contribution by an employee to an approved superannuation fund qualifies for deduction under section 80C.

(viii) Any sum paid or deposited in Sukanya Samridhi Account

Subscription to any such security of the Central Government or any such deposit scheme as the Central Government as may notify in the Official Gazette. Accordingly, Sukanya Samriddhi Scheme has been notified to provide that any sum paid or deposited during the previous year in the said Scheme, by an individual in the name of –

(a) any girl child of the individual; or

(b) any girl child for whom such individual is the legal guardian

would be eligible for deduction under section 80C.

Exemption on payment from Sukanya Samriddhi Account [Section 10(11A)]

Section 10(11A) provides that any payment from an account opened in accordance with the Sukanya Samriddhi Account Rules, 2014, made under the Government Savings Bank Act, 1873, shall **not** be included in the total income of the assessee. Accordingly, the interest accruing on deposits in, and withdrawals from any account under the said scheme would be exempt.

(ix) Subscription to National Savings Certificates VIII

Subscription to any Savings Certificates under the Government Savings Certificates Act, 1959 notified by the Central Government in the Official Gazette (i.e. National Savings Certificate (VIII Issue) issued under the Government Savings Certificates Act, 1959).

(x) Contribution to approved annuity plan of LIC

Contributions to approved annuity plans of LIC (New Jeevan Dhara and New Jeevan Akshay, New Jeevan Dhara I and New Jeevan Akshay I, II and III) or any other insurer (Tata AIG

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Easy Retire Annuity Plan of Tata AIG Life Insurance Company Ltd.) as the Central Government may, by notification in the Official Gazette, specify in this behalf.

(xi) Subscription towards notified units of mutual fund or UTI

Subscription to any units of any mutual fund referred to in section 10(23D) or from the Administrator or the specified company under any plan formulated in accordance with such scheme notified by the Central Government;

(xii) Contribution to notified pension fund set up by mutual fund or UTI

Contribution by an individual to a pension fund set up by any Mutual Fund referred to in section 10(23D) or by the Administrator or the specified company as the Central Government may specify (i.e., UTI-Retirement Benefit Pension Fund set up by the specified company referred to in section 2(h) of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 as a pension fund).

"Specified company" means a company formed and registered under the Companies Act, 1956[1] and whose entire capital is subscribed by such financial institutions or banks as may be specified by the Central Government, by notification in the Official Gazette, for the purpose of transfer and vesting of the undertaking

"Administrator" means a person or a body of persons appointed as Administrator by the Central Government. The Central Government shall appoint a person or a body of persons, as the "Administrator of the specified undertaking of the Unit Trust of India" for the purpose of taking over the administration thereof and the Administrator shall carry on the management of the specified undertaking of the Trust for and on behalf of the Central Government.

"Specified undertaking" includes all business, assets, liabilities and properties of the Trust representing and relatable to the schemes and Development Reserve Fund.

(xiii) Contribution to National Housing Bank (Tax Saving) Term Deposit Scheme, 2008

Subscription to any deposit scheme or contribution to any pension fund set up by the National Housing Bank i.e., National Housing Bank (Tax Saving) Term Deposit Scheme, 2008.

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[1] *Now Companies Act, 2013*

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(xiv) Subscription to notified deposit scheme

Subscription to any such deposit scheme of

- a public sector company which is engaged in providing long-term finance for construction, or purchase of houses in India for residential purposes or
- any such deposit scheme of any authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages or for both.

The deposit scheme should be notified by the Central Government, for example, public deposit scheme of HUDCO.

(xv) Payment of tuition fees to any university, college, school or other educational institutions within India for full-time education for maximum 2 children

Payment of tuition fees by an individual assessee at the time of admission or thereafter to any university, college, school or other educational institutions within India for the purpose of full-time education of any **two children** of the individual. This benefit is only for the amount of tuition fees for full-time education and shall not include any payment towards development fees or donation or payment of similar nature and payment made for education to any institution situated outside India.

(xvi) Repayment of housing loan including stamp duty, registration fee and other expenses

Any payment made towards the **cost of purchase or construction** of a new residential house property. The income from such property –

(1) should be chargeable to tax under the head "Income from house property";

(2) would have been chargeable to tax under the head "Income from house property" had it not been used for the assessee's own residence.

The approved types of payments are as follows:

(1) Any instalment or part payment of the amount due under any self-financing or other schemes of any development authority, Housing Board or other authority engaged in the construction and sale of house property on ownership basis; or

(2) Any instalment or part payment of the amount due to any company or a cooperative society of which the assessee is a shareholder or member towards the cost of house allotted to him; or

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(3) Repayment of amount borrowed by the assessee from:

(a) The Central Government or any State Government;

(b) Any bank including a co-operative bank;

(c) The Life Insurance Corporation;

(d) The National Housing Bank;

(e) Any public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes which is eligible for deduction under section 36(1)(viii);

(f) Any company in which the public are substantially interested or any cooperative society engaged in the business of financing the construction of houses;

(g) The assessee's employer, where such employer is an authority or a board or a corporation or any other body established or constituted under a Central or State Act;

(h) The assessee's employer where such employer is a public company or public sector company or a university established by law or a college affiliated to such university or a local authority or a co-operative society.

(4) Stamp duty, registration fee and other expenses for the purposes of transfer of such house property to the assessee.

Inadmissible payments: However, the following amounts do not qualify for rebate:

(1) admission fee, cost of share and initial deposit which a shareholder of a company or a member of a co-operative society has to pay for becoming a shareholder or member; or

(2) the cost of any addition or alteration or renovation or repair of the house property after the issue of completion certificate in respect of the house property or after the house has been occupied by the assessee or any person on his behalf or after it has been let out; or

(3) any expenditure in respect of which deduction is allowable under section 24.

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(xvii) Subscription to certain equity shares or debentures

Subscription to equity shares or debentures forming part of any eligible issue of capital approved by the Board on an application made by a public company or as subscription to any eligible issue of capital by any public financial institution in the prescribed form.

A lock-in period of three years is provided in respect of such equity shares or debentures. In case of any sale or transfer of shares or debentures within three years of the date of acquisition, the aggregate amount of deductions allowed in respect of such equity shares or debentures in the previous year or years preceding the previous year in which such sale or transfer has taken place shall be deemed to be the income of the assessee of such previous year and shall be liable to tax in the assessment year relevant to such previous year.

A person shall be treated as having acquired any shares or debentures on the date on which his name is entered in relation to those shares or debentures in the register of members or of debenture-holders, as the case may be, of the public company.

(xviii) Subscription to certain units of mutual fund

Subscription to any units of any mutual fund referred to in section 10(23D) and approved by the Board on an application made by such mutual fund in the prescribed form.

It is necessary that such units should be subscribed only in the eligible issue of capital of any company.

Eligible issue of capital for (xvii) and (xviii) means an issue made by a public company formed and registered in India or a public financial institution and the entire proceeds of the issue are utilised wholly and exclusively for the purposes of any business referred to in section 80-IA(4).

(xix) Investment in five year Term Deposit

Investment in term deposit -

(1) for a period of not less than five years with a scheduled bank; and

(2) which is in accordance with a scheme framed and notified by the Central Government in the Official Gazette

qualifies as an eligible investment for availing deduction under section 80C.

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The maximum limit for investment in term deposit is ₹ 1,50,000.

Scheduled bank means -

(1) the State Bank of India

(2) a subsidiary bank of SBI, or

(3) a corresponding new bank constituted under section 3 of the -

(a) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, or

(b) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, or

(4) any other bank, being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934.

(xx) Subscription to notified bonds issued by NABARD

Subscription to such bonds issued by NABARD (as the Central Government may notify in the Official Gazette) qualifies for deduction under section 80C.

(xxi) Deposit in Senior Citizens Savings Scheme Rules, 2004

Deposit in an account under the Senior Citizens Savings Scheme Rules, 2004 qualifies for deduction under section 80C.

(xxii) Investment in five year Post Office time deposit

Investment in five year time deposit in an account under Post Office Time Deposit Rules, 1981 qualifies for deduction under section 80C.

(xxiii) Contribution to additional account under NPS

Contribution by a Central Government employee to additional account under NPS (specified account) referred to in section 80CCD for a fixed period of not less than 3 years and which is in accordance with the scheme[2] notified by the Central Government for this purpose qualifies for deduction under section 80C. It may be noted that only the contribution to the **additional account under NPS** will qualify for deduction under section 80C.

There are two types of NPS account i.e., Tier I and Tier II, to which an individual can contribute. Section 80CCD provides deduction in respect of contribution to individual pension

[2] *National Pension Scheme Tier II- Tax Saver Scheme, 2020 notified for this purpose.*

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account [Tier I account] under the NPS [referred to in section 20(2)(a) of the Pension Fund Regulatory and Development Authority Act, 2013 (PFRDA)] whereas deduction under section 80C is allowable in respect of contribution by Central Government employee to additional account [Tier II account] of NPS [referred to in section 20(3) of the PFRDA], which does not qualify for deduction under section 80CCD. **Thus, Tier II account is the additional account under NPS, contribution to which would qualify for deduction under section 80C only in the hands of a Central Government employee.**

Termination of Insurance Policy or Unit Linked Insurance Plan or transfer of House Property or withdrawal of deposit:

Where, in any previous year, an assessee:

(1) terminates his contract of insurance referred to in (iii) above, by notice to that effect or where the contract ceases to be in force by reason of not paying the premium, by not reviving the contract of insurance, -

(a) in case of any single premium policy, within two years after the date of commencement of insurance; or

(b) in any other case, before premiums have been paid for two years; or

(2) terminates his participation in any Unit Linked Insurance Plan referred to in (i) or (ii) above, by notice to that effect or where he ceases to participate by reason of failure to pay any contribution, by not reviving his participation, before contributions in respect of such participation have been paid for five years, or

(3) transfers the house property referred to in (xvi) above, before the expiry of five years from the end of the financial year in which possession of such property is obtained by him, or receives back, whether by way of refund or otherwise, any sum specified in (xvi) above,

then, no deduction will be allowed to the assessee in respect of sums paid during such previous year and the total amount of deductions of income allowed in respect of the previous year or years preceding such previous year, shall be deemed to be income of the assessee of such previous year and shall be liable to tax in the assessment year relevant to such previous year.

Further, where any amount is withdrawn by the assessee from his account under the Senior Citizens Savings Scheme or under the Post Office Time Deposit Rules before the expiry of a period of 5 years from the date of its deposit, the amount so withdrawn shall be deemed to be the income of the assessee of the previous year in which the amount is withdrawn. Accordingly, the amount so withdrawn would be chargeable to tax in the assessment year relevant to such previous year. The

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amount chargeable to tax would also include that part of the amount withdrawn which represents interest accrued on the deposit.

However, if any part of the amount relating to interest so received or withdrawn has been subject to tax in any of the earlier years, such amount shall not be taxed again.

If any amount has been received by the nominee or legal heir of the assessee, on the death of such assessee, the amount would not be chargeable to tax. But if the amount relating to interest on deposit was not included in the total income of the assessee in any of any earlier years, then such interest would be chargeable to tax.

ILLUSTRATION 5

Mr. Binu, aged about 40 years, has earned a lottery income of ₹ 1,30,000 (gross) during the P.Y. 2025-26. He also has interest on Fixed Deposit of ₹ 35,000. He invested an amount of ₹ 20,000 in Public Provident Fund account and ₹ 34,000 in five years term deposit. What is the total income of Mr. Binu for the A.Y.2026-27 if he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)?

SOLUTION

Computation of total income of Mr. Binu for A.Y.2026-27

Particulars	₹	₹
Income from Other Sources		
- Interest on Fixed Deposit		35,000
- Lottery income		1,30,000
Gross Total Income		**1,65,000**
Less: **Deductions under Chapter VIA [See Note below]**		
Under section 80C		
- Deposit in Public Provident Fund	20,000	
- Investment in five years term deposit	34,000	
	54,000	
Restricted to		35,000
Total Income		**1,30,000**

Note: *Though the value of eligible investments is ₹ 54,000, however, deduction under Chapter VI-A cannot exceed the gross total income exclusive of long term capital gains u/s 112/112A, short-term capital gains covered under section 111A, winnings of lotteries etc. of the assessee.*

Therefore, the maximum permissible deduction u/s 80C = ₹ 1,65,000 – ₹ 1,30,000 = ₹ 35,000.

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(2) Deduction in respect of contribution to certain pension funds [Section 80CCC]

(i) **Eligible assessee -** Where an assessee, being an individual, has in the previous year paid or deposited any amount out of his income chargeable to tax to effect or keep in force a contract for any **annuity plan of LIC** of India or any **other insurer** for receiving pension from the fund set up by LIC or such other insurer, he shall be allowed a deduction in the computation of his total income.

For this purpose, the interest or bonus accrued or credited to the assessee's account shall not be reckoned as contribution.

Note: Where any amount paid or deposited by the assessee has been taken into account for the purposes of this section, a deduction under section 80C shall not be allowed with reference to such amount.

(ii) **Maximum Deduction:** The maximum permissible deduction is ₹ 1,50,000 [Further, the overall limit of ₹ 1,50,000 prescribed in section 80CCE will continue to be applicable i.e. the maximum permissible deduction under sections 80C, 80CCC and 80CCD(1) put together is ₹ 1,50,000].

(iii) **Deemed Income:** Where any amount standing to the credit of the assessee in the fund in respect of which a deduction has been allowed, together with interest or bonus accrued or credited to the assessee's account is received by the assessee or his nominee on account of the surrender of the annuity plan in any previous year or as pension received from the annuity plan, such amount will be deemed to be the income of the assessee or the nominee in that previous year in which such withdrawal is made or pension is received. It will be chargeable to tax as income of that previous year.

Note - *The deduction under section 80CCC is available only to an individual exercising the option of shifting out of the default tax regime provided under section 115BAC(1A). It is not available under the default tax regime under section 115BAC.*

(3) Deduction in respect of contribution to pension scheme notified by the Central Government [Section 80CCD]

(i) **Pension Scheme of Central Government:** As per the "Restructured Defined Contribution Pension System" applicable to new entrants to Government service, it is mandatory for persons entering the service of the Central Government on or after 1st January, 2004, to contribute 10% of their salary every month towards their pension account. A matching

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contribution is required to be made by the Government to the said account. The benefit of this scheme is also available to individuals employed by any other employer as well as to self-employed individuals.

(ii) Deduction: Section 80CCD provides deduction in respect of contribution made to the pension scheme notified by the Central Government.

Accordingly, in exercise of the powers conferred by section 80CCD(1), the Central Government has notified the 'Atal Pension Yojana (APY)' as a pension scheme, contribution to which would qualify for deduction under section 80CCD in the hands of the individual.

(iii) Quantum of deduction

(a) Section 80CCD(1) provides a deduction for the amount paid or deposited by an employee in his pension account subject to a maximum of 10% of his salary. The deduction in the case of a self-employed individual would be restricted to 20% of his gross total income in the previous year.

Note - *Deduction u/s 80CCD(1) would be available to an individual only if he exercises the option of shifting out of the default tax regime u/s 115BAC(1A) (i.e., if he pays tax under the optional tax regime i.e., the normal provisions of the Act).*

Deduction under section 80CCD(1)

(b) Section 80CCD(1B) provides for an additional deduction of up to ₹ 50,000 in respect of the whole of the amount paid or deposited by an individual assessee under NPS in the previous year, whether or not any deduction is allowed under section 80CCD(1).

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Note - *Deduction u/s 80CCD(1B) would be available to an individual only if he exercises the option of shifting out of the default tax regime provided u/s 115BAC(1A) (i.e., it is available only if he pays tax under the optional tax regime – the normal provisions of the Act)*

(c) Whereas the deduction under section 80CCD(1) is subject to the overall limit of ₹ 1.50 lakh under section 80CCE (i.e., the maximum permissible deduction under sections 80C, 80CCC and 80CCD(1) put together is ₹ 1,50,000), the deduction of upto ₹ 50,000 under section 80CCD(1B) is in addition to the overall limit of ₹ 1.50 lakh provided under section 80CCE.

(d) Under section 80CCD(2), contribution made by the Central Government or State Government or any other employer in the previous year to the said account of an employee, is allowed as a deduction in computation of the total income of the assessee.

(e) The entire employer's contribution would be included in the salary of the employee. However, deduction under section 80CCD(2) would be restricted to,

- In case of contribution made by the Central Government or State Government - 14% of salary and
- In case of contribution made by any other employer - 10% of salary (14% of salary in case assessee is paying tax as per default tax regime under section 115BAC).

Notes:

1. Deduction u/s 80CCD(2) would be available to an individual irrespective of the regime under which he pays tax.
2. The limit of ₹ 1,50,000 under section 80CCE does not apply to employer's contribution to pension scheme of Central Government which is allowable as deduction under section 80CCD(2).
3. No deduction will be allowed u/s 80C in respect of amounts paid or deposited by the assessee, for which deduction has been allowed u/s 80CCD(1) or 80CCD(1B).
4. For computation of limit under section 80CCD(1) and (2), salary includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.

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(iv) ***Deduction for contribution made to NPS Vatsalya Scheme:*** *NPS Vatsalya is a NPS Scheme designed for minor Indian citizen upto the age of 18 years. The account will be opened and operated by the guardian on behalf of the minor. When the minor attains the age of 18 years, the account will continue to be operational and will be shifted into a NPS Tier-I Account.*

Deduction under section 80CCD(1B) is allowed for any amount paid or deposited in the account of minor under the pension scheme by the assessee, being the parent or guardian of such minor. However, the aggregate amount of deduction under section 80CCD(1B) shall not exceed ₹ 50,000.

(v) **Deemed income:** The amount standing to the credit of the *assessee or a minor, in his or a minor's pension account* (for which deduction has already been claimed by him under this section) and accretions to such account, shall be taxed as income in the year in which such amounts are received by the assessee or his nominee on -

(a) closure of the account or

(b) his opting out of the said scheme or

(c) receipt of pension from the annuity plan purchased or taken on such closure or opting out.

However, the amount received by the nominee on the death of the assessee under the circumstances referred to in (a) and (b) above, shall not be deemed to be the income of the nominee.

It is further provided that the amount received by a person, being the parent or guardian or nominee of a minor, shall not be deemed to be the income of such person if such amount is received on account of closure of pension scheme due to the death of minor.

Further, 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.

Notes:

1. ***Exemption on payment from NPS Trust to an assessee on closure of his account or on his opting out of the pension scheme [Section 10(12A)]***

   (i) As per section 80CCD, any payment from National Pension System Trust to an assessee on account of closure or his opting out of the pension scheme is chargeable to tax.

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(ii) Section 10(12A) provides that any payment from National Pension System Trust to an assessee on account of closure or his opting out of the pension scheme referred to in section 80CCD, to the extent it does not exceed **60%** of the total amount payable to him at the time of closure or his opting out of the scheme, shall be exempt from tax.

2. ***Exemption on payment from NPS Trust to an employee on partial withdrawal [Section 10(12B)]***

To provide relief to an employee subscriber of NPS, section 10(12B) provides that any payment from National Pension System Trust **to an employee** under the pension scheme referred to in section 80CCD, on partial withdrawn made out of his account in accordance with the terms and conditions specified under the Pension Fund Regulatory and Development Authority Act, 2013 and the regulations made there under, shall be exempt from tax to the extent it does not exceed **25%** of amount of contributions made by him.

3. ***Exemption on payment from NPS Trust to an assessee, being the parent or guardian of minor on partial withdrawal [Section 10(12BA)]***

*Section 10(12BA) provides that any payment from National Pension System Trust **to an assessee, being the parent or guardian of minor** under the pension scheme referred to in section 80CCD, on partial withdrawn made out of minor's account in accordance with the terms and conditions specified under the Pension Fund Regulatory and Development Authority Act, 2013 and the regulations made there under, shall be exempt from tax to the extent it does not exceed 25% of amount of contributions made by him.*

(vi) ***Unified Pension Scheme:*** *The Unified Pension Scheme (UPS) has been introduced **as an option** under the National Pension System (NPS) by the Central Government for the Central Government employees covered under NPS so that they may receive an assured payout after their retirement.*

It is a 'fund-based' payout system which relies on the regular and timely accumulation and investment of applicable contributions (from both the employee and the employer (the Central Government) for grant of monthly payout to the retiree.

To align the tax treatment of the UPS with the NPS, Taxation Law (Amendment) Act, 2025 has inserted sub-section (3A) and (6) in section 80CCD and clause (12AA) and (12AB) in section 10.

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Section 80CCD(3A) provides that the amount standing to the credit of the assessee, being a subscriber to the UPS, in his account (for which deduction has already been claimed by him under this section) and accretions to such account, received by the assessee or his nominee, in whole or part in any previous year on account of his superannuation or voluntary retirement or retirement under Rule 56(j) of the Fundamental Rules (not treated as penalty) shall be deemed to be the income of the assessee or his nominees and taxed in the year in which such amounts are received.

However, the assessee shall be deemed not to have received any amount in the previous year if such amount is transferred to the pool corpus from individual corpus on account of his superannuation, voluntary retirement or retirement. [Section 80CCD(6)].

Exemption on payment from NPS Trust to an assessee, being a subscriber to the UPS, at the time of his superannuation or voluntary retirement or retirement [Section 10(12AA)]

Any payments from the NPS Trust to an assessee, being a subscriber to the UPS, at the time of superannuation, voluntary retirement or retirement, to the extent it does not exceed 60% of the individual's corpus, shall be exempt from income tax.

Exemption on lumpsum amount received by an assessee, being a subscriber to the UPS [Section 10(12AB)]

Any sum received as a lump sum amount as per clause (vi) of paragraph 2 of the notification number FX-1/3/2024-PR, dated the 24th January, 2025, of the Department of Financial Services, by an assessee being a subscriber to the Unified Pension Scheme shall be exempt from tax.

As per clause (vi) of paragraph 2 of the notification number FX-1/3/2024-PR, dated the 24th January, 2025, of the Department of Financial Services, a lump sum payment will be allowed on superannuation at the rate of 10% of monthly emoluments (Basic Pay + Dearness Allowance) for every completed six months of qualifying service.

(4) Limit on deductions under sections 80C, 80CCC & 80CCD(1) [Section 80CCE]

This section restricts the aggregate amount of deduction under section 80C, 80CCC and 80CCD(1) to ₹ 1,50,000. It may be noted that the deduction of upto ₹ 50,000 under section 80CCD(1B) and employer's contribution to pension scheme, allowable as deduction under section 80CCD(2) in the hands of the employee, would be outside the overall limit of ₹ 1,50,000 stipulated under section 80CCE.

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The following table summarizes the ceiling limit under these sections –

Section	Particulars	Ceiling limit (₹)
80C	Investment in LIP, Deposit in PPF/SPF/RPF etc.	1,50,000
80CCC	Contribution to certain pension funds	1,50,000
80CCD(1)	Contribution to NPS of Government	10% of salary **or** 20% of GTI, as the case may be.
80CCE	Aggregate deduction under sections 80C, 80CCC & 80CCD(1)	1,50,000
80CCD(1B)	Contribution to NPS notified by the Central Government (outside the limit of ₹ 1,50,000 under section 80CCE)	50,000
80CCD(2)	Contribution by the Central Government or State Government to NPS A/c of its employees (outside the limit of ₹ 1,50,000 under section 80CCE)	14% of salary
	Contribution by any other employer to NPS A/c of its employees (outside the limit of ₹ 1,50,000 under section 80CCE)	
	- Where assessee is paying tax as per optional tax regime	10% of salary
	- where assessee is paying tax as per default regime u/s 115BAC(1A)	14% of salary

ILLUSTRATION 6

The basic salary of Mr. Arjun is ₹ 1,00,000 p.m. He is entitled to dearness allowance, which is 40% of basic salary. 50% of dearness allowance forms part of pay for retirement benefits. Both Mr. Arjun and his employer contribute 15% of basic salary to the pension scheme referred to in section 80CCD. Examine the tax treatment in respect of such contribution in the hands of Mr. Arjun if he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

What would be your answer if Mr. Arjun pays tax under the default tax regime under section 115BAC?

SOLUTION

(i) Tax treatment in the hands of Mr. Arjun in respect of employer's and own contribution to pension scheme referred to in section 80CCD, where Mr. Arjun has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A) [i.e., where Mr. Arjun pays tax under the normal provisions of the Act]

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(a) Employer's contribution to such pension scheme would be treated as salary since it is specifically included in the definition of "salary" under section 17(1)(viii). Therefore, ₹ 1,80,000, being 15% of basic salary of ₹ 12,00,000, will be included in Mr. Arjun's salary.

(b) Mr. Arjun's contribution to pension scheme is allowable as deduction under section 80CCD(1). However, the deduction is restricted to 10% of salary. Salary, for this purpose, means basic pay plus dearness allowance, if it forms part of pay for retirement benefits.

Therefore, deduction under section 80CCD for Mr. Arjun would be –

Particulars	₹
Basic salary = ₹ 1,00,000 × 12 =	12,00,000
Dearness allowance = 40% of ₹ 12,00,000 = ₹ 4,80,000	
50% of Dearness Allowance forms part of pay = 50% of ₹ 4,80,000	2,40,000
Salary for the purpose of deduction under section 80CCD	**14,40,000**
Deduction under section 80CCD(1) is restricted to 10% of ₹ 14,40,000 (as against actual contribution of ₹ 1,80,000, being 15% of basic salary of ₹ 12,00,000)	1,44,000
As per section 80CCD(1B), a further deduction of upto ₹ 50,000 is allowable. Therefore, deduction under section 80CCD(1B) is ₹ 36,000 (₹ 1,80,000 - ₹ 1,44,000).	36,000

₹ 1,44,000 is allowable as deduction under section 80CCD(1). This would be taken into consideration and be subject to the overall limit of ₹ 1,50,000 under section 80CCE. ₹ 36,000 allowable as deduction under section 80CCD(1B) is outside the overall limit of ₹ 1,50,000 under section 80CCE.

In the alternative, ₹ 50,000 can be claimed as deduction under section 80CCD(1B). The balance ₹ 1,30,000 (₹ 1,80,000 - ₹ 50,000) can be claimed as deduction under section 80CCD(1).

(c) Employer's contribution to pension scheme would be allowable as deduction under section 80CCD(2), subject to a maximum of 10% of salary. Therefore, deduction under section 80CCD(2), would also be restricted to ₹ 1,44,000, even though the entire employer's contribution of ₹ 1,80,000 is included in salary under section 17(1)(viii). However, this deduction of employer's contribution of ₹ 1,44,000 to pension scheme would be outside the overall limit of ₹ 1,50,000 under section 80CCE i.e., this deduction would be over and above the other deductions which are subject to the limit of ₹ 1,50,000.

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(ii) Where Mr. Arjun pays tax under the default tax regime under section 115BAC

Mr. Arjun would not be eligible for deduction under section 80CCD(1)/(1B) in respect of his contribution to pension scheme under the default tax regime under section 115BAC. However, he would be allowed deduction of upto ₹ 2,01,600 being 14% of salary [₹ 14,40,000, computed in (i) above] under section 80CCD(2) in respect of employer's contribution to pension scheme. Accordingly, entire employer's contribution of ₹ 1,80,000 would be allowed as deduction under section 80CCD(2).

ILLUSTRATION 7

The gross total income of Mr. Neeraj for the A.Y.2026-27 is ₹ 9,00,000. He has made the following investments/ payments during the F.Y.2025-26 –

	Particulars	*₹*
(1)	*Contribution to PPF*	*1,30,000*
(2)	*Payment of tuition fees to Sunrise School, Mumbai, for education of his son studying in Class X*	*95,000*
(3)	*Repayment of housing loan taken from Canara Bank*	*30,000*
(4)	*Contribution to approved pension fund of LIC*	*1,05,000*

Compute the eligible deduction under Chapter VI-A for the A.Y.2026-27 if Mr. Neeraj exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

Computation of deduction under Chapter VI-A for the A.Y.2026-27

Particulars	₹
Deduction under section 80C	
- Contribution to PPF	1,30,000
- Payment of tuition fees to Sunrise School, Mumbai, for education of his son studying in Class X	95,000
- Repayment of housing loan	30,000
	2,55,000
Restricted to ₹ 1,50,000, being the maximum permissible deduction u/s 80C	1,50,000
Deduction under section 80CCC	
- Contribution to approved pension fund of LIC	1,05,000
	2,55,000

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As per section 80CCE, the aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1,50,000	
Deduction allowable under Chapter VIA for the A.Y.2026-27	**1,50,000**

(5) Deduction in respect of contribution to Agnipath Scheme [Section 80CCH]

(i) **Meaning of Agnipath scheme:** Agnipath scheme is a Central Government scheme launched in 2022 for enrolment of Indian youth in the Indian Armed Forces.

(ii) **Meaning of Agniveer Corpus Fund:** The Agniveer Corpus Fund means a fund in which consolidated contributions of all the Agniveers and matching contributions of the Central Government along with interest on both these contributions are held.

(iii) **Features of the Agnipath Scheme:** Each Agniveer is to contribute 30% of his monthly customized Agniveer Package to the individual's Agniveer Corpus Fund. Further, the Government will also contribute a matching amount to the 'Agniveer Corpus Fund'. The Government will also pay to the subscriber interest as approved from time to time on the contributions standing in his account.

(iv) **Quantum of deduction:**

(a) Section 80CCH(1) provides a deduction for the amount paid or deposited by an assessee, being an individual enrolled in the Agnipath Scheme and subscribing to the Agniveer Corpus Fund on or after 1.11.2022, in his account in the Agniveer Corpus Fund.

Note - *Deduction u/s 80CCH(1) would be available to an individual only if he has exercised the option of shifting out of the default tax regime provided u/s 115BAC(1A).*

(b) Under section 80CCH(2), the whole amount of contribution made by the Central Government to the said account of an assessee in the Agniveer Corpus Fund, is allowed as a deduction in computation of the total income of the assessee.

(e) The entire Central Government's contribution to the Agniveer Corpus Fund would be included in the salary of the assessee. However, deduction under section 80CCH(2) would be available for the same.

Note - *Deduction u/s 80CCH(2) would be available to an individual irrespective of the regime under which he pays tax.*

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Exemption on payment from Agnipath Corpus Fund to a person enrolled under the Agnipath Scheme or to his nominee [Section 10(12C)]

Any payment from the Agnipath Corpus Fund to a person enrolled under the Agnipath Scheme or to his nominee would be exempt from tax.

(6) Deduction in respect of medical insurance premium [Section 80D]

(i) In case of an Individual

(a) **Deduction in respect of insurance premium paid for family:** A deduction to the extent of ₹ 25,000 is allowed in respect of the following payments–

(1) premium paid to effect or keep in force an insurance on the health of self, spouse and dependant children or

(2) any contribution made to the Central Government Health Scheme or

(3) such other health scheme as may be notified by the Central Government. Contributory Health Service Scheme of the Department of Atomic Energy has been notified by the Central Government.

(b) **Deduction in respect of insurance premium for parents:** A further deduction up to ₹ 25,000 is allowable to effect or to keep in force an insurance on the health of parents of the assessee.

Quantum of deduction in case of senior citizen: An increased deduction of **₹ 50,000** (instead of ₹ 25,000) shall be allowed in case any of the persons mentioned above is a **senior citizen** i.e., an individual resident in India of the age of 60 years or more at any time during the relevant previous year.

(c) **Deduction in respect of payment towards preventive health check-up:** Section 80D provides that deduction to the extent of ₹ 5,000 shall be allowed in respect payment made on account of preventive health check-up of self, spouse, dependant children or parents made during the previous year. However, the said deduction of ₹ 5,000 is within the overall limit of ₹ 25,000 or **₹ 50,000**, specified in (a) and (b) above.

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(d) **Mode of payment:** For claiming such deduction under section 80D, the payment can be made:

(1) by any mode, including cash, in respect of any sum paid on account of preventive health check-up;

(2) by any mode other than cash, in all other cases.

(e) **Deduction for medical expenditure incurred on senior citizens:** As a welfare measure towards **senior citizens** i.e., person of the age of 60 years or more and resident in India, who are unable to get health insurance coverage, deduction of upto **₹ 50,000** would be allowed in respect of any payment made on account of medical expenditure in respect of a such person(s), if no payment has been made to keep in force an insurance on the health of such person(s).

'Senior citizen' means an individual resident in India who is of the age of 60 years or more at any time during the relevant previous year.

(ii) In case of a HUF

Deduction under section 80D is allowable in respect of premium paid to insure the health of any member of the family. The maximum deduction available to a HUF would be ₹ 25,000 and in case any member is a senior citizen, **₹ 50,000**.

Further, the amount paid on account of medical expenditure incurred on the health of any member(s) of a family who is a **senior citizen** would qualify for deduction subject to a maximum of **₹ 50,000** provided no amount has been paid to effect or keep in force any insurance on the health of such person(s).

(iii) Other conditions

The other conditions to be fulfilled are that such premium should be paid by any mode, other than cash, in the previous year out of his income chargeable to tax. Further, the medical insurance should be in accordance with a scheme made in this behalf by -

(a) the General Insurance Corporation of India and approved by the Central Government in this behalf; or

(b) any other insurer and approved by the Insurance Regulatory and Development Authority.

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The following table summarizes the provisions of section 80D –

S. No.	Nature of payment/ expenditure	Expenditure on behalf of	Deduction
I	(i) Any premium paid, otherwise than by way of cash, to keep in force an insurance on the health (ii) Contribution to Central Government Health Scheme (CGHS) (iii) Preventive health check up expenditure	In case of individual: Self, spouse and dependent children In case of HUF: Family member In case any of the above persons is of the age of 60 years or more (+) resident in India	₹ 25,000 ₹ 50,000
II	(i) Any premium paid, otherwise than by way of cash, to keep in force an insurance on the health (ii) Preventive health check up	In case either or both the parents is of the age of 60 years or more + Resident in India Parents	₹ 25,000 ₹ 50,000
Maximum ₹ 5,000 allowed as deduction for aggregate of preventive health check up expenditure, by any mode including cash, mentioned in I and II (Subject to overall limit of ₹ 25,000 or ₹ 50,000, as the case may be)			
III	Amount paid on account of medical expenditure	For self/ spouse/ parents + who is of the age of 60 years or more + Resident in India + no payment has been made to keep in force an insurance on the health of such person	₹ 50,000

Note: In case the individual or any of his family members is a senior citizen, the aggregate of deduction, in respect of payment of premium, contribution to CGHS and medical expenditure incurred, as specified in **(I) & (III)** above, cannot exceed **₹ 50,000**.

In case one of the parents is a senior citizen who is covered under mediclaim policy and another is also a senior citizen but not covered under mediclaim policy, the aggregate of deduction, in respect of payment of medical insurance premium and medical expenditure incurred, as specified in **(II) & (III)** above, cannot exceed **₹ 50,000**.

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(iv) Deduction where premium for health insurance is paid in lump sum [Section 80D(4A)]

(a) **Appropriate fraction of lump sum premium allowable as deduction:** In a case where mediclaim premium is paid in lumpsum for more than one year by:

(1) an individual, to effect or keep in force an insurance on his health or health of his spouse, dependent children or parents; or

(2) a HUF, to effect or keep in force an insurance on the health of any member of the family,

then, the deduction allowable under this section for each of the relevant previous year would be equal to the appropriate fraction of such lump sum payment.

(b) **Meaning of certain terms**

Term	Meaning
Appropriate fraction	1 ÷ Total number of relevant previous years
Relevant previous year	The previous year in which such lump sum amount is paid; and the subsequent previous year(s) during which the insurance would be in force.

Note - *Deduction under section 80D would be available to an individual/ HUF only if he/it exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

ILLUSTRATION 8

Mr. Ravi, aged 45 years, paid medical insurance premium of ₹ 22,000 during the P.Y.2025-26 to insure his health as well as the health of his spouse. He also paid medical insurance premium of ₹ 47,000 during the year to insure the health of his father, aged 65 years, who is not dependant on him. He contributed ₹ 4,600 to Central Government Health Scheme during the year. He has incurred ₹ 3,000 in cash on preventive health check-up of himself and his spouse and ₹ 4,500 by cheque on preventive health check-up of his father. Compute the deduction allowable under section 80D for the A.Y. 2026-27 if Mr. Ravi has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

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SOLUTION

Deduction allowable under section 80D for the A.Y.2026-27

	Particulars	Actual Payment ₹	Maximum deduction allowable ₹
A.	**Premium paid and medical expenditure incurred for self and spouse**		
	(i) Medical insurance premium paid for self and spouse	22,000	22,000
	(ii) Contribution to CGHS	4,600	3,000
	(iii) Exp. on preventive health check-up of self & spouse	3,000	Nil
		29,600	**25,000**
B.	**Premium paid and medical expenditure incurred for father, who is a senior citizen**		
	(i) Mediclaim premium paid for father, who is over 60 years of age	47,000	47,000
	(ii) Expenditure on preventive health check-up of father	4,500	3,000
		51,500	**50,000**
	Total deduction under section 80D (₹ 25,000 + ₹ 50,000)		75,000

Notes:

(1) The total deduction under A.(i), (ii) and (iii) above should not exceed ₹ 25,000. Therefore, the contribution to CGHS would be restricted to ₹ 3,000 [₹ 25,000 (-) ₹ 22,000] and expenditure on preventive health check-up for self and spouse would be Nil [₹ 25,000 (-) ₹ 22,000 (-) ₹ 3,000].

(2) The total deduction under B. (i) and (ii) above should not exceed ₹ 50,000. Therefore, the expenditure on preventive health check-up for father would be restricted to ₹ 3,000, being [₹ 50,000 (-) ₹ 47,000].

(3) In this case, the total deduction allowed on account of expenditure on preventive health check-up of self, spouse and father is ₹ 3,000, which is less than the maximum permissible limit of ₹ 5,000.

ILLUSTRATION 9

Mr. Yatin, aged 48 years, paid medical insurance premium of ₹ 23,000 during the P.Y.2025-26 to insure his health as well as the health of his spouse and dependant children. He also paid

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medical insurance premium of ₹ 35,000 during the year to insure the health of his mother, aged 71 years, who is not dependant on him. He incurred medical expenditure of ₹ 24,000 on his father, aged 78 years, who is not covered under mediclaim policy. His father is also not dependent upon him. He contributed ₹ 6,500 to Central Government Health Scheme during the year. Compute the deduction allowable under section 80D for the A.Y.2026-27 if Mr. Yatin has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

Deduction allowable under section 80D for the A.Y.2026-27

Particulars			₹
(i)	Medical insurance premium paid for self, spouse and dependent children	₹ 23,000	
(ii)	Contribution to CGHS	₹ 6,500	
		₹ 29,500	
	restricted to		25,000
(iii)	Mediclaim premium paid for mother, who is over 60 years of age	₹ 35,000	
(iv)	Medical expenditure incurred for father, who is over 60 years of age and not covered by any insurance	₹ 24,000	
		₹ 59,000	
	restricted to		50,000
			75,000

(7) Deduction in respect of maintenance including medical treatment of a dependant disabled [Section 80DD]

(i) Eligible assessee: Section 80DD provides deduction to an assessee, who is a resident in India, **being an individual or Hindu undivided family**.

(ii) Payment qualifying for deduction:

(a) Any amount –

- incurred for the medical treatment (including nursing), training and rehabilitation of a dependant, being a person with disability, or
- paid or deposited under a scheme framed in this behalf by the Life Insurance Corporation or any other insurer or the Administrator or the Specified Company

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as referred to in section 2(h) of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002, for the maintenance of a dependant, being a person with disability

qualifies for deduction.

(b) The benefit of deduction under this section is also available to assessees incurring expenditure on maintenance including medical treatment of persons suffering from autism, cerebral palsy and multiple disabilities.

(iii) Quantum of deduction: The quantum of deduction is **₹ 75,000** and in case of severe disability (i.e. person with 80% or more disability) the deduction shall be **₹ 1,25,000**.

(iv) Conditions:

(a) The scheme should provide for payment of annuity or a lump sum amount for the benefit of a dependant, being a person with disability,

I in the event of the death of the individual or member of the HUF, in whose name subscription was made; or

II on attaining the age of 60 years or more by such individual or the member of the HUF, and the payment or deposit to such scheme has been discontinued

and the assessee must nominate 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.

(b) For claiming the deduction, the assessee shall have to furnish a copy of the certificate issued by the medical authority under the Persons with Disability (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 along with the return of income under section 139.

(c) Where the condition of disability requires reassessment, a fresh certificate from the medical authority shall have to be obtained after the expiry of the period mentioned in the original certificate in order to continue to claim the deduction.

(v) Deemed income: If the dependent, being a person with disability, predeceases the individual or the member of HUF, in whose name subscription was made, then, the amount paid or deposited under the said scheme would be chargeable to tax in the hands of the assessee (individual or member of HUF) in the previous year in which such amount is received by him.

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However, such deeming provisions would not apply, to the amount received by the dependant, being a person with disability, before his death, by way of annuity or lump sum under the scheme mentioned in II of (a) above i.e., when the individual or member of HUF attains the age of 60 years or more, and the payment or deposit to such scheme has been discontinued.

(vi) Meaning of "Dependant":

	Assessee	Dependant
(1)	Individual	the spouse, children, parents, brother or sister of the individual who is wholly or mainly dependant on such individual and not claimed deduction under section 80U in the computation of his income
(2)	HUF	a member of the HUF, wholly or mainly dependant on such HUF and not claimed deduction under section 80U in the computation of his income

Note - *Deduction under section 80DD would be available to an individual/HUF only if he/it exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

ILLUSTRATION 10

Mr. Mohan is a resident individual. He deposits a sum of ₹ 60,000 with Life Insurance Corporation every year for the maintenance of his disabled grandfather who is wholly dependant upon him. The disability is one which comes under the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995. A copy of the certificate from the medical authority is submitted. Compute the amount of deduction available under section 80DD for the A.Y. 2026-27 if Mr. Mohan has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

Since the amount deposited by Mr. Mohan was for his grandfather, he will not be allowed any deduction under section 80DD. The deduction is available if the individual assessee incurs any expense for a dependant disabled relative. Grandfather does not come within the meaning of "dependant" as defined under section 80DD.

ILLUSTRATION 11

What will be the deduction if Mr. Mohan had made this deposit for his dependant father?

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SOLUTION

Since the expense was incurred for a dependant disabled relative, Mr. Mohan will be entitled to claim a deduction of ₹ 75,000 under section 80DD, irrespective of the amount deposited. In case his father has severe disability, the deduction would be ₹ 1,25,000.

(8) Deduction in respect of medical treatment etc. [Section 80DDB]

(i) Eligible assessee: This section provides deduction to an assessee, who is resident in India, being an individual and Hindu undivided family. The deduction is available to an individual for medical expenditure incurred on himself or a dependant. It is also available to a Hindu undivided family (HUF) for such expenditure incurred on any of its members.

(ii) Meaning of "Dependant":

	Assessee	Dependant
(1)	Individual	the spouse, children, parents, brother or sister of the individual or any of them, wholly or mainly dependant on such individual for his support and maintenance.
(2)	HUF	a member of the HUF, wholly or mainly dependant on such HUF for his support and maintenance.

(iii) Payment qualifying for deduction: Any amount actually paid for the medical treatment of such disease or ailment as may be specified in the rules made in this behalf by the Board for himself or a dependant, in case the assessee is an individual or for any member of a HUF, in case the assessee is a HUF will qualify for deduction.

(iv) Quantum of deduction: The amount of deduction under this section shall be equal to the amount actually paid or **₹ 40,000**, whichever is less, in respect of that previous year in which such amount was actually paid.

In case the amount is paid in respect of a senior citizen, i.e., a resident individual of the age of 60 years or more at any time during the relevant previous year, then the deduction would be the amount actually paid or **₹ 1,00,000**, whichever is less.

The deduction under this section shall be reduced by the amount received, if any, under insurance from an insurer, or reimbursed by an employer, for the medical treatment of the assessee or the dependant.

(v) Maximum deduction: The maximum limit of deduction under section 80DDB for the various categories of dependant are summarized hereunder:

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	Dependant	Maximum limit (₹)
(1)	A senior citizen, being a resident individual	1,00,000
(2)	Other than a senior citizen	40,000

(vi) **Condition:** No such deduction shall be allowed unless the assessee obtains the prescription for such medical treatment from a neurologist, an oncologist, a urologist, a hematologist, an immunologist or such other specialist, as may be prescribed.

Note - *Deduction under section 80DDB would be available to an individual/HUF only if he/it exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

(9) Deduction in respect of interest loan taken for higher education [Section 80E]

(i) **Eligible assessee:** Section 80E provides deduction to an individual-assessee in respect of any interest on loan paid by him in the previous year out of his income chargeable to tax.

(ii) **Conditions:** The loan must have been taken for the purpose of pursuing his higher education or for the purpose of higher education of his or her relative. The loan must have been taken from any financial institution or approved charitable institution.

(iii) **Meaning of certain terms:**

	Term	Meaning
(a)	**Relative**	Spouse and children of the individual or the student for whom the individual is the legal guardian
(b)	**Higher education**	It means any course of study (including vocational studies) pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorized by the Central Government or State Government or local authority to do so. Therefore, interest on loan taken for pursuing any course after Class XII or its equivalent, will qualify for deduction under section 80E.
(c)	**Period of deduction**	The deduction is allowed in computing the total income in respect of the initial assessment year (i.e., the assessment year relevant to the previous year, in which the assessee starts paying the interest on the loan) and seven assessment years immediately succeeding the initial assessment year or until the interest is paid in full by the assessee, whichever is earlier.

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(d)	**Approved charitable institution**	It means an institution established for charitable purposes and approved by the prescribed authority under section 10(23C) or an institution referred to in section 80G(2)(a).
(e)	**Financial institution**	It means – (a) a banking company to which the Banking Regulation Act, 1949 applies (including a bank or banking institution referred to in section 51 of the Act); or (b) any other financial institution which the Central Government may, by notification in the Official Gazette, specify in this behalf

Note - *Deduction under section 80E would be available to an individual only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

ILLUSTRATION 12

Mr. Gopal has taken three education loans on April 1, 2025, the details of which are given below:

	Loan 1	Loan 2	Loan 3
For whose education loan was taken	*Gopal*	*Son of Gopal*	*Daughter of Gopal*
Purpose of loan	*MBA*	*B. Tech.*	*B.Tech.*
Amount of loan (₹)	*6,00,000*	*3,00,000*	*4,50,000*
Annual repayment of loan (₹)	*1,20,000*	*48,000*	*88,000*
Annual repayment of interest (₹)	*24,000*	*12,000*	*16,000*

Compute the amount deductible under section 80E for the A.Y.2026-27 if Mr. Gopal has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

Deduction under section 80E is available to an individual assessee exercising the option of shifting out of the default tax regime provided under section 115BAC(1A), in respect of any interest paid by him in the previous year in respect of loan taken for pursuing his higher education or higher education of his spouse or children. Higher education means any course of study pursued after senior secondary examination.

Therefore, interest repayment in respect of all the above loans would be eligible for deduction.

Deduction under section 80E = ₹ 24,000 + ₹ 12,000 + ₹ 16,000 = ₹ 52,000.

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(10) Deduction for interest on loan borrowed for acquisition of house property by an individual [Section 80EE]

(i) **Eligible assessee:** An individual who has taken a loan for acquisition of residential house property from any financial institution. Interest payable on such loan would qualify for deduction under this section.

(ii) **Conditions:** The conditions to be satisfied for availing this deduction are as follows –

(iii) **Period of benefit:** The benefit of deduction under this section would be available till the repayment of loan continues.

(iv) **Quantum of deduction:** The maximum deduction allowable is ₹ 50,000. The deduction of upto ₹ 50,000 under section 80EE is over and above the deduction of upto ₹ 2,00,000 available under section 24 for interest paid in respect of loan borrowed for acquisition of a self-occupied property.

(v) **No deduction under any other provision:** The interest allowed as deduction under section 80EE will not be allowed as deduction under any other provision of the Act for the same or any other assessment year.

(vi) **Meaning of certain terms:**

	Term	Meaning
(a)	Financial institution	▪ A banking company to which the Banking Regulation Act, 1949 applies; or ▪ Any bank or banking institution referred to in section 51 of the Banking Regulation Act, 1949; or ▪ A housing finance company.

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(b)	Housing finance company	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.

Note - *Deduction under section 80EE would be available to an individual only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

ILLUSTRATION 13

Mr. Ankur purchased a residential house property for self-occupation at a cost of ₹ 48 lakh on 1.4.2017, in respect of which he took a housing loan of ₹ 35 lakh from Bank of India@11% p.a. on the same date. The loan was sanctioned on 10th March, 2017. Compute the eligible deduction in respect of interest on housing loan for A.Y.2026-27 if Mr. Ankur has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A), assuming that the entire loan was outstanding as on 31.3.2026 and he does not own any other house property.

SOLUTION

Particulars	₹
Interest deduction for A.Y.2026-27	
(i) **Deduction allowable while computing income under the head "Income from house property"**	
Deduction under section 24(b) ₹ 3,85,000 [₹ 35,00,000 × 11%]	
Restricted to	2,00,000
(ii) **Deduction under Chapter VI-A from Gross Total Income**	
Deduction under section 80EE ₹ 1,85,000 (₹ 3,85,000 – ₹ 2,00,000)	
Restricted to	50,000

(11) Deduction in respect of interest payable on loan taken for acquisition of residential house property [Section 80EEA]

(i) **Eligible assessee**: An individual who has taken a loan for acquisition of residential house property from any financial institution. Interest payable on such loan would qualify for deduction under this section.

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(ii) **Conditions:** The conditions to be satisfied for availing this deduction are as follows –

(iii) **Period of benefit:** The benefit of deduction under this section would be available for interest payable for each assessment year.

(iv) **Quantum of deduction:** The maximum deduction allowable is ₹ 1,50,000. The deduction of upto ₹ 1,50,000 under section 80EEA is over and above the deduction available under section 24(b) in respect of interest payable on loan borrowed for acquisition of a residential house property.

(v) **No deduction under any other provision:** The interest allowed as deduction under section 80EEA will not be allowed as deduction under any other provision of the Act for the same or any other assessment year.

(vi) **Meaning of certain terms:**

	Term	Meaning
(a)	Financial institution	• A banking company to which the Banking Regulation Act, 1949 applies; or • Any bank or banking institution referred to in section 51 of the Banking Regulation Act, 1949; or • A housing finance company.
(b)	Housing finance company	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.

Note - *Deduction under section 80EEA would be available to an individual only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

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In case the individual assessee pays tax under default tax regime under section 115BAC

In case the individual assessee has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)

(12) Deduction in respect of interest payable on loan taken for purchase of electric vehicle [Section 80EEB]

(i) **Eligible Assessee**: An individual who has taken a loan for purchase of an electric vehicle from any financial institution. Interest payable on such loan would qualify for deduction under this section.

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(ii) Conditions: The conditions to be satisfied for availing this deduction are as follows –

(iii) Period of benefit: The benefit of deduction under this section would be available for interest payable on such loan for each assessment year.

(iv) Quantum of deduction: Interest payable, subject to a maximum of ₹ 1,50,000.

(v) No deduction under any other provision: The interest allowed as deduction u/s 80EEB will not be allowed as deduction under any other provision of the Act for the same or any other assessment year.

(vi) Meaning of certain terms:

	Term	Meaning
(a)	Financial institution	• A banking company to which the Banking Regulation Act, 1949 applies; or • Any bank or banking institution referred to in section 51 of the Banking Regulation Act, 1949; or • Any deposit taking NBFC • A systemically important non-deposit taking NBFC i.e., a NBFC which is not accepting or holding public deposits and having total assets of not less than ₹ 500 crore as per the last audited balance sheet and is registered with the RBI.
(b)	Electric Vehicle	A vehicle which is powered exclusively by an electric motor whose traction energy is supplied exclusively by traction battery installed in the vehicle. The vehicle should have electric regenerative braking system, which during braking provides for the conversion of vehicle kinetic energy into electrical energy.

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Note - *Deduction under section 80EEB would be available to an individual only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

ILLUSTRATION 14

The following are the particulars relating to Mr. Arun, Mr. Barun, Mr. Chetan and Mr. Dinesh, salaried individuals, for A.Y.2026-27 –

Particulars	Mr. Arun	Mr. Barun	Mr. Chetan	Mr. Dinesh
Amount of loan taken	₹ 43 lakhs	₹ 45 lakhs	₹ 20 lakhs	₹ 12 lakhs
Loan taken from	HFC	Deposit taking NBFC	Deposit taking NBFC	Public sector bank
Date of sanction of loan	1.4.2021	1.4.2020	1.4.2020	30.3.2019
Date of disbursement of loan	1.5.2021	1.5.2020	1.5.2020	1.5.2019
Purpose of loan	Acquisition of residential house property for self-occupation	Acquisition of residential house property for self-occupation	Purchase of electric vehicle for personal use	Purchase of electric vehicle for personal use
Stamp duty value of house property	₹ 45 lakhs	₹ 48 lakhs	-	-
Cost of electric vehicle	-	-	₹ 22 lakhs	₹ 18 lakhs
Rate of interest	9% p.a.	9% p.a.	10% p.a.	10% p.a.

Compute the amount of deduction, if any, allowable under the provisions of the Income-tax Act, 1961 for A.Y.2026-27 in the hands of Mr. Arun, Mr. Barun, Mr. Cehtan and Mr. Dinesh if they have exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). Assume that there has been no principal repayment in respect of any of the above loans upto 31.3.2026.

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SOLUTION

Particulars		₹
Mr. Arun		
Interest deduction for A.Y.2026-27		
(i)	**Deduction allowable while computing income under the head "Income from house property"**	
	Deduction u/s 24(b) ₹ 3,87,000 [₹ 43,00,000 × 9%]	
	Restricted to	2,00,000
(ii)	**Deduction under Chapter VI-A from Gross Total Income**	
	Deduction u/s 80EEA ₹ 1,87,000 (₹ 3,87,000 – ₹ 2,00,000)	
	Restricted to	1,50,000
Mr. Barun		
Interest deduction for A.Y.2026-27		
(i)	**Deduction allowable while computing income under the head "Income from house property"**	
	Deduction u/s 24(b) ₹ 4,05,000 [₹ 45,00,000 × 9%]	
	Restricted to	2,00,000
(ii)	**Deduction under Chapter VI-A**	
	Deduction u/s 80EEA is not permissible since: (i) loan is taken from NBFC (ii) stamp duty value exceeds ₹ 45 lakh. Deduction under section 80EEA would not be permissible due to either violation listed above.	Nil
Mr. Chetan		
Deduction under Chapter VI-A from Gross Total Income		
Deduction u/s 80EEB for interest payable on loan taken for purchase of electric vehicle [₹ 20 lakhs x 10% = ₹ 2,00,000, restricted to ₹ 1,50,000, being the maximum permissible deduction]		1,50,000
Mr. Dinesh		
Deduction under Chapter VI-A from Gross Total Income		
Deduction u/s 80EEB is not permissible since loan was sanctioned before 1.4.2019.		Nil

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(13) Deduction in respect of donations to certain funds, charitable institutions etc. [Section 80G]

(i) **Eligible assessee:** Where an assessee pays any sum as donation to eligible funds or institutions, he is entitled to a deduction, subject to certain limitations, from the gross total income.

> ***Note -*** *In case of an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person, deduction u/s 80G would not be available under the default tax regime under section 115BAC(1A). Deduction under section 80G would be available only if such person has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A) and pays tax as per the optional tax regime under the regular provisions of the Act.*
>
> *In case of companies and co-operative societies, deduction would not be available if they opted for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction would be available only if companies and co-operative societies pay tax under the normal provisions of the Act.*

(ii) **Quantum of deduction:** There are four categories of deductions. The following table gives the details of the institutions and funds to which donations can be made for the purpose of claiming deduction under section 80G, –

I	Donation qualifying for 100% deduction, without any qualifying limit
(1)	The National Defence Fund set up by the Central Government
(2)	Prime Minister's National Relief Fund.
(3)	Prime Minister's Armenia Earthquake Relief Fund
(4)	The Africa (Public Contributions-India) Fund
(5)	The National Children's Fund
(6)	The National Foundation for Communal Harmony
(7)	Approved University or educational institution of national eminence
(8)	Chief Minister's Earthquake Relief Fund, Maharashtra
(9)	Any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of the Gujarat earthquake
(10)	Any Zila Saksharta Samiti for primary education in villages and towns and for literacy and post-literacy activities

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(11)	National Blood Transfusion Council or any State Blood Transfusion Council whose sole objective is the control, supervision, regulation or encouragement of operation and requirements of blood banks
(12)	Any State Government Fund set up to provide medical relief to the poor
(13)	The Army Central Welfare Fund or Indian Naval Benevolent Fund or Air Force Central Welfare Fund established by the armed forces of the Union for the welfare of past and present members of such forces or their dependants.
(14)	The Andhra Pradesh Chief Minister's Cyclone Relief Fund, 1996
(15)	The National Illness Assistance Fund
(16)	The Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund in respect of any State or Union Territory
(17)	The National Sports Development Fund set up by the Central Government
(18)	The National Cultural Fund set up by the Central Government
(19)	The Fund for Technology Development and Application set up by the Central Government
(20)	National Trust for welfare of persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities
(21)	The Swachh Bharat Kosh, set up by the Central Government, other than the sum spent by the assessee in pursuance of CSR u/s 135(5) of the Companies Act, 2013
(22)	The Clean Ganga Fund, set up by the Central Government, where such assessee is a resident, other than the sum spent in pursuance of CSR u/s 135(5) of the Companies Act, 2013
(23)	The National Fund for Control of Drug Abuse constituted under section 7A of the Narcotic Drugs and Psychotroic Substances Act, 1985
(24)	Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM Cares Fund)
II	**Donation qualifying for 50% deduction, without any qualifying limit**
(1)	Prime Minister's Drought Relief Fund
III	**Donation qualifying for 100% deduction, subject to qualifying limit**
(1)	The Government or to any approved local authority, institution or association as may be approved for promotion of family planning
(2)	**Sum paid by a company** as donation to the Indian Olympic Association or any other association/institution established in India, as may be notified by the Government established –

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	- for the development of infrastructure for sports or games, or - the sponsorship of sports and games in India
IV	**Donation qualifying for 50% deduction, subject to qualifying limit**
(1)	Any Institution or Fund established in India for charitable purposes fulfilling prescribed conditions under section 80G(5).
(2)	The Government or any local authority for utilisation for any charitable purpose other than the purpose of promoting family planning.
(3)	An authority constituted in India by or under any other law enacted either for the purpose - of dealing with and satisfying the need for housing accommodation or - of planning, development or improvement of cities, towns and villages, or both.
(4)	Any Corporation established by the Central Government or any State Government for promoting the interests of the members of a minority community as referred in section 10(26BB).
(5)	for renovation or repair of any such temple, mosque, gurdwara, church or other place as notified by the Central Government to be of historic, archaeological or artistic importance or to be a place of public worship of renown throughout any State or States.

(iii) Qualifying limit: The eligible donations referred to in III and IV should be aggregated and the sum total should be limited to 10% of the adjusted gross total income. This would be the maximum permissible deduction.

The donations qualifying for 100% deduction would be first adjusted from the maximum permissible deduction and thereafter 50% deduction of the balance would be allowed.

Steps for computation of qualifying limit

Step 1:	Compute adjusted total income i.e., the GTI as reduced by the following: (i) Deductions under Chapter VI-A, except under section 80G (ii) Short-term capital gain taxable under section 111A (iii) Long-term capital gains taxable under sections 112 & 112A (iv) Any income on which income-tax is not payable (v) Income referred to in section 115A(1)(a), 115AB, 115AC, 115AD and 115D
Step 2:	Calculate 10% of adjusted total income
Step 3:	Calculate the actual donation, which is subject to qualifying limit (Total of Category III and IV donations, shown in the table above)

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Step 4:	Lower of Step 2 or Step 3 is the maximum permissible deduction.
Step 5:	The said deduction is adjusted first against donations qualifying for 100% deduction (i.e., Category III donations). Thereafter, 50% of balance qualifies for deduction under section 80G.

(iv) **Conditions:** Donation to any institution or fund referred in point no. (1) of (IV) above i.e., donation to whom would qualify for 50% deduction, subject to qualifying limit, shall be eligible for deduction if it is established in India for charitable purposes and fulfill the following conditions:

(1) The institution or fund is:

(a) constituted as a public charitable trust, or

(b) registered under the Societies Registration Act, 1860 or under any corresponding law or under section 25 of the Companies Act, 1956[3], or

(c) a University established by law or

(d) any other educational institution recognized by the Government or by a university established by law or affiliated to any university established by law

(e) an institution financed wholly or in part by the Government or a local authority [Section 80G(5)(v)].

(2) Where such institution or fund derives any income, such income should not be liable to inclusion in its total income under the provisions of section 10(23AA), 10(23C) or 11 or 12 [Section 80G(5)(i)].

However, in respect of profits and gains of business, the condition of such income should not be liable to inclusion in its total income under the provisions of section 11 shall not be applicable if –

- the institution or fund maintains separate books of account in respect of such business;
- the donation made to it are not used by it, directly or indirectly, for the purpose of such business; and
- the institution or fund issues certificate to the donor in respect of the above compliance.

[3] *Section 8 of the Companies Act, 2013*

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Further, it may be noted that the assessee will not lose the benefit of deduction if:

(a) subsequent to the donation, any part of the income of the Institution has become chargeable to tax due to non-compliance with any of the provisions of section 11 or section 12 or section 12A.

(b) as a result of the operation of section 13(1)(*c*), exemption under section 11 or section 12 is denied to the institution in relation to any income arising to it from any investment made in a concern in which the person specified under section 13(3) has substantial interest and aggregate of fund so invested does not exceed 5% of the capital of that concern. *[Explanation 2* to section 80G*]*

(3) No part of the income or assets of the Institution or Fund is transferable or applied at any time for any purposes other than charitable purpose [Section 80G(5)(ii)].

Such charitable purpose however does not include any purpose the whole or substantially the whole of which is of a religious nature *[Explanation 3* to Section 80G*].*

However, where an institution or fund incurs expenditure of a religious nature for an amount not exceeding 5% of its total income in that previous year, such institution or fund shall be deemed to be a fund or institution to which the provisions of this section apply [Section 80G(5B)].

(4) For the purposes of this section, an association or institution having as its object the control, supervision, regulation or encouragement in India of such games or sports as the Central Government may, by notification in the Official Gazette, specify in this behalf, shall be deemed to be an institution established in India for a charitable purpose. *[Explanation 4* to Section 80G*]*

(5) The Institution or Fund is not expressed to be for the benefit of any particular religious community or caste [Section 80G(5)(iii)].

An institution or fund established for the benefit of women and children or of Scheduled Castes, Backward classes or Scheduled Tribes is not however to be treated as an institution or fund for the benefit of a religious community or caste. [*Explanation 1* to Section 80G]

(6) The Institution or Fund maintains regular accounts of its receipt and expenditure [Section 80G(5)(iv)].

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(7) Such institution or fund must be approved by the Principal Commissioner or Commissioner [Section 80G(5)(vi)]

First, second, third and fourth provisos to section 80G(5) provide that the institution or fund has to make an application in the prescribed form and manner to the Principal Commissioner (PC) or Commissioner (C), for grant of approval within the prescribed time period and the PC or C will pass an order for grant of approval.

(8) Filing of statement of donation received by the institution or fund: The institution or fund is required to prepare such statement for such period as may be prescribed and deliver or cause to be delivered to the prescribed income-tax authority or the person authorised by such authority such statement in such form and verified in such manner and setting forth such particulars and within such time as may be prescribed [Section 80G(5)(viii)].

The institution or fund can also deliver to the said prescribed authority a correction statement for rectification of any mistake or to add, delete or update the information furnished in the statement delivered under this sub-section in such form and verified in such manner as may be prescribed.

(9) Furnishing of certificate to the donor: The institution or fund is also required to furnish to the donor, a certificate specifying the amount of donation in such manner, containing such particulars and within such time from the date of receipt of donation, as may be prescribed [Section 80G(5)(ix)]

Consequently, *Explanation 2A* to section 80G provides that claim of the assessee for a deduction in respect of any donation made to an institution or fund, in the return of income for any assessment year filed by him, is allowed on the basis of information relating to said donation furnished by the institution or fund, subject to verification in accordance with the risk management strategy formulated by the Board from time to time.

(v) Other points:

(a) Where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not qualify for deduction under any other provision of the Act for the same or any other assessment year [Section 80G(5A)].

(b) Donations in kind shall not qualify for deduction.

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(c) No deduction shall be allowed in respect of donation of any sum exceeding ₹ 2,000 unless such sum is paid by any mode other than cash [Section 80G(5D)].

(d) The deduction under section 80G can be claimed whether it has any nexus with the business of the assessee or not.

(e) As per *Circular No.2/2005 dated 12.1.2005*, in cases where employees make donations to the Prime Minister's National Relief Fund, the Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund through their respective employers, it is not possible for such funds to issue separate certificate to every such employee in respect of donations made to such funds as contributions made to these funds are in the form of a consolidated cheque. An employee who makes donations towards these funds is eligible to claim deduction under section 80G. It is, hereby, clarified that the claim in respect of such donations as indicated above will be admissible under section 80G on the basis of the certificate issued by the Drawing and Disbursing Officer (DDO)/ Employer in this behalf.

ILLUSTRATION 15

Mr. Arjun aged 45 years, has gross total income of ₹ 8,85,000 comprising of income from salary and house property. He has made the following payments and investments:

(i) Premium paid to insure the life of her major daughter (policy taken on 1.4.2019) (Assured value ₹ 1,80,000) – ₹ 20,000

(ii) Medical Insurance premium for self – ₹ 14,000; Spouse – ₹ 15,000

(iii) Donation to a public charitable institution registered under 80G ₹ 50,000 by way of cheque

(iv) LIC Pension Fund – ₹ 60,000

(v) Donation to National Children's Fund - ₹ 25,000 by way of cheque

(vi) Donation to PM CARES Fund – ₹ 10,000 by way of cheque.

(vii) Donation to approved institution for promotion of family planning - ₹ 40,000 by way of cheque

(viii) Deposit in PPF - ₹ 1,20,000

Compute the total income of Mr. Arjun for A.Y. 2026-27 if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).

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SOLUTION

Computation of Total Income of Mr. Arjun for A.Y. 2026-27

Particulars	₹	₹
Gross Total Income		**8,85,000**
***Less*: Deduction under section 80C**		
Deposit in PPF	1,20,000	
Life insurance premium paid for insurance of major daughter (Maximum 10% of the assured value ₹ 1,80,000, as the policy is taken after 31.3.2012)	18,000	
	1,38,000	
Deduction u/s 80CCC in respect of LIC pension fund	60,000	
	1,98,000	
As per section 80CCE, deduction u/s 80C & 80CCC is restricted to		1,50,000
Deduction under section 80D		
Medical Insurance premium in respect of self and spouse	29,000	
Restricted to		25,000
Deduction under section 80G (See Working Note below)		90,500
Total income		**6,19,500**

Working Note: Computation of deduction under section 80G

	Particulars of donation	Amount donated (₹)	% of deduction	Deduction u/s 80G (₹)
(i)	National Children's Fund	25,000	100%	25,000
(ii)	PM Cares Fund	10,000	100%	10,000
(iii)	Approved institution for promotion of family planning	40,000	100%, subject to qualifying limit	40,000
(iv)	Public Charitable Trust	50,000	50% subject to qualifying limit (See Note below)	15,500
				90,500

Note - Adjusted total income = Gross Total Income (–) Amount of deductions under section 80C to 80U except section 80G i.e., ₹ 7,10,000, in this case., ₹ 71,000, being 10% of adjusted total income is the qualifying limit, in this case.

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Firstly, donation of ₹ 40,000 to approved institution for family planning qualifying for 100% deduction subject to qualifying limit, has to be adjusted against this amount. Thereafter, donation to public charitable trust qualifying for 50% deduction, subject to qualifying limit is adjusted. Hence, the contribution of ₹ 50,000 to public charitable trust is restricted to ₹ 31,000 (being, ₹ 71,000 - ₹ 40,000), 50% of which would be the deduction under section 80G. Therefore, the deduction under section 80G in respect of donation to public charitable trust would be ₹ 15,500, which is 50% of ₹ 31,000.

(14) Deduction in respect of rent paid [Section 80GG]

(i) **Eligible assessee**: Assessee, who is not in receipt of HRA qualifying for exemption under section 10(13A) from employer and who pays rent for accommodation occupied by him for residential purposes.

(ii) **Conditions:** The following conditions have to be satisfied for claiming deduction under section 80GG -

(a) The assessee should not be receiving any house rent allowance exempt under section 10(13A).

(b) The expenditure incurred by him on rent of any furnished or unfurnished accommodation should exceed 10% of his total income arrived at after all deductions under Chapter VI A except section 80GG.

(c) The accommodation should be occupied by the assessee for the purposes of his own residence.

(d) The assessee should fulfill such other conditions or limitations as may be prescribed, having regard to the area or place in which such accommodation is situated and other relevant considerations.

(e) The assessee or his spouse or his minor child or an HUF of which he is a member should not own any accommodation at the place where he ordinarily resides or perform duties of his office or employment or carries on his business or profession; or

(f) If the assessee owns any accommodation at any place other than that referred to above, such accommodation should not be in the occupation of the assessee and its annual value is not required to be determined under section 23(2)(a) or section 23(4)(a).

(g) The assessee should file a declaration in the prescribed form, confirming the details of rent paid and fulfillment of other conditions, with the return of income.

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(iii) Quantum of deduction: The deduction admissible will be the least of the following:

(a) Actual rent paid minus 10% of the total income of the assessee before allowing the deduction, or

(b) 25% of such total income (arrived at after making all deductions under Chapter VI-A but before making any deduction under this section), or

(c) Amount calculated at ₹ 5,000 p.m.

Note - *Deduction under section 80GG would be available to an individual/HUF only if he/it exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

ILLUSTRATION 16

Mr. Rakesh, a businessman, whose total income (before allowing deduction under section 80GG) for A.Y.2026-27 is ₹ 4,60,000, paid house rent at ₹ 12,000 p.m. in respect of residential accommodation occupied by him at Mumbai. Compute the deduction allowable to him under section 80GG for A.Y.2026-27 if he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

The deduction under section 80GG will be computed as follows:

(i) Actual rent paid *less* 10% of total income

₹ 1,44,000 (-) ₹ 46,000 (10% x ₹ 4,60,000) = ₹ 98,000

(ii) 25% of total income i.e., ₹ 4,60,000

= ₹ 1,15,000

(iii) Amount calculated at ₹ 5,000 p.m. = ₹ 60,000

Deduction allowable u/s 80GG [least of (i), (ii) and (iii)] = ₹ 60,000

(15) Deduction in respect of donations for scientific research or rural development [Section 80GGA]

(i) Eligible assessee: Section 80GGA grants deduction in respect of the donations made for scientific research or rural development by any assessee not having income chargeable under the head "Profits and gains of business or profession".

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(ii) Donations qualifying for deduction:

(a) Any sum paid by the assessee in the previous year to a research association which has, as its object, the undertaking of scientific research or to a University, college or other institution to be used for scientific research; and

Such research association, University, college or institution must be approved under section 35(1)(ii).

(b) Any sum paid to a research Association which has as its object the undertaking of research in social science or statistical research, University, College or other institution to be used for research in social science or statistical research.

Such Research Association, University, College or institution must be approved under section 35(1)(iii).

(c) Any sum paid by the assessee in the previous year

- to an association or institution which has as its object the undertaking of any programme of rural development to be used for carrying out any programme of rural development approved by the prescribed authority for purposes of section 35CCA or
- to an institution or association which has as its object the training of persons for implementing programmes of rural development.

It is, however, essential that assessee furnishes the certificate from such institution or association as referred to in section 35CCA(2) & (2A).

(d) Any sum paid to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme.

(e) Further, it has been clarified that the deduction to which an assessee (i.e. donor) is entitled on account of payment of any sum

- to a research association or university college or other institution for scientific research or research in a social science or statistical research,
- an association or institution for carrying out the programme of rural development

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- 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

shall not be denied merely on the ground that subsequent to payment of such sum by the assessee, the approval granted to any of the aforesaid entities or to such programme is withdrawn.

(f) Any sum paid to a rural development fund set up and notified under section 35CCA.

(g) Any sum paid by the assessee in the previous year to National Urban Poverty Eradication Fund (NUPEF).

(iii) Restrictions on deduction:

(a) No deduction under this section would be allowed in the case of an assessee whose gross total income includes income which is chargeable under the head "Profits and gains of business or profession".

(b) Where a deduction under this section is claimed and allowed for any assessment year, deduction shall not be allowed in respect of such payment under any provision of this Act for the same or any other assessment year.

(c) No deduction shall be allowed in respect of donation of any sum exceeding **₹ 2,000** unless such sum is paid by any mode other than cash.

(d) Deduction under this section claimed by the assessee in the return of income for any assessment year would be allowable on the basis of the information relating to donation furnished by the payee to the prescribed income-tax authority or person specified by such authority, subject to verification in accordance with the risk management strategy formulated by the CBDT from time to time.

Note - *An individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person will be eligible for deduction u/s 80GGA only if such person has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).*

(16) Deduction in respect of contributions given by companies to political parties [Section 80GGB]

(i) Deduction & Conditions: This section provides for deduction of any sum contributed in the previous year by an Indian company not opting for section 115BAA/ 115BAB to any political

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party or an electoral trust. However, no deduction shall be allowed in respect of any sum contributed by way of cash.

(ii) **Meaning of "contribute":** For the purposes of this section, the word "contribute" has the same meaning assigned to it under section 293A of the Companies Act, 1956[4], which provides that -

(a) a donation or subscription or payment given by a company to a person for carrying on any activity which is likely to effect public support for a political party shall also be deemed to be contribution for a political purpose;

(b) the expenditure incurred, directly or indirectly, by a company on advertisement in any publication (being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like) by or on behalf of a political party or for its advantage shall also be deemed to be a contribution to such political party or a contribution for a political purpose to the person publishing it.

(iii) **Meaning of "Political party":** It means a political party registered under section 29A of the Representation of the People Act, 1951.

ILLUSTRATION 17

During the P.Y.2025-26, Sky Ltd., an Indian company contributed a sum of ₹ 3.5 lakh to an electoral trust; and incurred expenditure of ₹ 52,000 on advertisement in a brochure of a political party.

Is the company eligible for deduction in respect of such contribution/expenditure, assuming that the contribution was made by cheque? If so, what is the quantum of deduction? Sky Ltd. does not opt for section 115BAA.

SOLUTION

An Indian company is eligible for deduction under section 80GGB in respect of any sum contributed by it in the previous year to any political party or an electoral trust. Further, the word "contribute" in section 80GGB has the meaning assigned to it in section 293A of the Companies Act, 1956, and accordingly, it includes the amount of expenditure incurred on advertisement in a brochure of a political party.

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[4] *Now section 182 of the Companies Act, 2013*

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Therefore, Sky Ltd. is eligible for a deduction of ₹ 4,02,000 under section 80GGB in respect of sum of ₹ 3.5 lakh contributed to an electoral trust and ₹ 52,000 incurred by it on advertisement in a brochure of a political party.

It may be noted that there is a specific disallowance under section 37(2B) in respect of expenditure incurred on advertisement in a brochure of a political party. Therefore, the expenditure of ₹ 52,000 would be disallowed while computing business income/ gross total income. However, the said expenditure incurred by an Indian company is allowable as a deduction from gross total income under section 80GGB.

(17) Deduction in respect of contributions given by any person to political parties [Section 80GGC]

(i) **Deduction & Conditions:** This section provides for deduction of any sum contributed in the previous year by any person to a political party or an electoral trust. However, no deduction shall be allowed in respect of any sum contributed by way of cash.

(ii) **Persons not eligible for deduction:** This deduction will, however, not be available to a local authority and an artificial juridical person, wholly or partly funded by the Government.

(iii) **Meaning of "Political party":** It means a political party registered under section 29A of the Representation of the People Act, 1951.

Note - *An individual, HUF, AoP (other than a co-operative society) or BoI would be eligible for deduction u/s 80GGC only if such person has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). A co-operative society will not be eligible for deduction if it opts for special provisions of section 115BAD/115BAE.*

8.3 DEDUCTIONS IN RESPECT OF CERTAIN INCOMES

(1) Deductions in respect of profits and gains from undertakings or enterprises engaged in infrastructure development, etc. [Section 80-IA]

Applicability

Section 80-IA(1) provides a 10 year tax holiday to an assessee, whose gross total income includes any profits and gains derived by an undertaking or enterprise from an eligible business i.e., business referred to in sub-section (4), namely :

(i) **Infrastructure facility** - Any enterprise carrying on the business of:

(a) developing; or

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(b) operating and maintaining; or

(c) developing, operating and maintaining

(d) any infrastructure facility.

Conditions: However, such enterprise must fulfill the following conditions:

(1) It must be owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act.

(2) It has entered into an agreement with the Central or a State Government or a local authority or statutory body for (i) developing or (ii) operating and maintaining, or (iii) developing, operating and maintaining a new infrastructure facility.

(3) It starts operating and maintaining such infrastructure facility on or after 1-4-1995.

(4) However, where an enterprise which developed such infrastructure facility transfers it to another enterprise on or after 1-4-1999, and such transferee enterprise operates and maintains it according to the agreement drawn up with the Government, etc., this section will apply to the transferee enterprise for the unexpired period of deduction (which was available to the first enterprise).

Meaning of "infrastructure facility":

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Note:

1. Structures at the ports for storage, loading and unloading etc. will be included in the definition of port for the purpose of section 80-IA, if the concerned port authority has issued a certificate that the said structures form part of the port.

2. Effluent treatment and conveyance system is a part of water treatment system and would accordingly, qualify as an infrastructure facility for the purpose of section 80-IA.

3. The CBDT has, vide *Circular No. 4/2010 dated 18.5.2010*, clarified that widening of an existing road by constructing additional lanes as a part of a highway project by an undertaking would be regarded as a new infrastructure facility for the purpose of section 80-IA(4)(i). However, simply relaying of an existing road would not be classifiable as a new infrastructure facility for this purpose.

***Note** – Any enterprise which starts the development or operation and maintenance of the infrastructure facility on or after 1.4.2017 will not be eligible for deduction under section 80-IA. Instead, they would be eligible for investment-linked tax deduction under section 35AD.*

(ii) Power undertakings: Any undertaking which

is set up in any part of India for the generation or generation and distribution of power. However, such undertaking must begin to generate power at any time during the period between 1.4.1993 and 31.3.2017

starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period from 1.4.1999 and 31.3.2017. However, the deduction shall be allowed only in respect of profits derived from the laying of such network of new lines for transmission or distribution

undertakes substantial renovation and modernisation of the existing network of transmission or distribution lines at any time during the period beginning on 1.4.2004 and ending on 31.3.2017

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Meaning of "Substantial renovation and modernisation":

'Substantial renovation and modernisation' means an increase in the plant and machinery in the network of transmission or distribution lines by at least fifty per cent of the book value of such plant and machinery as on 1st April, 2004.

Rate of Deduction

The amount of deduction available will be 100% of the profits and gains derived from such business for **ten consecutive assessment years commencing at any time** during the periods specified in period of tax holiday/concession below.

Period of tax holiday/concession

	Eligible business	Period of tax holiday
1.	For all eligible business except business mentioned in point 2 below.	Assessee has the option to claim deduction for **10 consecutive assessment years out of 15 years** beginning from the year in which the undertaking or the enterprise develops or begins to operate the infrastructure facility or generates power or commences transmission or distribution of power or undertakes substantial renovation and modernization of the existing transmission or distribution lines.
2.	In case of an infrastructure facility being a public facility like – (i) a road, including a toll road, bridge or rail system; or (ii) a highway project including housing or other activities which are an integral part of the highway project; or (iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system	Assessee has the option to claim deduction for **10 consecutive assessment years out of 20 years** beginning from the year in which the undertaking or the enterprise develops or begins to operate the eligible business

Other provisions

(1) **Eligible business to be considered as the only source of income:** For the purpose of computing deduction under this section, the profits and gains of the eligible business shall

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be computed as if such eligible business were the only source of income of the assessee during the relevant previous years [Sub-section (5)].

(2) **Conditions to exempt profit from housing or other activities, being integral part of highway project:** Where housing or other activities are an integral part of a highway project and the profits and gains have been calculated in accordance with the section, the profits shall not be liable to tax if the following conditions have been fulfilled:

(a) The profit has been transferred to a special reserve account; and

(b) the same is actually utilised for the highway project excluding housing and other activities before the expiry of 3 years following the year of transfer to the reserve account;

(c) The amount remaining unutilised shall be chargeable to tax as income of the year in which the transfer to the reserve account took place [Sub-section (6)].

(3) **Audit of accounts:** The deduction shall be allowed to the undertaking only if the accounts of the undertaking for the relevant previous year have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant, before the specified date referred to in section 44AB i.e., the date one month prior to due date for filing return of income under section 139(1) [Sub-section (7)].

(4) **Transfer of goods/services between eligible business and other business of the assessee:** Where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the eligible business shall be computed as if the transfer was made at market value.

However, if, in the opinion of the Assessing Officer, such computation presents exceptional difficulties, the Assessing Officer may compute the profits on such reasonable basis as he may deem fit [Sub-section (8)].

For this purpose, the market value, in relation to any goods or services transferred between the eligible business and any other business carried on by the assessee, shall mean –

(i) the price that such goods or services would ordinarily fetch in the open market; or

(ii) the arm's length price as defined under section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.

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(5) **Deduction not to exceed profits of eligible business:** The deductions claimed and allowed under this section shall not exceed the profits and gains of the eligible business. Further, where deduction is claimed and allowed under this section for any assessment year no deduction in respect of such profits will be allowed under any other section under this chapter under the heading "Deductions in respect of certain incomes" [Sub-section (9)].

(6) **Assessing Officer empowered to make adjustment in case any transaction produces excessive profits to eligible business:** The Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case due to close connection or for any other reason the transaction between the assessee carrying on the eligible business under section 80-IA and any other person is so arranged that the transaction produces excessive profits to the eligible business [Sub-section (10)].

If the aforesaid arrangement between the assessee carrying on the eligible business and any other person is a specified domestic transaction referred to in section 92BA, then, the amount of profit of such transaction shall be determined having regard to arm's length price as defined under section 92F and not as per the reasonable profit from such transaction.

(7) **Central Government empowered to deny deduction to any class of eligible undertaking or enterprise:** The section empowers the Central Government to declare any class of industrial undertaking or enterprise as not being entitled to deduction under this section. The denial of exemption shall be with effect from such date as may be specified in the notification issued in the Official Gazette [Sub-section (11)].

(8) **Deduction in case of amalgamation or demerger:** In the case of any amalgamation or demerger, by virtue of which the Indian company carrying on the eligible business is transferred to another Indian company, deduction under this section will be available as follows:

(a) No deduction will be available to the amalgamating company or the demerged company, as the case may be, in the year of amalgamation/ demerger.

(b) The provisions of this section will apply to the amalgamated/ resulting company as they would have applied to the amalgamating/ demerged company if the amalgamation/ demerger had not taken place [Sub-section (12)].

However, such transfer of benefit of deduction to the amalgamated/ resulting company would not be available in respect of any enterprise or undertaking which is transferred in a scheme of amalgamation or demerger effected on or after 1.4.2007 [Sub-section (12A)].

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(9) No deduction to any business carrying on specified activities in the nature of a work contract: The tax holiday under section 80-IA would not be available in relation to a business referred to in sub-section (4) which is in the nature of a works contract awarded by any person (including the Central or State Government) and executed by the undertaking or enterprise referred to in section 80-IA(1).

(2) Deduction in respect of profits and gains by an undertaking or enterprise engaged in development of SEZ [Section 80-IAB]

(i) Quantum of deduction:

Sub-section (1) provides for a deduction of 100% of profits and gains derived by an undertaking or an enterprise from any business of developing a SEZ for 10 consecutive assessment years.

(ii) Eligible assessee:

The deduction is available to an assessee, being a Developer, whose gross total income includes any profits and gains derived by an undertaking or an enterprise from any business of developing a SEZ, notified on or after 1st April, 2005 under the SEZ Act, 2005.

Note - *No deduction would be available to an assessee, being a developer, where the development of SEZ begins on or after 1st April, 2017.*

(iii) Meaning of Developer:

(a) a person who, or

(b) a State Government which

has been granted a letter of approval by the Central Government under section 3(10) of the SEZ Act, 2005.

A developer includes –

(a) an authority and

(b) a Co-developer.

Co-developer means -

(a) a person who, or

(b) a State Government which

has been granted a letter of approval by the Central Government under section 3(12) of the SEZ Act, 2005.

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(iv) Option to choose 10 consecutive A.Y.s out of 15 years to claim deduction:

The assessee has the option of claiming the said deduction for any ten consecutive assessment years out of fifteen years beginning from the year in which a SEZ has been notified by the Central Government.

(v) Deduction to transferee in case of transfer of operation and maintenance of such SEZ:

In a case where an undertaking, being a Developer, who develops a SEZ on or after 1.4.2005 and transfers the operation and maintenance of such SEZ to another Developer, the deduction under sub-section (1) shall be allowed to such transferee Developer for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee Developer.

(vi) The provisions of sub-section (5) and sub-section (7) to (12) of section 80-IA shall apply to the Special Economic Zone for the purpose of allowing deductions under 80-IAB(1).

(3) Tax incentives for new start-ups [Section 80-IAC]

(i) Objective:

Section 80-IAC provides an incentive to start-ups in order to aid their growth in the early phase of their business.

(ii) Quantum of deduction:

Accordingly, a deduction of **100%** of the profits and gains derived by an eligible start-up from an eligible business is allowed for any **three consecutive assessment years out of ten** years beginning from the year in which the eligible start up is incorporated.

(iii) Meaning of eligible start-up:

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(iv) Meaning of eligible business:

A business carried out by an eligible start-up engaged in –

- Innovation, development or improvement of products or processes or services or
- a scalable business model with a high potential of employment generation or wealth creation

(v) Conditions to be fulfilled:

This incentive is available to an eligible start-up which fulfils the following conditions:

(1) It is not formed by splitting up, or the reconstruction, of a business already in existence.

Exception: However, this condition shall not apply in the case of an undertaking which is formed as a result of reconstruction, re-establishment or revival of the business of any undertaking which has been discontinued in any previous year due to extensive damage or destruction of any building, machinery, plant or furniture owned by the assessee and used for the purposes of such business. Further, the reason for damage or destruction is due to any natural calamity or other unforeseen circumstances such as the following:

(i) Flood, typhoon, hurricane, cyclone, earthquake or other natural calamity, or

(ii) riot or civil disturbance, or

(iii) accidental fire or explosion, or

(iv) enemy action or action taken in combat,

and such business is re-established or revived within 3 years from the end of such previous year.

(2) It is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Exceptions: However, 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 all the following conditions are fulfilled, namely:—

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

(b) such machinery or plant is imported into India;

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

Further, where in the case of a start-up, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used in the business, then, the condition specified that it should not be formed by transfer to a new business of plant and machinery used for any purpose shall be deemed to have been complied with.

(vi) The provisions of sub-section (5) and sub-section (7) to (11) of section 80-IA shall apply to the start-ups for the purpose of allowing deductions under 80-IAC(1).

(4) Deductions in respect of profits and gains from certain undertaking [Section 80-IB]

Applicability

This section will be applicable to assessees, whose gross total income includes any profits and gains from the business of processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains [Sub-section (11A)].

Conditions to be fulfilled, amount of deduction and period of deduction

In order to claim deduction, the undertaking should fulfill the following conditions:

(i) It should be deriving profits from the business of processing, preservation and packaging of fruits or vegetables or meat or meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains.

(ii) It should begin to operate such business on or after 1.4.2001.

(iii) It should begin operates such business on or after 1.4.2009 in case of an undertaking deriving profit from the business of processing, preservation and packaging of meat or meat products or poultry or marine or dairy products.

Quantum and period of deduction: The amount of deduction shall be 100% of the profits and gains derived from such business for 5 assessment years beginning with the initial assessment year i.e. the assessment year relevant to the previous year in which the undertaking begins such

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business. Thereafter, the deduction allowable is 25%. In the case of a company, the rate of 25% shall be substituted by 30%. The total period of deduction should not exceed 10 consecutive assessment years.

The provisions of sub-section (5) and sub-section (7) to (12) of section 80-IA shall apply to the eligible business under section 80-IB.

(5) Deductions in respect of profits and gains from housing projects/rental housing project [Section 80-IBA]

(i) Objective:

Section 80-IBA provides impetus to affordable housing sector to achieve the larger objective of 'Housing for All'.

(ii) Quantum of deduction:

Where the gross total income of an assessee includes any profits and gains derived from

- the business of developing and building housing projects an amount equal to 100% of the profits and gains derived from such business is allowable as deduction under section 80-IBA, subject to fulfilment of certain conditions [Section 80-IBA(1)].
- the business of developing and building rental housing project an amount equal to 100% of the profits and gains derived from such business is allowable as deduction [Section 80-IBA(1A)].

(iii) Conditions to be fulfilled for claim of deduction in respect of housing project referred under section 80-IBA(1):

(a) the project is approved by the competent authority after 1st June, 2016 but on or before 31st March, 2022;

(b) the project is completed within a period of **five years** from the date of approval by the competent authority:

However, in a case where the approval in respect of a housing project is obtained more than once, the project shall be deemed to have been approved on the date on which the building plant of such housing project was first approved by the competent authority and the project shall be deemed to have been completed when a certificate of completion of project as a whole is obtained in writing from the competent authority.

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(c) the carpet area of the shops and other commercial establishments included in the housing project does not exceed 3% of the aggregate carpet area;

Additional conditions to be fulfilled if the project is approved by the competent authority before 1st September, 2019

(a) where a residential unit in the housing project is allotted to an individual, no other residential unit in the housing project shall be allotted to the individual or the spouse or the minor children of such individual;

(b) **Conditions relating to size of plot of land, residential units etc.**

	Location of the housing project	Size on plot of land on which the project is located	Carpet area of the residential unit comprised in the housing project	Percentage of floor area ratio to be utilised by the project
(1)	(2)	(3)	(4)	(5)
(i)	Within the cities of Chennai, Delhi, Kolkata or Mumbai	Not less than 1,000 sq. m.	Not more than 30 sq. m.	Not less than 90% of the floor area ratio permissible in respect of the plot of land under the rules to be made by the Central Government or the State Government or the local authority, as the case may be.
(ii)	In any other place	Not less than 2,000 sq. m.	Not more than 60 sq. m.	not less than 80% of such floor area ratio

(c) The project is the only housing project on the plot of land [referred to in column (3)].

(d) the assessee maintains separate books of account in respect of the housing project.

Additional conditions to be fulfilled if the project is approved by the competent authority on or after 1st September, 2019

(a) where a residential unit in the housing project is allotted to an individual, no other residential unit in the housing project shall be allotted to the individual or the spouse or the minor children of such individual;

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(b) Conditions relating to size of plot of land, residential units etc.

	Location of the housing project	Size on plot of land on which the project is located	Carpet area of the residential unit comprised in the housing project	Percentage of floor area ratio to be utilised by the project
(1)	(2)	(3)	(4)	(5)
(i)	Within the metropolitan cities of Bengaluru, Chennai, Delhi National Capital Region (limited to Delhi, Noida, Greater Noida, Ghaziabad, Gurugram, Faridabad), Hyderabad, Kolkata and Mumbai (whole of Mumbai Metropolitan Region)	Not less than 1,000 sq. m.	Not more than 60 sq. m.	Not less than 90% of the floor area ratio permissible in respect of the plot of land under the rules to be made by the Central Government or the State Government or the local authority, as the case may be.
(ii)	In any other place	Not less than 2,000 sq. m.	Not more than 90 sq. m.	Not less than 80% of such floor area ratio

(c) The project is the only housing project on the plot of land [referred to in column (3) above].

(d) the assessee maintains separate books of account in respect of the housing project.

(e) the stamp duty value of a residential unit in the housing project does not exceed ₹ 45 lakhs.

(iv) No deduction for person executing the housing project as a works contract:

An assessee who merely executes the housing project as a works-contract awarded by any person (including the Central Government or the State Government) would not be eligible for deduction under this section.

(v) Consequence of non-completion of housing project within 5 years:

In a case where the housing project is not completed within the period of five years from the date of approval by the competent authority and in respect of which a deduction has been claimed and allowed under this section, the total amount of deduction so claimed and

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allowed in one or more previous years, shall be deemed to be the income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the period for completion so expires.

(vi) No deduction under any other provision of the Act in respect of such profits:

Where any amount of profits and gains derived from the business of developing and building housing projects is claimed and allowed under this section for any assessment year, deduction to the extent of such profit and gains shall not be allowed under any other provision of this Act.

(vii) Meaning of certain terms:

	Term	Meaning
(a)	**Carpet area**	Net usable floor area of an apartment Excluding – • The area covered by the external walls, • areas under service shafts • exclusive balcony or verandah area and • exclusive open terrace area **However, carpet area <u>includes</u>** the area covered by the internal partition walls of the apartment. Exclusive balcony or verandah and exclusive open terrace area means the area of the balcony or verandah and the area of open terrace respectively, which is appurtenant to the net usable floor area of an apartment, meant for the exclusive use of the allottee.
(b)	**Competent authority**	The authority empowered by the Central Government to approve the building plan by or under any law for the time being in force.
(c)	**Floor area ratio**	The quotient obtained by dividing the total covered area of plinth area on all the floors by the area of the plot of land
(d)	**Housing project**	A project consisting predominantly of residential units with such other facilities and amenities as the competent authority may approve subject to the provisions of this section
(e)	**Rental housing project**	A project which is notified by the Central Government under this clause on or before the 31.03.2022 and fulfils such conditions as may be specified in the said notification.
(f)	**Residential unit**	An independent housing unit with separate facilities for living, cooking and sanitary requirements, distinctly

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		separated from other residential units within the building, which is directly accessible from an outer door or through an interior door in a shared hallway and not by walking through the living space of another household.
(g)	**Stamp duty value**	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.

(6) Tax holiday in respect of profits and gains from eligible business of certain undertakings in North-Eastern States [Section 80-IE]

(i) Applicability:

This section provides for an incentive to an undertaking which has during the period between 1st April, 2007 and 1st April, 2017, begun or begins, in any of the North-Eastern States (i.e., the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura) -

(1) to manufacture or produce any eligible article or thing;

(2) to undertake substantial expansion to manufacture or produce any eligible article or thing;

(3) to carry on any eligible business.

(ii) Meaning of certain terms:

	Terms	Meaning
(a)	**Eligible article or thing**	the article or thing other than - goods falling under Chapter 24 of the First Schedule to the Central Excise Tariff Act, 1985 which pertains to tobacco and manufactured tobacco substitutes; - pan masala as covered under Chapter 21 of the First Schedule to the Central Excise Tariff Act, 1985; - plastic carry bags of less than 20 microns; and - goods falling under Chapter 27 of the First Schedule to the Central Excise Tariff Act, 1985 produced by petroleum oil or gas refineries
(b)	**Substantial expansion**	Increase in the investment in the plant and machinery by at least 25% of the book value of plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken

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(c)	**Eligible business**	Business of - - hotel (not below two star category); - adventure and leisure sports including ropeways; - providing medical and health services in the nature of nursing home with a minimum capacity of 25 beds; - running an old-age home; - operating vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and para-medical, civil aviation related training, fashion designing and industrial training; - running information technology related training centre; - manufacturing of information technology hardware; and - Bio-technology.

(iii) Quantum of deduction and period:

Where the gross total income of an assessee includes any profits and gains derived by such an undertaking, a deduction of 100% of the profits and gains derived from such business for 10 consecutive assessment years commencing with the initial assessment year shall be allowed in computing the total income of the assessee. Initial assessment year means the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or completes substantial expansion.

(iv) No deduction under any other section of Chapter VIA or section 10AA of the Act in respect of such profits:

No benefit to these undertakings will be available under any of the sections in Chapter VIA or in section 10AA in relation to the profits and gains of such undertakings.

(v) Maximum permissible deduction:

While computing the total period of 10 years the period for which the benefit under section 80-IC has already been availed, if any, shall also be included.

(vi) The provisions of sub-section (5) and sub-section (7) to (12) of section 80-IA shall apply to the eligible undertaking under this section.

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SUMMARY OF DEDUCTIONS IN RESPECT OF CERTAIN INCOMES: SECTIONS 80-IA to 80-IE

Section	Eligible Business		Year of commencement of eligible business	Period of Deduction	Quantum of Deduction
80-IA	**(1)**	**(i) Developing or** **(ii) Operating and maintaining or** **(iii) Developing, operating and maintaining any infrastructure facility**	On or after 1.4.1995 but not later than 1.4.2017	**Infrastructure Facility of road, or a bridge or a rail system or a highway project or a water supply project:** 10 consecutive assessment years out of 20 years beginning from the year in which the enterprise develops or begins to operate the eligible business. **Other eligible businesses:** 10 consecutive assessment years out of 15 years beginning from the year in which the enterprise develops or begins to operate the eligible business.	100% of the profits and gains derived from such business for 10 consecutive assessment years.
	(2)	**Power undertakings**	**Generation or Generation and distribution:** Set up between 1.4.1993 & 31.3.2017. **Transmission or distribution:** Start transmission during the period from 1.4.1999 & 31.3.2017. **Renovation and modernisation of existing network:** Undertakes substantial renovation and modernisation during the period on or after 1.4.2004 & ending on 31.3.2017.		

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80-IAB	**Development of Special Economic Zones(SEZs)**	Develops SEZ, notified on or after 1st April 2005 but before 1st April 2017.	10 consecutive AYs out of 15 years beginning from the year in SEZ has been notified.	100% of the profits and gains derived from such business.
80-IAC	**A business carried out by an eligible start-up engaged in Innovation, Development or Improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation**	The company or LLP is incorporated during the period 1.4.2016 - ***31.3.2030***	3 consecutive AYs out of 10 years beginning from the year in which company or LLP, incorporated.	100% of the profits and gains derived from such business.
80-IB	**Processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage and transportation of foodgrains**	**Processing, preservation and packaging of meat or meat products or poultry or marine or dairy products:** On or after 1.4.2009 **Other eligible businesses:** On or after 1.4.2001	10 consecutive AYs beginning with the initial AY	100% of the profits and gains derived from such business for 5 AYs beginning with the initial AY 25% (30% in case of company) for remaining 5 years
80-IBA	**Developing and building housing projects or rental housing project**	Housing Project referred under section 80-IBA(1) is approved after 1st June 2016 but on or before 31st March 2022	----	100% of the profits and gains derived from such housing project.
80-IE	**Undertaking begun or begins, in any of the North-Eastern States** (i.e., the States of Arunachal	between 1st April, 2007 and ending before 1st April, 2017	10 consecutive AYs Commencing with the initial AY	100% of the profits and gains derived from such business

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	Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura) - (1) to manufacture or produce any eligible article or thing; (2) to undertake substantial expansion to manufacture or produce any eligible article or thing; (3) to carry on any eligible business.			

Note - *In case of an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person, deduction under section 80-IA to 80-IE would be available only if such person has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). It would not be available if such person pays concessional rates of tax under the default tax regime u/s 115BAC.*

In case of companies and co-operative societies, deduction under section 80-IA to 80-IE would not be available if they opted for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction would be available only if companies and co-operative societies pay tax under the normal provisions of the Act.

Admissibility of deduction under Chapter VI-A on the profits enhanced due to disallowance of expenditure related to business activity [Circular No.37/2016, Dated 02.11.2016]

Chapter VI-A of the Income-tax Act, 1961, provides for deductions in respect of certain incomes. In computing the profits and gains of a business activity, the Assessing Officer may make certain disallowances, such as disallowances pertaining to sections 32, 40(a)(ia), 40A(3), 43B etc., of the Act. At times, disallowance out of specific expenditure claimed may also be made. The effect of such disallowances is an increase in the profits.

The issue is whether such higher profits would also result in claim for a higher profit-linked deduction under Chapter VI-A.

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The courts have generally held that if the expenditure disallowed is related to the business activity against which the Chapter VI-A deduction has been claimed, the deduction needs to be allowed on the enhanced profits. Some illustrative cases upholding this view are as follows:

(i) If an expenditure incurred by assessee for the purpose of developing a housing project was not allowable on account of non-deduction of TDS under law, such disallowance would ultimately increase assessee's profits from business of developing housing project. The ultimate profits of assessee after adjusting disallowance under section 40(a)(ia) would qualify for deduction under section 80-IB.

(ii) If deduction under section 40A(3) is not allowed, the same would have to be added to the profits of the undertaking on which the assessee would be entitled for deduction under section 80-IB.

In view of the aforesaid judgements, the CBDT has accepted the settled position that the disallowances made under sections 32, 40(a)(ia), 40A(3), 43B, etc. and other specific disallowances, related to the business activity against which the Chapter VI-A deduction has been claimed, result in enhancement of the profits of the eligible business, and that deduction under Chapter VI-A is admissible on the profits so enhanced by the disallowance.

(7) Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste [Section 80JJA]

(i) Eligible business: The deduction is allowable 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 -

(1) for generating power, or

(2) producing bio-fertilizers, bio-pesticides or other biological agents, or

(3) for producing bio-gas, or

(4) making pellets or briquettes for fuel or organic manure.

(ii) Quantum of deduction and period: The deduction allowable under this section is an amount equal to the whole of such profits and gains for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the business commences.

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Note - *In case of an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person, deduction under section 80JJA would be available only if such person has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). It would not be available if such person pays concessional rates of tax under the default tax regime u/s 115BAC.*

In case of companies and co-operative societies, deduction under section 80JJA would not be available if they opted for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction would be available only if companies and co-operative societies pay tax under the normal provisions of the Act.

(8) Deduction in respect of employment of new employees [Section 80JJAA]

(i) Quantum and period of deduction:

Where the gross total income of an assessee to whom section 44AB applies, includes any profits and gains derived from business, a deduction of an amount equal to 30% of additional employee cost incurred in the course of such business in the previous year, would be allowed for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

(ii) Conditions to be fulfilled:

The deduction would be allowed only subject to fulfilment of the following conditions:

- The business should not be formed by splitting up, or the reconstruction, of an existing business
- The business is not acquired by the assessee by way of transfer from any other person or as a result of any business reorganisation
- The report of the accountant, giving the prescribed particulars, has to be furnished before the specified date referred to in section 44AB i.e., the date one month prior to due date for filing ROI u/s 139(1)

(iii) Meaning of certain terms:

	Term	Meaning	
(a)	**Additional employee cost**	Total emoluments paid or payable to additional employees employed during the previous year.	
		In the case of an existing business	The additional employee cost shall be Nil, if— (a) there is no increase in the number of employees from

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			the total number of employees employed as on the last day of the preceding year; (b) emoluments are paid otherwise than by an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account or through any other prescribed electronic mode [credit card, debit card, net banking, IMPS (Immediate Payment Services), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Fund Transfer), BHIM (Bharat Interface for Money) Aadhar Pay].
		In the first year of a new business	The emoluments paid[5] or payable to employees employed during that previous year shall be deemed to be the additional employee cost.
(b)	**Additional employee**	An employee who has been employed during the previous year and whose employment has the effect of increasing the total number of employees employed by the employer as on the last day of the preceding year. **Exclusions from the definition**: (a) an employee whose total emoluments are more than ₹ 25,000 per month; or (b) an employee for whom the entire contribution is paid by the Government under the Employees' Pension Scheme notified in accordance with the provisions of the	

[5] *As per Form No.10DA read with Rule 19AB, the amount shall **not** include emoluments paid otherwise than by way of account payee cheque/bank draft/ECS through a bank account and prescribed electronic modes.*

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		Employees' Provident Funds and Miscellaneous Provisions Act, 1952; or (c) an employee employed for a period of less than 240 days during the previous year. In case of an assessee engaged in the business of manufacturing of apparel or footwear or leather products, an employee employed for a period of less than 150 days during the previous year; or (e) an employee who does not participate in the recognised provident fund. ***Note –*** *If an employee is employed during the previous year for less than 240 days or 150 days, as the case may be, but is employed for a period of 240 days or 150 days, as the case may be, in the immediately succeeding year, he shall be deemed to have been employed in the succeeding year.* *Accordingly, the employer would be entitled to deduction of 30% of additional employee cost of such employees for three years from the succeeding year.*
(c)	**Emoluments**	any sum paid or payable to an employee in lieu of his employment by whatever name called. **Exclusions from the definition**: (a) any contribution paid or payable by the employer to any pension fund or provident fund or any other fund for the benefit of the employee under any law for the time being in force; and (b) any lump-sum payment paid or payable to an employee at the time of termination of his service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and the like.

Note - *Deduction u/s 80JJAA would be available to an assessee irrespective of the regime under which such assessee pays tax.*

ILLUSTRATION 18

Mr. Vikas has commenced the business of manufacture of computers on 1.4.2025. He employed 420 new employees during the P.Y.2025-26, the details of whom are as follows –

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	No. of employees	Date of employment	Regular/Casual	Total monthly emoluments per employee (₹)
(i)	75	1.4.2025	Regular	24,000
(ii)	125	1.5.2025	Regular	26,000
(iii)	120	1.7.2025	Casual	24,500
(iv)	100	1.9.2025	Regular	24,000

The regular employees participate in recognized provident fund while the casual employees do not. Compute the deduction, if any, available to Mr. Vikas for A.Y.2026-27, if the profits and gains derived from manufacture of computers that year is ₹ 90 lakhs and his total turnover is ₹ 11.48 crores.

What would be your answer if Mr. Vikas has commenced the business of manufacture of leather products on 1.4.2025?

SOLUTION

Mr. Vikas is eligible for deduction under section 80JJAA since he is subject to tax audit under section 44AB for A.Y.2026-27, and he has employed "additional employees" during the P.Y.2025-26.

I. <u>If Mr. Vikas is engaged in the business of manufacture of computers</u>

Additional employee cost = ₹ 24,000 × 12 × 75 **[See Working Note below]** = ₹ 2,16,00,000

Deduction under section 80JJAA = 30% of ₹ 2,16,00,000 = ₹ 64,80,000.

<u>Working Note:</u>

Number of additional employees

Particulars		No. of workmen	
Total number of employees employed during the year			420
Less: Casual employees employed on 1.7.2025 who do not participate in recognized provident fund		120	
Regular employees employed on 1.5.2025, since their total monthly emoluments exceed ₹ 25,000		125	
Regular employees employed on 1.9.2025 since they have been employed for less than 240 days in the P.Y.2025-26.		100	345
Number of "additional employees"			**75**

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Notes –

(i) Since casual employees do not participate in recognized provident fund, they do not qualify as additional employees. Further, 125 regular employees employed on 1.5.2025 also do not qualify as additional employees since their monthly emoluments exceed ₹ 25,000. Also, 100 regular employees employed on 1.9.2025 do not qualify as additional employees for the P.Y.2025-26, since they are employed for less than 240 days in that year.

Therefore, only 75 employees employed on 1.4.2025 qualify as additional employees, and the total emoluments paid or payable to them during the P.Y.2025-26 is deemed to be the additional employee cost.

(ii) As regards 100 regular employees employed on 1.9.2025, they would be treated as additional employees for previous year 2026-27, if they continue to be employees in that year for a minimum period of 240 days. Accordingly, 30% of additional employee cost in respect of such employees would be allowable as deduction under section 80JJAA in the hands of Mr. Vikas for the A.Y. 2027-28.

II. <u>If Mr. Vikas is engaged in the business of manufacture of leather products</u>

If Mr. Vikas is engaged in the business of manufacture of leather products, then, he would be entitled to deduction under section 80JJAA in respect of employee cost of regular employees employed on 1.9.2025, since they have been employed for more than 150 days in the previous year 2025-26.

Additional employee cost = ₹ 2,16,00,000 + ₹ 24,000 × 7 × 100 = ₹ 3,84,00,000

Deduction under section 80JJAA = 30% of ₹ 3,84,00,000 = ₹ 1,15,20,000

(9) Deduction in respect of certain income of Offshore Banking Units and International Financial Services Centre [Section 80LA]

(i) Eligible assessee:

This section is applicable to the following assessees -

(a) a scheduled bank having an Offshore Banking Unit in a SEZ; or

(b) any bank, incorporated by or under the laws of a country outside India, and having an Offshore Banking Unit in a SEZ; or

(c) a Unit of an International Financial Services Centre (IFSC).

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(ii) Eligible income qualifying for deduction:

The deduction will be allowed on account of the following income included in the gross total income of such assessees -

(a) income from an Offshore Banking Unit in a SEZ; or

(b) income from the business referred to in section 6(1) of the Banking Regulation Act, 1949, with -

(1) an undertaking located in a SEZ or

(2) any other undertaking which develops, develops and operates or develops, operates and maintains a SEZ; or

(c) income from any Unit of the IFSC from its business for which it has been approved for setting up in such a Centre in a SEZ; or

(d) income arising from the transfer of an asset, being an aircraft or a ship or a helicopter or an engine of an aircraft or a helicopter, or any part thereof, which was leased by a unit of an IFSC referred to in clause (c) to a person, subject to the condition that the unit has commenced operation on or before ***31.03.2030***.

(iii) Quantum and period of deduction:

S. No.	Eligible assessee	Quantum and period of deduction	Relevant previous year from which deduction is allowed
(a)	a scheduled bank having an Offshore Banking Unit in a SEZ, whose GTI includes any income referred to in (ii) above	100% of such income for 5 consecutive AYs. Thereafter, 50% of such income for the next 5 consecutive AYs. **However, w.e.f. A.Y. 2023-24, such deduction of 50% available for next 5 consecutive assessment years has been enhanced to 100% of such income.**	Beginning with the assessment year relevant to the previous year in which (1) the permission under section 23(1)(a) of the Banking Regulation Act, 1949 was obtained; or (2) the permission or registration under the SEBI Act, 1992 was obtained; or (3) the permission or registration under the International Financial Services Centre Authority Act, 2019 was obtained.
(b)	any bank, incorporated by or under the laws of a country outside India, and having an Offshore Banking Unit in a SEZ, whose GTI includes any income referred to in (ii) above		
(c)	Unit of an International Financial Services Centre (IFSC), whose GTI includes any income referred to in (ii) above	100% of such income for any 10 consecutive AYs at the option of the assessee, out of 15 years.	

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(iv) Conditions:

The following conditions have to be fulfilled for claiming deduction under this section-

(a) The report of a Chartered Accountant in the prescribed form certifying that the deduction has been correctly claimed in accordance with the provisions of this section, should be submitted along with the return of income.

(b) A copy of the permission obtained under section 23(1)(a) of the Banking Regulation Act, 1949 or copy of permission or registration obtained under the International Financial Services Centre Authority Act, 2019 should also be furnished along with the return of income.

(10) Deduction in respect of inter-corporate dividends [Section 80M]

(i) Eligible assessee: Deduction under this section would be allowable to a domestic company if its gross total income includes in any previous year, any income by way of dividends received from any other domestic company or foreign company or a business trust.

(ii) Quantum of deduction: In computing the total income of such domestic company, a deduction of an amount equal to the amount of dividends received from other domestic company or foreign company or business trust as does not exceed the amount of dividend distributed by such domestic company on or before the due date.

In simple words, deduction under this section would be amount of dividend received from other domestic company/foreign company/business trust or dividend distributed by the domestic company, whichever is lower.

Example: *X Ltd. a domestic company received dividend of ₹ 10 lakhs from "Y Ltd", a domestic company (100% subsidiary of X Ltd.) during the previous year 2025-26. On 15th May, 2026, X Ltd. declared and distributed dividend of ₹ 5 lakhs.*

In this case, X Ltd. would be eligible for deduction under section 80M in respect of dividend received from Y Ltd. to the extent of ₹ 5 lakhs, being the amount of dividend declared and distributed by X Ltd. Hence, the deduction under section 80M would be ₹ 5 lakhs.

(iii) Meaning of due date: "Due date" means the date one month prior to the date for furnishing the return of income under section 139(1).

(iv) No deduction: Where any deduction, in respect of the amount of dividend distributed by the domestic company, has been allowed under this section in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.

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Note - *Deduction u/s 80M would be available to Indian company irrespective of the regime under which it pays tax.*

(11) Deduction in respect of income of co-operative societies [Section 80P]

(i) Applicability:

Under this section, certain specified income of a co-operative society would be allowed as a deduction, provided such income is included in the gross total income of the society.

(ii) Eligible income for deduction and quantum of deduction:

Deduction in respect of profit attributable to certain specified activities

100% deduction shall be allowed in respect of profits and gains attributable to any one or more of the following activities to a co-operative society engaged in -

(1) carrying on the business of banking or providing credit facilities to its members; or

(2) a cottage industry; or

(3) the marketing of the agricultural produce grown by its members; or

(4) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture or for the purpose of supplying them to its members; or

(5) the processing without the aid of power, of the agricultural produce of its members; or

(6) the collective disposal of the labour to its member; or

(7) fishing and other allied pursuits, such as catching, curing, processing, preserving, storing and marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to their members.

However, the exemption in respect of income referred to in (6) or (7) will be available only in the case of those co-operative societies which, under their rules and by-laws, restrict the voting rights to

(i) members who contribute their labour force or who actually carry on the fishing or other allied activities,

(ii) the co-operative credit societies which provide financial assistance to the society and

(iii) the State Government.

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Deduction in respect of profit of primary co-operative societies

100% of the profits and gains of the business would be allowed as deduction from the gross total income of the co-operative society in case of a primary co-operative society engaged in supplying milk, oilseeds, fruits or vegetables raised or grown by its members to –

- a federal co-operative society engaged in supplying milk, oilseeds, fruits or vegetables, as the case may be, or
- the Government or a local authority or
- a Government company as defined in section 617[6] of the Companies Act, 1956 or a corporation established by or under a Central, State or Provincial Act (engaged in supplying milk, oilseeds, fruits or vegetables, as the case may be, to the public),

Deduction in respect of other activities

A co-operative society which is engaged in activities other than to those mentioned above either independently of, or in addition to, all or any of the activities so specified, is eligible for deduction upto ₹ 50,000 to the extent of its business income arising from other activities. The limit is ₹ 1,00,000 in the case of consumer co-operative societies.

For this purpose, consumer co-operative society means a society for the benefit of the consumers.

Deduction in respect of Interest or dividend income

Any income arising to a co-operative society by way of any interest and dividends derived from its investments with any other co-operative society is deductible in full under this section.

Deduction in respect of letting-out income for certain purpose

The income derived by a co-operative society from the letting out of godowns or warehouses for storage, processing or facilitating the marketing of commodities is fully allowable as deduction.

Deduction in respect of interest on securities and income from house property to certain co-operative societies

Any income arising to a co-operative society by way of 'Interest on securities' or 'Income from house property' (chargeable under section 22) is fully deductible under this section

[6] *As defined in section 2(45) of the Companies Act, 2013*

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where the gross total income of the co-operative society does not exceed ₹ 20,000 and it is not a housing society or an urban consumer's society or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power. Thus, a majority of small co-operative societies would not have to pay any income-tax.

(iii) Meaning of urban consumers' co-operative society:

It means a society for the benefit of the consumers within the limits of a municipal corporation, municipality, municipal committee, notified area committee, town area or cantonment.

(iv) Deduction under other section of Chapter VI-A of the Act:

Where the co-operative society is also entitled to the deduction available under section 80-IA, the deduction under this section shall be allowed with reference to the gross total income as reduced by the deduction allowable under section 80-IA.

(v) Non-eligible co-operative societies:

Co-operative banks, other than primary agricultural credit societies (i.e. as defined in Part V of the Banking Regulation Act, 1949) and primary co-operative agricultural and rural development banks (i.e. societies having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities) are not eligible to claim deduction under section 80P. Moreover, the CBDT has, vide *Circular No. 6/2010 dated 20.9.2010* clarified that the Regional Rural Banks are not eligible for deduction under section 80P.

However, co-operative societies engaged in providing credit facilities solely to its members cannot be said to be a co-operative bank. Thus, such co-operative societies are eligible for deduction under section 80P [***PCIT v. Annasaheb Patil Mathadi Kamgar Sahakari Pathpedi Ltd. [2023] 454 ITR 117 (SC)]***.

Note - *In case of co-operative societies, deduction under section 80P would not be available if they opt for the special provisions u/s 115BAD/115BAE. In other words, deduction would be available only if they pay tax under the normal provisions of the Act.*

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(12) Deduction in respect of royalty income, etc., of authors of certain books other than text books [Section 80QQB]

(i) Eligible assessee and Quantum of deduction: Under section 80QQB, deduction of up to a maximum ₹ 3,00,000 is allowed to an individual resident in India, being an author including a joint author in respect of income derived by him in the exercise of his profession i.e., the deduction shall be the income derived as author or **₹ 3,00,000**, whichever is less.

(ii) Eligible income:

(a) This income may be received either by way of a lumpsum consideration for the assignment or grant of any of his interests in the copyright of any book.

(b) Such book should be a work of literary, artistic or scientific nature, or of royalties or copyright fees (whether receivable in lump sum or otherwise) in respect of such book.

(c) This deduction shall not, however, be available in respect of royalty income from brochures, commentaries, diaries, guides, journals, magazines, newspapers, pamphlets, textbook for schools, tracts and other publications of similar nature.

Note - Where an assessee claims deduction under this section, no deduction in respect of the same income may be claimed under any other provision of the Income-tax Act, 1961.

(iii) Manner of computation of deduction: For the purpose of calculating the deduction under this section, the amount of eligible income (royalty or copyright fee received otherwise than by way of lumpsum) before allowing expenses attributable to such income, shall not exceed 15% of the value of the books sold during the relevant previous year.

However, this condition is not applicable where the royalty or copyright fees is receivable in lump sum in lieu of all rights of the author in the book.

(iv) Conditions:

(a) **Furnishing of certificate in prescribed form**: For claiming the deduction, the assessee shall have to furnish a certificate in the prescribed manner in the prescribed format, duly verified by the person responsible for making such payment, setting forth such particulars as may be prescribed.

(b) **Period for repatriation of income earned outside India:** Where the assessee earns any income from any source outside India, he should bring such income into India in convertible foreign exchange within a period of six months from the end of the previous year in which such income is earned or within such further period as the

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competent authority may allow in this behalf for the purpose of claiming deduction under this section.

The competent authority shall mean the Reserve Bank of India or such other authority as is authorised under any law for the time being in force for regulating payments and dealings in foreign exchange.

Note - *Deduction under section 80QQB would be available to an individual resident in India only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

ILLUSTRATION 19

Mr. Aakash earned royalty of ₹ 2,88,000 from a foreign country for a book authored by him, being a work of literary nature. The rate of royalty is 18% of value of books. The expenditure incurred by him for earning this royalty was ₹ 40,000. The amount remitted to India till 30th September, 2026 is ₹ 2,30,000. The remaining amount was not remitted till 31st March, 2027. Compute the amount includible in the gross total income of Mr. Aakash and the amount of deduction which he will be eligible for under section 80QQB if he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

The net royalty of ₹ 2,48,000 (i.e., royalty of ₹ 2,88,000 *less* ₹ 40,000, being expenditure to earn such income) is includible in gross total income. Deduction u/s 80QQB would be ₹ 1,90,000 as calculated hereunder –

	₹
Deduction u/s 80QQB:	
Royalty ₹ 2,88,000 x 15/18 = ₹ 2,40,000	
Restricted to	
Amount brought into India in convertible foreign exchange within the prescribed time	2,30,000
Less: Expenses already allowed as deduction while computing royalty income	40,000
Deduction u/s 80QQB	**1,90,000**

(13) Deduction in respect of royalty on patents [Section 80RRB]

(i) **Eligible assessee:** This deduction shall be available only to a resident individual who is registered as the true and first inventor in respect of an invention under the Patents Act, 1970, including the co-owner of the patent and earning income by way of royalty of a patent registered on or after 1.4.2003.

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(ii) **Quantum of deduction:** This section allows deduction to a resident individual in respect of income by way of royalty of a patent registered on or after 1.4.03 up to an amount of **₹ 3 lakhs**.

Note - No deduction in respect of such income will be allowed under any other provision of the Income-tax Act, 1961

(iii) **Eligible income:** This deduction shall be restricted to the royalty income including consideration for transfer of rights in the patent or for providing information for working or use of a patent, use of a patent or the rendering of any services in connection with these activities.

The deduction shall not be available on any consideration for sale of product manufactured with the use of the patented process or patented article for commercial use.

(iv) **Conditions:**

(a) In respect of any such income which is earned from sources outside India, the deduction shall be restricted to such sum as is brought to India in convertible foreign exchange within a period of 6 months or extended period as is allowed by the competent authority (Reserve Bank of India).

(b) For claiming this deduction the assessee shall be required to furnish a certificate in the prescribed form signed by the prescribed authority, alongwith the return of income.

(v) **Rectification of assessment where patent is revoked subsequently:** Where the patent is subsequently revoked or the name of the assessee was excluded from the patents register as patentee in respect of that patent, the deduction allowed during the period shall be deemed to have been wrongly allowed and the assessment shall be rectified under the provisions of section 155.

The period of 4 years for rectification shall be reckoned from the end of the previous year in which the order of the revocation of the patent is passed.

Note - *Deduction under section 80RRB would be available to an individual resident in India only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

8.4 DEDUCTIONS IN RESPECT OF OTHER INCOME

(1) Deduction in respect of interest on deposits in savings accounts [Section 80TTA]

(i) **Eligible assessee and Quantum of deduction:** Section 80TTA provides that in case the gross total income of an assessee, being an individual or a Hindu Undivided Family, includes any income by way of an interest on deposits in a saving account (not being time deposits,

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which are deposits repayable on expiry of fixed periods), deduction upto **₹ 10,000** in aggregate shall be allowed while computing the total income of such assessee. Such deduction shall be allowed in case the saving account is maintained with:

(a) a banking company to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act);

(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.

Note - *Deduction under this section would, however, not be available to a senior citizen eligible for deduction under section 80TTB.*

(ii) Restriction: If the aforesaid income is derived from any deposit in a savings account held by, or on behalf of, a firm, an AOP/BOI, no deduction shall be allowed in respect of such income in computing the total income of any partner of the firm or any member of the AOP or any individual of the BOI.

In effect, the deduction under this section shall be allowed only in respect of the income derived in form of the interest on the saving bank deposit (other than time deposits) made by the individual or Hindu Undivided Family directly.

Note - *Deduction under section 80TTA would be available to an individual/HUF only if he/it exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

(2) Deduction in respect of interest on deposits in case of senior citizens [Section 80TTB]

(i) Eligible assessee: A senior citizen (a resident individual who is of the age of 60 years or more at any time during the relevant previous year), whose gross total income includes income by way of interest on deposits (both fixed deposits and saving accounts) with –

(a) a banking company to which Banking Regulation Act, 1949 applies

(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)

(c) a Post Office.

(ii) Quantum of deduction: Actual amount of interest on deposits or **₹ 50,000**, whichever is lower.

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(iii) Non-availability of deduction to partner/member, where deposit held by firm/AOP/BOI: Where interest income is derived from any deposit held by, or on behalf of, a firm, an AOP or a BOI, the partner of the firm or member of AOP/BOI would not be allowed deduction in respect of such income while computing their total income.

Note - *Deduction under section 80TTB would be available an individual only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

ILLUSTRATION 20

Mr. Shivpal, a resident individual aged about 64 years, has earned business income (computed) of ₹ 1,40,000, lottery income of ₹ 1,60,000 (gross) during the P.Y. 2025-26. He also has interest on Fixed Deposit of ₹ 51,000 with banks. He invested an amount of ₹ 1,50,000 in Public Provident Fund account. What is the total income of Mr. Shivpal for the A.Y.2026-27 if he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)?

SOLUTION

Computation of total income of Mr. Shivpal for A.Y.2026-27

Particulars	₹	₹
Profits and gains of business or profession		1,40,000
Income from other sources		
- Interest on Fixed Deposit with banks		51,000
- lottery income		1,60,000
Gross Total Income		**3,51,000**
Less: Deductions under Chapter VIA **[See Note below]**		
Under section 80C		
- Deposit in Public Provident Fund	1,50,000	
Under section 80TTB		
- Interest on fixed deposits with banks, allowable as deduction to the extent of	50,000	
	2,00,000	
Restricted to		1,91,000
Total Income		**1,60,000**

Note: *In case of resident individuals of the age of 60 years or more, interest on bank fixed deposits qualifies for deduction upto ₹ 50,000 under section 80TTB.*

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Though the aggregate of deductions under Chapter VI-A is ₹ 2,00,000, however, the maximum permissible deduction cannot exceed the gross total income exclusive of long term capital gains taxable under section 112 and section 112A, short-term capital gains covered under section 111A and winnings from lotteries of the assessee.

Therefore, the maximum permissible deduction under Chapter VI-A = ₹ 3,51,000 – ₹ 1,60,000 = ₹ 1,91,000.

8.5 OTHER DEDUCTIONS

Deduction in the case of a person with disability [Section 80U]

(1) Section 80U harmonizes the criteria for defining disability as existing under the Income-tax Rules with the criteria prescribed under the Persons with Disability (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995.

(2) **Eligible assessee:** This section is applicable to a resident individual, who, at any time during the previous year, is certified by the medical authority to be a person with disability.

The benefit of deduction under this section has also been extended to persons suffering from autism, cerebral palsy and multiple disabilities.

(3) **Quantum of deduction:** A deduction of **₹ 75,000** in respect of a person with disability and **₹ 1,25,000** in respect of a person with severe disability (having disability over 80%) is allowable under this section.

(4) **Conditions:**

(a) The assessee claiming a deduction under this section shall furnish a copy of the certificate issued by the medical authority in the form and manner, as may be prescribed, along with the return of income under section 139, in respect of the assessment year for which the deduction is claimed.

(b) Where the condition of disability requires reassessment, a fresh certificate from the medical authority shall have to be obtained after the expiry of the period mentioned on the original certificate in order to continue to claim the deduction.

Note - *Deduction under section 80U would be available to an individual only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).*

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8.6 DEDUCTION UNDER SECTION 10AA

A deduction of profits and gains which are derived by an assessee being an entrepreneur from the export of articles or things or providing any service, shall be allowed from the total income of the assessee.

Note - *In case of an individual, HUF, AoP (other than a co-operative society) or BoI or an artificial juridical person, deduction would be available only if such person has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). The deduction would be available only under the optional tax regime, where they pay tax under the normal provisions of the Act.*

In case of companies and co-operative societies, deduction would not be available if they opt for the special provisions u/s 115BAA/ 115BAB and section 115BAD/ 115BAE, respectively. The deduction would be available if they pay tax under the normal provisions of the Act.

(1) Assessees who are eligible for deduction

Deduction is available to all categories of assessees who derive any profits or gains from an undertaking, being a unit, engaged in the manufacturing or production of articles or things or things or provision any service. Such assessee should be an entrepreneur referred to in section 2(j) of the SEZ Act, 2005 i.e., a person who has been granted a letter of approval by the Development Commissioner under section 15(9) of the said Act.

(2) Essential conditions to claim deduction

The deduction would be available to an undertaking which fulfils the following conditions:

(i) It has begun to manufacture or produce articles or things or provide any service in any SEZ during the previous year relevant to A.Y.2006-07 or any subsequent assessment year but not later than A.Y.2020-21.

However, in case where letter of approval, required to be issued in accordance with the provisions of the SEZ Act, 2005, has been issued on or before 31st March, 2020 and the manufacture or production of articles or things or providing services has not begun on or before 31st March, 2020 then, the date for manufacture or production of articles or things or providing services has been extended to 31st March, 2021 or such other date after 31st March, 2021, as notified by the Central Government.

Example: If SEZ unit has received the necessary approval by 31.3.2020 and begins manufacture or production of articles or things or providing services on or

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before 31st March, 2021, then it would be deemed to have begun manufacture or production of articles or things or providing services during the A.Y. 2020-21 and would be eligible for exemption under section 10AA. [The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020]

(ii) The assessee should furnish in the prescribed form, before the date specified in section 44AB i.e., one month prior to the due date for furnishing return of income u/s 139(1), the report of a chartered accountant certifying that the deduction has been correctly claimed.

(iii) **No deduction** under section 10AA would be allowed to an assessee **who does not furnish a return of income on or before the due date specified u/s 139(1).**

Example: *An individual, subject to tax audit u/s 44AB, claiming deduction u/s 10AA is required to furnish return of income on or before 31.10.2026 for A.Y. 2026-27 and the report of a chartered accountant before 30.9.2026, certifying the deduction claimed u/s 10AA.*

(iv) Deduction under section 10AA would be available to a Unit, if the proceeds from sale of goods or provision of services is received in, or brought into, India by the assessee in convertible foreign exchange, within a period of 6 months from the end of the previous year or, within such further period as the competent authority may allow in this behalf.

The export proceeds from sale of goods or provision of services shall be deemed to have been received in India where such export turnover is credited to a separate account maintained for that purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India.

Meaning of Competent authority – Competent authority means RBI or such authority as is authorized under any law for the time being in force for regulating payments and dealings in foreign exchange.

(3) Period for which deduction is available

The unit of an entrepreneur, which begins to manufacture or produce any article or thing or provide any service in a SEZ on or after 1.4.2005, shall be allowed a deduction of:

(i) 100% of the profits and gains derived from the export, of such articles or things or from services for a period of 5 consecutive assessment years beginning with the

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assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, and

(ii) 50% of such profits and gains for further 5 assessment years.

(iii) so much of the amount not exceeding 50% of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilised in the manner laid down under section 10AA(2) for next 5 consecutive years.

However, *Explanation* below section 10AA(1) has been inserted to clarify that amount of deduction under section 10AA shall be allowed from the total income of the assessee computed in accordance with the provisions of the Act before giving effect to the provisions of this section and the deduction under section 10AA shall not exceed such total income of the assessee.

Example: *An undertaking is set up in a SEZ and begins manufacturing on 15.10.2011. The deduction under section 10AA shall be allowed as under:*

(a) 100% of profits of such undertaking from exports from A.Y.2012-13 to A.Y.2016-17.

(b) 50% of profits of such undertaking from exports from A.Y.2017-18 to A.Y. 2021-22.

(c) 50% of profits of such undertaking from exports from A.Y.2022-23 to A.Y.2026-27 provided certain conditions are satisfied.

(4) Conditions to be satisfied for claiming deduction for further 5 years (after 10 years) [Section 10AA(2)]

Sub-section (2) provides that the deduction under (3)(iii) above shall be allowed only if the following conditions are fulfilled, namely:-

(i) the amount credited to the Special Economic Zone Re-investment Reserve Account is utilized -

(1) for the purposes of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and

(2) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking. However, it should not be utilized for

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(i) distribution by way of dividends or profits; or

(ii) for remittance outside India as profits; or

(iii) for the creation of any asset outside India;

(ii) the particulars, as may be specified by the CBDT in this behalf, have been furnished by the assessee in respect of machinery or plant. Such particulars include details of the new plant/ machinery, name and address of the supplier of the new plant/ machinery, date of acquisition and date on which new plant/machinery was first put to use. Such particulars have to be furnished along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.

(5) Consequences of mis-utilisation / non-utilisation of reserve [Section 10AA(3)]

Where any amount credited to the Special Economic Zone Re-investment Reserve Account -

(i) has been utilised for any purpose other than those referred to in sub-section (2), the amount so utilized shall be deemed to be the profits in the year in which the amount was so utilised and charged to tax accordingly; or

(ii) has not been utilised before the expiry of the said period of 3 years, the amount not so utilised, shall be deemed to be the profits in the year immediately following the said period of three years and be charged to tax accordingly.

(6) Computation of profit and gains from exports of such undertakings

The profits derived from export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the unit, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking i.e.

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

<u>Clarification on issues relating to export of computer software</u>

Section 10AA provides deduction to assessees who derive any profits and gains from export of articles or things or services (including computer software) from the year in which the Unit

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begins to manufacture or produce such articles or things or provide services, as the case may be, subject to fulfillment of the prescribed conditions. The profits and gains derived from the 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.

Meaning of Export turnover: It means the consideration in respect of export by the undertaking, being the unit of articles or things or services received in India or brought into India by the assessee in convertible foreign exchange within 6 months from the end of the previous year or within such further period as the competent authority may allow in this behalf.

However, it does not include

- ✓ freight
- ✓ telecommunication charges
- ✓ insurance

attributable to the delivery of the articles or things outside India or expenses incurred in foreign exchange in rendering of services (including computer software) outside India

Computation of admissible deduction u/s 10AA of the Income-tax Act, 1961 [Circular No. 4/2018, Dated 14-8-2018]

As per the provisions of section 10AA(7), the profits derived from export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the undertaking.

Further as per clause (ia) to *Explanation 1* to section 10AA, "export turnover" means the consideration in respect of export by the undertaking, being the unit of articles or things or services received in India or brought into India by the assessee in convertible foreign exchange within 6 months from the end of the previous year or within such further period as the competent authority may allow in this behalf, 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.

The issue of whether freight, telecommunication charges and insurance expenses are to be excluded from both "export turnover"' and "total turnover' while working out deduction

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admissible under section 10AA on the ground that they are attributable to delivery of articles or things outside India has been highly contentious. Similarly, the issue whether charges for rendering services outside India are to be excluded both from "export turnover" and "total turnover" while computing deduction admissible under section 10AA on the ground that such charges are relatable towards expenses incurred in convertible foreign exchange in rendering services outside India has also been highly contentious.

The controversy has been finally settled by the Hon'ble Supreme Court vide its judgment dated 24.4.2018 in the case of Commissioner of Income Tax, Central-III Vs. M/s HCL Technologies Ltd. (CA No. 8489-8490 of 2013, NJRS Citation 2018-LL-0424-40), in relation to section 10A.

The issue had been examined by CBDT and it is clarified, in line with the above decision of the Supreme Court, that **freight, telecommunication charges and insurance expenses are to be excluded both from "export turnover" and "total turnover', while working out deduction admissible under section 10AA to the extent they are attributable to the delivery of articles or things outside India.**

Similarly, expenses incurred in foreign exchange for rendering services outside India are to be excluded from both "export turnover" and "total turnover" while computing deduction admissible under section 10AA.

Note: *Though this CBDT Circular is issued in relation to erstwhile section 10A, the same is also relevant in the context of section 10AA. Accordingly, the reference to section 10A in the Circular and the relevant sub-section and Explanation number thereto have been modified and given with reference to section 10AA and the corresponding sub-sections, Explanation number and clause of Explanation.*

(7) Restriction on other tax benefits

(i) During the period of deduction, depreciation is deemed to have been allowed on the assets. Written Down Value shall accordingly be reduced.

(iii) No deduction under section 80-IA and 80-IB shall be allowed in relation to the profits and gains of the undertaking.

(iv) Any unabsorbed depreciation under section 32(2) or business loss under section 72(1) or loss under the head “Capital gains” under section 74 of the undertaking, being the Unit shall be allowed to be carried forward or set off.

(v) The conditions laid down in section 80-IA(8) (relating to inter-unit transfer) and in section 80-IA(10) (relating to showing excess profit from such unit) shall, so far as

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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.

Conditions laid down in section 80-IA(8): Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee, or where any goods or service held for any other business carried on by the assessee are transferred to the eligible business and, in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value of such goods or services on the date of transfer.

In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis as he may deem fit.

Conditions laid down in section 80-IA(10): Where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits of such eligible business on a reasonable basis for allowing the deduction.

(vii) Where a deduction under this section is claimed and allowed in relation to any specified business eligible for investment-linked deduction under section 35AD, no deduction shall be allowed under section 35AD in relation to such specified business for the same or any other assessment year.

(8) Deduction allowable in case of amalgamation and demerger

In the event of any undertaking, being the Unit which is entitled to deduction under this section, being transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger, -

(i) no deduction shall be admissible under this section to the amalgamating or the demerged Unit for the previous year in which the amalgamation or the demerger takes place; and

(ii) the provisions of this section would apply to the amalgamated or resulting Unit, as they would have applied to the amalgamating or the demerged Unit had the amalgamation or demerger had not taken place.

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Circular No. 1/2013, dated 17.01.2013 provides certain clarifications in respect of following issues arising out of the said provisions:

	Issue	Clarification given by the CBDT
(1)	Would "On-site" development of computer software qualify as an export activity for tax benefit under section 10AA?	The software developed abroad at a client's place would be eligible for such benefit, because these would amount to 'deemed export'. However, it is necessary that there must exist a direct and intimate nexus or connection of development of software done abroad with the eligible units set up in India and such development of software should be pursuant to a contract between the client and the eligible unit.
(2)	Would receipts from deputation of technical manpower for such "On-site" software development abroad at the client's place be eligible for deduction under section 10AA?	*Explanation 2* to section 10AA clarifies that profits and gains derived from 'services for development of software' outside India would also be deemed as profits derived from export. Therefore, profits earned as a result of deployment of technical manpower at the client's place abroad specifically for software development work pursuant to a contract between the client and the eligible unit should not be denied benefit under section 10AA provided such deputation of manpower is for the development of such software and all the prescribed conditions are fulfilled.
(3)	Is it necessary to have separate master service agreement (MSA) for each work contract?	As per the practice prevalent in the software development industry, generally two types of agreement are entered into between the Indian software developer and the foreign client. Master Services Agreement (MSA) is an initial general agreement between a foreign client and the Indian software developer setting out the broad and general terms and conditions of business under the umbrella of which specific and individual Statement of Works (SOW) are formed. These SOWs, in fact, enumerate the specific scope and nature of the particular task or project that has to be rendered by a particular unit under the overall ambit of the MSA. Clarification has been sought whether more than one SOW can be executed under the ambit of a particular MSA and whether SOW should be given precedence over MSA. It is clarified that the tax benefits under section 10AA would not be denied merely on the ground that a separate and specific MSA does not exist for each SOW. The SOW would normally prevail over the MSA in determining the eligibility for tax benefits unless the Assessing Officer is able to establish that there has been splitting up or reconstruction of an existing business or non-fulfillment of any other prescribed condition.

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(4)	Would tax benefit under section 10AA continue to be available in case of a slump sale of a unit?	The answer to this issue would depend on the facts of each case, such as how a slump-sale is made and what is its nature. It will also be important to ensure that the slump sale would not result into any splitting or reconstruction of existing business. It is, however, clarified that on the sole ground of change in ownership of an undertaking, the claim of exemption cannot be denied to an otherwise eligible undertaking and the tax holiday can be availed of for the unexpired period at the rates as applicable for the remaining years, subject to fulfillment of prescribed conditions.
(5)	Can tax benefits under section 10AA be enjoyed by an eligible SEZ unit consequent to its transfer to another SEZ?	It is clarified that the tax holiday should not be denied merely on the ground of physical relocation of an eligible SEZ unit from one SEZ to another in accordance with Instruction No. 59 of Department of Commerce, if all the prescribed conditions are satisfied under the Income-tax Act, 1961. It is further clarified that the unit so relocated will be eligible to avail of the tax benefit for the unexpired period at the rates applicable to such years.

ILLUSTRATION 21

ABC Ltd. furnishes you the following information for the year ended 31.3.2026:

Particulars	*₹ (in lakhs)*
Total turnover of Unit A located in Special Economic Zone	*120*
Profit of the business of Unit A	*45*
Export turnover of Unit A received in India in convertible foreign exchange on or before 30.9.2026	*60*
Total turnover of Unit B located in Domestic Tariff Area (DTA)	*225*
Profit of the business of Unit B	*25*

Compute deduction under section 10AA for the A.Y. 2026-27, assuming that ABC Ltd. commenced operations in SEZ and DTA in the year 2019-20.

SOLUTION

50% of the profit derived from export of articles or things or services is eligible for deduction under section 10AA, since F.Y.2025-26 is the seventh year commencing from the year of manufacture or production of articles or things or provision of services by the Unit in SEZ. As per section 10AA(7),

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the profit derived from export of articles or things or services shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of articles or things or services bears to the total turnover of the business carried on by the undertaking.

Deduction under section 10AA

$$= \text{Profit of the business of Unit A} \times \frac{\text{Export Turnover of Unit A}}{\text{Total Turnover of Unit A}} \times 50\%$$

$$₹45 \text{ lakhs} \times \frac{₹\ 60 \text{ lakhs}}{₹\ 120 \text{ lakhs}} \times 50\% = ₹\ 11.25 \text{ lakhs}$$

Note – No deduction under section 10AA is allowable in respect of profits of business of Unit B located in DTA.

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SIGNIFICANT SELECT CASES

S. No.	Case Law	
1.	***CIT v. Reliance Energy Ltd. (2022) 441 ITR 346 (SC)***	
	Issue	**Analysis & Decision**
	Does profit-linked deduction under Chapter VI-A have to be restricted to income computed under the head "Profits and gains of business or profession"?	For the purpose of calculating profit-linked deduction under any section of Chapter VI-A, loss sustained in other divisions or units cannot be taken into account, as only profits from the eligible business have to be taken into account as if it was the only source of income. Profits and gains from eligible business cannot be reduced by the loss suffered in any other business owned by the assessee for consideration of deduction, *inter alia,* under section 80-IA. The deduction admissible under section 80-IA could not be limited to income under the head "Profits and gains of business or profession", by setting-off losses from non-eligible business against profits from eligible business. ***Note –*** *The issue arises in a case where loss from non-eligible business is being set-off against profits from eligible business, which results in income under the head "Profits and gains of business and profession" being lower than the profits from eligible business. In such a case, deduction under Chapter VI-A in respect of profits from eligible business would not be restricted to income computed under the head "Profits and gains of business and profession". The same would however be restricted to gross total income as per the requirement in section 80A(2).* *For example, let us take the case of XYZ Ltd., an Indian company, for P.Y.2025-26. The following are the particulars relating to the said company –* *(i) Profits from eligible business - ₹ 90 lakhs,* *(ii) Loss from non-eligible business - ₹ 20 lakhs (which is set-off against profits from eligible business)* *(iii) Income under the head "Profits and gains of business or profession" – ₹ 70 lakhs [₹ 90 lakhs – ₹ 20 lakhs]* *(iv) Income from Other Sources, comprising of interest income - ₹ 15 lakhs* *(v) Gross total income – ₹ 85 lakhs* *In this case, assuming deduction under section 80-IA is the only deduction under Chapter VI-A for XYZ Ltd., the same would not be restricted to ₹ 70 lakhs (being the income under the head "Profits*

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		and gains of business or profession"). However, the same would be restricted to ₹ 85 lakhs, being the gross total income as per the requirement in section 80A(2). *If, in the above example, the gross total income was ₹ 95 lakhs (instead of ₹ 85 lakhs), then, the entire profits of ₹ 90 lakhs from eligible business would be allowed as deduction u/s 80-IA.*
2.	***CIT v. Container Corporation of India Limited (2018) 404 ITR 397 (SC)***	
	Issue	**Analysis & Decision**
	Can Inland Container Depots (ICDs) be treated as infrastructure facility, for profits derived therefrom to be eligible for deduction u/s 80-IA?	Inland Container Depots function for the benefit of exporters and importers located in industrial centres which are situated at distance from sea ports. The purpose of establishing them was to promote the export and import in the country as these depots act as a facilitator and reduce inconvenience to the exporter or importer. Section 80-IA provides for a deduction of profits derived from operation of an infrastructure facility. The definition of "infrastructure facility" in *Explanation* to section 80-IA(4)(i) includes an inland port. **Considering the nature of work such as custom clearance carried out at inland container depots, it can be considered as an inland port within the meaning of section 80-IA(4).**
3.	***CIT v. Meghalaya Steels Ltd (2016) 383 ITR 217 (SC)***	
	Issue	**Analysis & Decision**
	Can transport subsidy, interest subsidy and power subsidy received from the Government be treated as profits "derived from" business or undertaking to qualify for deduction u/s 80-IE?	There is a direct nexus between profits and gains of the undertaking or business, and reimbursement of such subsidies. Transport subsidy, interest subsidy and power subsidy from Government were revenue receipts which were reimbursed to the assessee for elements of cost relating to manufacture or sale of their products. Thus, the **subsidies were only in order to reimburse, wholly or partially, costs actually incurred by the assessee in the manufacturing and selling of its products.** **Accordingly, these subsidies qualify for deduction u/s 80-IE**. ***Note*** *– Though this decision was in relation to deduction under section 80-IB, presently, it is relevant in the context of section 80-IE.*
4.	***CIT v. Orchev Pharma P. Ltd. (2013) 354 ITR 227 (SC) [Liberty India v. CIT (2009) 317 ITR 218 (SC) followed]***	
	Issue	**Analysis & Decision**
	Can Duty Drawback be treated as profit derived from the business of the eligible	DEPB / Duty drawback are incentives which flow from the schemes framed by the Central Government or from section 75 of the Customs Act, 1962. Section 80-IE provides for allowing of deduction in respect of profits and gains derived by undertaking from business mentioned

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	business to be eligible for deduction u/s 80-IE?	therein. However, incentive profits are **not** profits derived from eligible business u/s 80-IE. They belong to the category of ancillary profits of such undertaking. Profits derived by way of incentives such as DEPB/Duty drawback cannot be credited against the cost of manufacture of goods debited in the statement of profit and loss and they do not fall within the expression "profits derived from undertaking from manufacturing" u/s 80-IE. **Hence, Duty drawback receipts and DEPB benefits do not form part of the profits derived by undertaking from manufacturing business for the purpose of the deduction u/s 80-IE.** ***Note*** *– Though this decision was in relation to deduction under section 80-IB, presently, it is relevant in the context of section 80-IE.*
5.	***CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245 (Kar.)***	
	Issue	**Analysis & Decision**
	Can unabsorbed depreciation of a business of an industrial undertaking eligible for deduction u/s 80-IA be set off against income of another non-eligible business of the assessee?	**The deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1).** The assessee had incurred loss in eligible business after claiming depreciation. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed. It is thereafter that section 70(1) comes into play, whereby the assessee is entitled to set off the losses from one source against income from another source under the same head of income. Therefore, **the assessee was entitled to the benefit of set off of loss of eligible business against the profits of non-eligible business.** However, once set-off is allowed u/s 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off u/s 70(1) has to be first deducted while computing profits eligible for deduction u/s 80-IA in the subsequent year.
6.	***CIT v. Sunil Vishwambharnath Tiwari (2016) 388 ITR 630 (Bom)***	
	Issue	**Decision**
	Is the increase in gross total income consequent to disallowance u/s 40(a)(ia) eligible for profit-linked deduction under Chapter VI-A?	The assessee is entitled to claim deduction u/s 80-IBA in respect of the enhanced gross total income as a consequence of disallowance of expenditure u/s 40(a)(ia). ***Note*** *- The CBDT has, in its Circular No.37/2016 dated 2.11.2016, mentioned that the courts have generally held that if the expenditure disallowed is related to the business activity against which the Chapter VI-A deduction has been claimed, the deduction needs to be allowed on the enhanced profits. Thus, the settled position is that the disallowances made under sections 32,*

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		40(a)(ia), 40A(3), 43B, etc. and other specific disallowances, relating to the business activity against which the Chapter VI-A deduction has been claimed, result in enhancement of the profits of the eligible business, and that deduction under Chapter VI-A is admissible on the profits so enhanced on account of such disallowance.
7.	***CIT v. Nestor Pharmaceuticals Ltd. / Sidwal Refrigerations Ind Ltd. v. DCIT (2010) 322 ITR 631 (Delhi)***	
	Issue	**Analysis & Decision**
	Does the period of exemption u/s 80-IE commence from the year of trial production or year of commercial production? Would it make a difference if sale was effected from out of the trial production?	The assessee had started trial production in March 2015 whereas commercial production started only in April, 2015. With mere trial production, the manufacture for the purpose of marketing the goods had not started which starts only with commercial production, namely, when the final product to the satisfaction of the manufacturer has been brought into existence and is fit for marketing. However, in this case, since the assessee had effected sale in March 2015, it had crossed the stage of trial production and the final saleable product had been manufactured and sold. The quantum of commercial sale and the purpose of sale (namely, to obtain registration of excise / sales-tax) is not material. **With the sale of those articles, marketable quality was established.** Therefore, the conditions stipulated in section 80-IE were fulfilled with the commercial sale of the two items in that assessment year, and hence the ten year period has to be reckoned from A.Y.2015-16. ***Note*** *– Though this decision was in relation to deduction under section 80-IA, as it stood prior to its substitution by the Finance Act, 1999 w.e.f. 1.4.2000, presently, it is relevant in the context of section 80-IE.*
8.	***CIT v. Chetak Enterprises Pvt. Ltd. [2020] 423 ITR 267 (SC)***	
	Issue	**Analysis & Decision**
	Can an agreement entered into by a firm with a State Government and work done in pursuance thereof survive upon its conversion into a company and be considered compliant with sub-clauses (a) and (b) of section 80-	Section 80-IA(4)(i) requires that the assessee must be an enterprise carrying on business of (i) developing, (ii) maintaining and operating or (iii) developing, maintaining and operating any infrastructure facility, which enterprise is owned by a company registered in India fulfilling the conditions mentioned in sub-clauses (a) to (c) thereunder. Sub-clause (a) requires that the enterprise should be owned by a company registered in India. Sub-clause (b) requires that the enterprise should have entered into an agreement with the Central Government or State Government or local authority or any other statutory body for developing, operating and maintaining or developing, operating and maintaining a new

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	IA(4)(i), to qualify for deduction thereunder?	infrastructure facility. Sub-clause (c) requires that the enterprise should start operating and maintaining infrastructure facility on or after 1.4.1995. The assessee-company Memorandum of Association states that its main object was to acquire as a going concern, and continue the business carried on by the firm. The effect of conversion of the firm into a company was that all the properties of the firm, in law, vested in the company and the firm ceased to exist and assumed the status of a company after its registration as a company. Accordingly, the assessee-company is qualified for the deduction under section 80-IA being an enterprise carrying on the stated business pertaining to infrastructure facility and owned by a company registered in India on the basis of the agreement executed with the State Government to which the assessee-company has succeeded in law after conversion of the partnership firm into a company.
9.	***Praveen Soni v. CIT (2011) 333 ITR 324 (Delhi)***	
	Issue	**Analysis & Decision**
	Can an assessee who has not claimed deduction under section 80-IE in the initial years, start claiming deduction thereunder for the remaining years during the period of eligibility, if the conditions are satisfied?	On this issue, the Delhi High Court held that the provisions of section 80-IE nowhere stipulated a condition that the claim for deduction under this section had to be made from the first year of qualification of deduction failing which the claim will not be allowed in the remaining years of eligibility. Therefore, the deduction under section 80-IE should be allowed to the assessee for the remaining years up to the period for which his entitlement would accrue, provided the conditions mentioned under section 80-IE are fulfilled. ***Note*** *– Though this decision was in relation to deduction under section 80-IB, presently, it is relevant in the context of section 80-IE.*
10.	***PCIT v. Annasaheb Patil Mathadi Kamgar Sahakari Pathpedi Ltd. [2023] 454 ITR 117 (SC)***	
	Issue	**Analysis & Decision**
	Would a co-operative society engaged in providing credit facilities solely to its members be eligible for deduction under section 80P?	Merely because a co-operative society gives credit to its members, it cannot be said to be a co-operative bank under the Banking Regulation Act, 1949. Banking activities under that Act are altogether different activities. There is a vast difference between credit societies giving credit to their own members only and banks providing banking services including the credit to the public at large also. Considering the CBDT Circulars and the definition of bank under the Banking Regulation Act, the assessee cannot be said to be a

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		co-operative bank/bank, and, therefore, section 80P(4) denying benefit of deduction to a co-operative bank would not be applicable in this case. Accordingly, the assessee could not be termed as a bank or cooperative bank. Being a credit society, it is entitled to deduction under section 80P.
11.	***CIT v. Cognizant Technology Solutions of India Pvt. Ltd. [2023] 454 ITR 1 (SC)***	
	Issue	**Analysis & Decision**
	Is deduction under section 10AA available in respect of foreign exchange gain solely relating to the export business of the assessee?	In order to avail deduction under section 10AA, benefit earned by the assessee derived by virtue of export made by the assessee is considered. The exchange value based on upward or downward of the rupee value is not in the hands of the assessee. The assessee does not determine the exchange value of the Indian rupee. But for the fact that, the assessee is an export house, there was no question of earning any foreign exchange. Therefore, when the fluctuation in foreign exchange rate was solely relatable to the export business of the assessee and the higher rupee value was earned by virtue of such exports carried out by the assessee, the deduction under section 10AA would be available in respect of such foreign exchange gains.
12	***CIT v. HCL Technologies Limited (2018) 404 ITR 719 (SC)***	
	Issue	**Analysis & Decision**
	Can expenditure incurred in foreign exchange for provision of technical services outside India, which is deductible for computing export turnover, be excluded from total turnover also for the purpose of computing deduction u/s 10AA?	Deduction u/s 10AA is based on the profit from export business, thus, expenses excluded from "export turnover" must also be excluded from "total turnover", since one of the components of "total turnover" is export turnover. Expenses incurred in foreign exchange for providing the technical services outside are thus, to be excluded from total turnover also. If deductions in respect of freight, telecommunication charges and insurance attributable to delivery of articles, things etc. or expenditure incurred in foreign exchange in rendering of services outside India are allowed only against export turnover but not from the total turnover for computing deduction u/s 10AA, then, it would give rise to inadvertent, unlawful, meaningless and illogical results causing grave injustice, which could have never have been the intent of the Legislature. Hence, such **expenditure incurred in foreign exchange for providing technical services outside India is deductible from total turnover also**.

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TEST YOUR KNOWLEDGE

Questions

1. *Mr. Srinivasan, aged 61 years, furnishes the following particulars for the year ending 31.03.2026:*

   (a) *Life Insurance Premium paid – ₹ 15,000, actual capital sum of the policy assured for ₹ 2,30,000. The insurance policy was taken on 31.03.2012;*

   (b) *Contribution to Public Provident Fund – ₹ 40,000 in the name of father;*

   (e) *Tuition fee payment – ₹ 8,000 each for 2 sons pursuing full time graduation course in Calcutta; Tuition fee for daughter pursuing PHD in Kellogg University, USA – ₹ 2.50 lakhs;*

   (d) *Housing loan principal repayment – ₹ 32,000 to Axis Bank. This property is under construction at Calcutta as on 31.03.2026;*

   (e) *Principal repayment of housing loan taken from a relative – ₹ 70,000. The property is self-occupied situated at Pune;*

   (f) *Deposit under Senior Citizens Savings Scheme – ₹ 15,000;*

   (g) *Five-year deposits in an account under Post Office Time Deposit Scheme – ₹ 50,000;*

   (h) *Investment in National Savings Certificate – ₹ 70,000;*

   Compute the deduction eligible under appropriate provisions of section 80C for A.Y. 2026-27 if he shifts out of the default tax regime under section 115BAC.

2. *X Ltd. has two units, unit 'N' and unit 'Y'. Unit 'N' engaged in the business of power generation installed a windmill in March, 2026 and had a profit of ₹ 100 lakhs in Assessment Year 2026-27. X Ltd. claimed depreciation of ₹ 120 lakhs on windmill against the profit of ₹ 100 lakhs from power generation business which was eligible for deduction under section 80-IA. Unit 'Y', engaged in manufacturing of wires, non-eligible business, had a profit of ₹ 70 lakhs for Assessment Year 2026-27.The loss of ₹ 20 lakhs, i.e., balance depreciation not set off pertaining to unit 'N' was set-off against the profits of unit 'Y' carrying on non-eligible business, by the assessee, X Ltd. The Assessing Officer was of the view that depreciation relating to a business eligible for deduction under section 80-IA cannot be set-off against non-eligible business income. Hence, unabsorbed depreciation should be carried forward to*

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the subsequent year to be set off against eligible business income of the assessee of that year.

Examine the correctness of the action of the Assessing Officer.

3. *From the following details, compute the total income of Mr. A, Mr. B and Mr. C for A.Y. 2026-27 if they shift out of the default tax regime under section 115BAC –*

	Particulars	Mr. A	Mr. B	Mr. C
		₹	₹	₹
(i)	Salary (computed)	9,25,000	10,45,000	11,15,000
(ii)	Interest income (on fixed deposits)	75,000	85,000	95,000

The particulars of their other investments/payments made during the P.Y.2025-26 are given hereunder –

	Particulars	₹
(1)	Deposit in Public Provident Fund (PPF) by Mr. A	1,50,000
(2)	Life insurance premium paid by Mr. C, the details of which are as follows –	

Date of issue of policy	Person insured	Actual capital sum assured (₹)	Insurance premium paid during 2025-26 (₹)
31/3/2012	Self	2,48,000	15,000
11/6/2020	Spouse	1,25,000	15,000
31/7/2020	Handicapped son (Section 80U disability)	2,00,000	32,000

(3) **Payment of medical insurance premium by the following persons to insure their health:**

Payer	Amount in ₹	Mode of payment
Mr. A (aged 55 years)	30,000	Account payee cheque
Mr. B (aged 52 years)	15,000	Cash
Mr. C (aged 48 years)	20,000	Crossed cheque

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(4)	*Mr. B paid interest on loan taken for the purchase of house in which he currently resides. He is claiming benefit of self-occupation under section 23(2) in respect of this house. He does not own any other house.*	*2,20,000*
	Repayment of principal amount of loan taken for purchase of the said house	*1,70,000*
(5)	*Contribution by Mr. A by cheque to National Children's Fund during the year.*	*30,000*
(6)	*Mr. B makes the following donations during the P.Y.2025-26 -*	
	Donation to BJP by crossed cheque	*50,000*
	Donation to Electoral trust by cash	*50,000*

4. Following issues have been raised by Navi Limited in connection with its eligibility for claiming deduction under Chapter VI-A for your consideration and advice for the assessment year 2026-27:

(i) It operates two separate undertakings. One undertaking is eligible for deduction under section 80-IB, while the other undertaking is not eligible for such deduction. If the eligible undertaking has profit and the other undertaking has loss, should it claim deduction after setting off the loss of the other undertaking against profit of the eligible undertaking?

(ii) Its profit from one undertaking in North Eastern States which is eligible for deduction u/s 80-IE includes sale of import entitlement, duty drawback and interest from customers for delayed payment. Is it permissible to claim deduction u/s 80-IE on these items of income?

5. PQR Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities, has received the following amounts during the year ending 31.3.2026:

(i) Interest amounting to ₹ 1,00,000 from its members on loans advanced to them.

(ii) Interest amounting to ₹ 1,50,000 on deposits with other co-operative societies.

(iii) Rent amounting to ₹ 2,00,000 from letting out its godowns for storage of commodities.

PQR Co-operative Bank seeks your advice in the matter of eligibility for deduction, if any, in respect thereof for the assessment year 2026-27.

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Answers

1. Computation of eligible deduction under section 80C for A.Y.2026-27

Particulars	₹
Life Insurance Premium **(See Note 1)**	15,000
Contribution to Public Provident fund **(See Note 2)**	Nil
Tuition fee of 2 sons for graduation course **(See Note 3)**	16,000
Housing loan principal repayment **(See Notes 4 & 5)**	Nil
Senior Citizen Savings Scheme deposit **(See Note 6)**	15,000
Post Office Time Deposit Scheme **(See Note 6)**	50,000
Investment in National Savings Certificate **(See Note 6)**	70,000
Total Investment	**1,66,000**
Eligible deduction under section 80C restricted to	1,50,000

Notes:

1. Any amount of life insurance premium paid in excess of the specified percentage of actual capital sum assured shall be ignored for the purpose of deduction under section 80C. In the given case, since the insurance policy has been issued before 1.04.2012, therefore, premium paid upto 20% of actual capital sum assured i.e., ₹ 46,000 shall be allowed as deduction. Hence, the premium of ₹ 15,000 paid during the year is allowable as deduction under section 80C.

2. In the case of an individual, contribution to PPF can be made in his name or in the name of his spouse or children to qualify for deduction under section 80C. **As the contribution was made in the name of his father, deduction is not allowable.**

3. Tuition fee paid is eligible for deduction under section 80C for a maximum of two children. Therefore, ₹ 16,000 shall be allowed as deduction. **Tuition fee paid to an educational institution situated outside India is not eligible for deduction.**

4. In order to claim the principal repayment on loan borrowed for house property as deduction, the construction of such property should have been completed and should be chargeable to tax under the head "Income from house property". In the given case, since the property is under construction, principal repayment does not qualify for deduction.

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5. Repayment of principal on housing loan is not allowed as deduction in case the loan is borrowed from friends, relatives etc. In order to qualify for deduction, the loan should have been obtained from Central Government / State Government / bank / specified employer / institution.

6. The following investments are also eligible for deduction under section 80C:-

   (1) five year time deposit in an account under Post Office Time Deposit Rules, 1981; and

   (2) deposit in an account under the Senior Citizens Savings Scheme Rules, 2004.

   (3) investment in National Savings Certificate.

2. In *CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245*, the Karnataka High Court observed that it is a generally accepted principle that the deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1).

In this case, X Ltd. had incurred loss in eligible business (power generation) on account of claiming depreciation of ₹ 120 lakhs. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed.

It is, thereafter, that section 70(1) comes into play, whereby an assessee is entitled to set off the losses from one source against income from another source under the same head of income. Accordingly, X Ltd. is entitled to the benefit of set off of loss of ₹ 20 lakhs (representing balance depreciation not set-off) pertaining to Unit N engaged in eligible business of power generation against profit of ₹ 70 lakhs of Unit Y carrying on non-eligible business. Therefore, the net profit of ₹ 50 lakhs would be taxable in the A.Y.2026-27.

However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year. Accordingly, in the A.Y.2027-28, the net profits of Unit N has to be reduced by ₹ 20 lakhs for computing the profits eligible for deduction under section 80-IA in that year.

The action of the Assessing Officer in not permitting set-off of loss of eligible business against profits of non-eligible business in this case is, therefore, not correct.

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3. Computation of total income for A.Y.2026-27

	Particulars	Mr. A	Mr. B	Mr. C
		₹	₹	₹
	Salary	9,25,000	10,45,000	11,15,000
	Income from house property ***[See Note 4]***		(2,00,000)	
	Income from other sources (Interest)	75,000	85,000	95,000
(A)	**Gross total income**	**10,00,000**	**9,30,000**	**12,10,000**
	***Less:* Deductions under Chapter VIA**			
	<u>Under section 80C</u>			
	Deposit in PPF ***[See Note 1]***	1,50,000		
	LIC premium paid ***[See Note 2]***			57,500
	Principal repayment of housing loan (restricted to ₹ 1,50,000) ***[See Note 4]***		1,50,000	
	<u>Under section 80D</u>			
	Medical insurance premium ***[See Note 3]***	25,000	Nil	20,000
	<u>Under section 80G</u>			
	Contribution to National Children's Fund ***[See Note 5]***	30,000		
	<u>Under section 80GGC</u> ***[See Note 6]***			
	Donation to BJP by crossed cheque		50,000	
	Cash donation to Electoral Trust		Nil	
(B)	**Total deduction under Chapter VIA**	**2,05,000**	**2,00,000**	**77,500**
(C)	**Total Income (A) – (B)**	**7,95,000**	**7,30,000**	**11,32,500**

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Notes:

(1) The maximum amount eligible for deduction under section 80C shall not exceed ₹ 1,50,000. Mr. A would be eligible for deduction of ₹ 1,50,000 in respect of PPF under section 80C.

(2) **Deduction u/s 80C in respect of life insurance premium paid by Mr. C**

Date of issue of policy	Person insured	Actual capital sum assured	Insurance premium paid during 2025-26	Restricted to % of sum assured	Deduction u/s 80C
31/3/2012	Self	2,48,000	15,000	20%	15,000
11/6/2020	Spouse	1,25,000	15,000	10%	12,500
31/7/2020	Handicapped Son (section 80U disability)	2,00,000	32,000	15%	30,000
				Total	**57,500**

(3) **Medical Insurance Premium**

(i) Medical insurance premium of ₹ 30,000 paid by account payee cheque by Mr. A is allowed as a deduction under section 80D, subject to a maximum of ₹ 25,000.

(ii) Medical insurance premium paid by cash is not allowable as deduction. Hence, Mr. B is not eligible for deduction under section 80D in respect of medical insurance premium of ₹ 15,000 paid in cash.

(iii) Mr. C is eligible for deduction of ₹ 20,000 under section 80D in respect of medical insurance premium paid by crossed cheque.

(4) **Deduction in respect of interest and principal repayment of housing loan**

Mr. B is eligible for a maximum deduction of ₹ 2,00,000 under section 24 in respect of interest on housing loan taken in respect of a self-occupied property, for which he is claiming benefit of "Nil" annual value. Therefore, ₹ 2,00,000 would represent his loss from house property.

Further, the maximum amount eligible for deduction under section 80C should not exceed ₹ 1,50,000. Since, Mr. B has no other investment under section 80C during the previous year 2025-26, he would be eligible for deduction of ₹ 1,50,000 in respect of principal repayment of housing loan.

(5) Contribution to National Children's Fund qualifies for 100% deduction under section 80G. Therefore, Mr. A is entitled to 100% deduction of the sum of ₹ 30,000 contributed by him by way of cheque to National Children's Fund.

(6) Mr. B is eligible for deduction under section 80GGC in respect of donation to a political party made otherwise than by way of cash. However, cash donations to electoral trust do not qualify for deduction under section 80GGC.

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4. **(i)** Section 80-IB(13) provides that the provisions contained in section 80-IA(5) shall, so far as may be, apply to the eligible business under section 80-IB. Accordingly, for the purpose of computing the deduction under section 80-IB, the profits and gains of an eligible business shall be computed as if such eligible business was the only source of income of the assessee.

Therefore, Navi Limited should claim deduction under section 80-IB on profit from the eligible undertaking without considering the set off of losses suffered in the other undertaking. It may be noted that the aggregate deduction under Chapter VI-A, however, cannot exceed the gross total income of the assessee. It was held in in case of *Reliance Energy Ltd. (2022) 441 ITR 346 (SC).*

(ii) Under section 80-IE, where the gross total income of an assessee includes any profits and gains derived by an undertaking referred to in the section, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains at the specified percentage and for such number of years as specified in the section. In *CIT vs. Sterling Foods (1999) 237 ITR 579 (SC)* and *Liberty India vs. CIT (2009) 317 ITR 218 (SC),* it was held that sale of import entitlement and duty drawback cannot be construed as income derived from undertaking. Therefore, such income cannot be included in computing income for the purpose of deduction under section 80-IE.

Interest income derived by an undertaking on delayed collection of sale proceeds shall be treated as income derived from the undertaking, and therefore, the same would be eligible for deduction under section 80-IE. [*Phatela Cotgin Industries Private Limited vs CIT (2008) 303 ITR 411 (P & H)].*

5. Sub-section (4) of section 80P provides that section 80P shall not apply to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Explanation to section 80P(4) defines a primary co-operative agricultural and rural development bank to mean a society having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities.

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PQR Co-operative Bank is a primary co-operative agricultural and rural development bank as defined in the said *Explanation* since it is a co-operative society having its area of operation confined to Gubbi Taluk and its principal object is to provide long-term credit for agricultural and rural development activities. Therefore, it is eligible for deduction under section 80P.

Interest of ₹ 1,00,000 received by the bank on loans advanced to its members is eligible for deduction in full under section 80P(2)(a)(i).

Interest of ₹ 1,50,000 received by the bank from deposits with other co-operative societies qualifies for deduction in full under section 80P(2)(d).

Rent of ₹ 2,00,000 received by the bank from letting out its godowns for storage of commodities is eligible for deduction in full under section 80P(2)(e).

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ANNEXURE

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Annexure – 1

A. Income Computation and Disclosure Standard I relating to accounting policies

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard deals with significant accounting policies.

Fundamental Accounting Assumptions

2. The following are fundamental accounting assumptions, namely:—

   (a) Going Concern

   "Going concern" refers to the assumption that the person has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the business, profession or vocation and intends to continue his business, profession or vocation for the foreseeable future.

   (b) Consistency

   "Consistency" refers to the assumption that accounting policies are consistent from one period to another;

   (c) Accrual

   "Accrual" refers to the assumption that revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the previous year to which they relate.

Accounting Policies

3. The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by a person.

Considerations in the Selection and Change of Accounting Policies

4. Accounting policies adopted by a person shall be such so as to represent a true and fair view of the state of affairs and income of the business, profession or vocation. For this purpose,

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(i) the treatment and presentation of transactions and events shall be governed by their substance and not merely by the legal form; and

(ii) marked to market loss or an expected loss shall not be recognised unless the recognition of such loss is in accordance with the provisions of any other Income Computation and Disclosure Standard.

5. An accounting policy shall not be changed without reasonable cause.

Disclosure of Accounting Policies

6. All significant accounting policies adopted by a person shall be disclosed.

7. Any change in an accounting policy which has a material effect shall be disclosed. The amount by which any item is affected by such change shall also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact shall be indicated. If a change is made in the accounting policies which has no material effect for the current previous year but which is reasonably expected to have a material effect in later previous years, the fact of such change shall be appropriately disclosed in the previous year in which the change is adopted and also in the previous year in which such change has material effect for the first time.

8. Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item.

9. If the fundamental accounting assumptions of Going Concern, Consistency and Accrual are followed, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact shall be disclosed.

Transitional Provisions

10. All contract or transaction existing on the 1st day of April, 2016 or entered into on or after the 1st day of April, 2016 shall be dealt with in accordance with the provisions of this standard after taking into account the income, expense or loss, if any, recognised in respect of the said contract or transaction for the previous year ending on or before the 31st March,2016.

B. Income Computation and Disclosure Standard II relating to valuation of inventories

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of Business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of Income Tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

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Scope

1. This Income Computation and Disclosure Standard shall be applied for valuation of inventories, except :

   (a) Work-in-progress arising under 'construction contract' including directly related service contract which is dealt with by the Income Computation and Disclosure Standard on construction contracts;

   (b) Work-in-progress which is dealt with by other Income Computation and Disclosure Standard;

   (c) Shares, debentures and other financial instruments held as stock-in-trade which are dealt with by the Income Computation and Disclosure Standard on securities;

   (d) Producers' inventories of livestock, agriculture and forest products, mineral oils, ores and gases to the extent that they are measured at net realisable value;

   (e) Machinery spares, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular, shall be dealt with in accordance with the Income Computation and Disclosure Standard on tangible fixed assets.

Definitions

2 (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

   (a) **"Inventories"** are assets:

      (i) held for sale in the ordinary course of business;

      (ii) in the process of production for such sale;

      (iii) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

   (b) **"Net realisable value"** is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

   (2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meanings assigned to them in that Act.

Measurement

3. Inventories shall be valued at cost, or net realisable value, whichever is lower.

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Cost of Inventories

4. Cost of inventories shall comprise of all costs of purchase, costs of services, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Costs of Purchase

5. The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates and other similar items shall be deducted in determining the costs of purchase.

Costs of Services

6. The costs of services shall consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads.

Costs of Conversion

7. The costs of conversion of inventories shall include costs directly related to the units of production and a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads shall be those indirect costs of production that remain relatively constant regardless of the volume of production. Variable production overheads shall be those indirect costs of production that vary directly or nearly directly, with the volume of production.

8. The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion shall be based on the normal capacity of the production facilities. Normal capacity shall be the production expected to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production shall be used when it approximates to normal capacity. The amount of fixed production overheads allocated to each unit of production shall not be increased as a consequence of low production or idle plant. Unallocated overheads shall be recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed production overheads allocated to each unit of production is decreased so that inventories are not measured above the cost. Variable production overheads shall be assigned to each unit of production on the basis of the actual use of the production facilities.

9. Where a production process results in more than one product being produced simultaneously and the costs of conversion of each product are not separately identifiable, the costs shall be allocated between the products on a rational and

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consistent basis. Where by-products, scrap or waste material are immaterial, they shall be measured at net realisable value and this value shall be deducted from the cost of the main product.

Other Costs

10. Other costs shall be included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition

11. Interest and other borrowing costs shall not be included in the costs of inventories, unless they meet the criteria for recognition of interest as a component of the cost as specified in the Income Computation and Disclosure Standard on borrowing costs.

Exclusions from the Cost of Inventories

12. In determining the cost of inventories in accordance with paragraphs 4 to paragraphs 11, the following costs shall be excluded and recognised as expenses of the period in which they are incurred, namely:—

    (a) Abnormal amounts of wasted materials, labour, or other production costs;

    (b) Storage costs, unless those costs are necessary in the production process prior to a further production stage;

    (c) Administrative overheads that do not contribute to bringing the inventories to their present location and condition ;

    (d) Selling costs.

Cost Formulae

13. The Cost of inventories of items

    (i) that are not ordinarily interchangeable; and

    (ii) goods or services produced and segregated for specific projects shall be assigned by specific identification of their individual costs.

14. 'Specific identification of cost' means specific costs are attributed to identified items of inventory.

15. Where there are a large numbers of items of inventory which are ordinarily interchangeable, specific identification of costs shall not be made.

First-in First-out and Weighted Average Cost Formula

16. Cost of inventories, other than the inventory dealt with in paragraph 13, shall be assigned by using the First-in First-out (FIFO), or weighted average cost formula. The formula used shall reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.

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17. The FIFO formula assumes that the items of inventory which were purchased or produced first are consumed or sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average shall be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances.

Techniques for the Measurement of Cost

18 (1) Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate the actual cost. Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of the current conditions.

(2) The retail method can be used in the retail trade for measuring inventories of large number of rapidly changing items that have similar margins and for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing from the sales value of the inventory, the appropriate percentage gross margin. The percentage used takes into consideration inventory, which has been marked down to below its original selling price. An average percentage for each retail department is to be used.

Net Realisable Value

19. Inventories shall be written down to net realisable value on an item-by-item basis. Where 'items of inventory' relating to the same product line having similar purposes or end uses and are produced and marketed in the same geographical area and cannot be practicably evaluated separately from other items in that product line, such inventories shall be grouped together and written down to net realisable value on an aggregate basis.

20. Net realisable value shall be based on the most reliable evidence available at the time of valuation. The estimates of net realisable value shall also take into consideration the purpose for which the inventory is held. The estimates shall take into consideration fluctuations of price or cost directly relating to events occurring after the end of previous year to the extent that such events confirm the conditions existing on the last day of the previous year.

21. Materials and other supplies held for use in the production of inventories shall not be written down below the cost, where the finished products in which they shall be incorporated are expected to be sold at or above the cost. Where there has been a

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decline in the price of materials and it is estimated that the cost of finished products will exceed the net realisable value, the value of materials shall be written down to net realisable value which shall be the replacement cost of such materials.

Value of Opening Inventory

22. The value of the inventory as on the beginning of the previous year shall be

    (i) the cost of inventory available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and

    (ii) the value of the inventory as on the close of the immediately preceding previous year, in any other case.

Change of Method of Valuation of Inventory

23. The method of valuation of inventories once adopted by a person in any previous year shall not be changed without reasonable cause.

Valuation of Inventory in Case of Certain Dissolutions

24. In case of dissolution of a partnership firm or association of person or body of individuals, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value.

Transitional Provisions

25. Interest and other borrowing costs, which do not meet the criteria for recognition of interest as a component of the cost as per para 11, but included in the cost of the opening inventory as on the 1st day of April, 2016, shall be taken into account for determining cost of such inventory for valuation as on the close of the previous year beginning on or after 1st day of April, 2016 if such inventory continue to remain part of inventory as on the close of the previous year beginning on or after 1st day of April, 2016.

Disclosure

26. The following aspects shall be disclosed, namely:—

    (a) the accounting policies adopted in measuring inventories including the cost formulae used. Where Standard Costing has been used as a measurement of cost, details of such inventories and a confirmation of the fact that standard cost approximates the actual cost; and

    (b) the total carrying amount of inventories and its classification appropriate to a person.

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C. Income Computation and Disclosure Standard III relating to construction contracts

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard should be applied in determination of income for a construction contract of a contractor.

Definitions

2 (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) **"Construction contract"** is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use and includes :

(i) contract for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects;

(ii) contract for destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

(b) **"Fixed price contract"** is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which may be subject to cost escalation clauses.

(c) **"Cost plus contract"** is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a mark up on these costs or a fixed fee.

(d) **"Retentions"** are amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified.

(e) **"Progress billings"** are amounts billed for work performed on a contract whether or not they have been paid by the customer.

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(f) **"Advances"** are amounts received by the contractor before the related work is performed.

(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning respectively assigned to them in the Act.

3. A construction contract may be negotiated for the construction of a single asset. A construction contract may also deal with the construction of a number of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

4. Construction contracts are formulated in a number of ways which, for the purposes of this Income Computation and Disclosure Standard, are classified as fixed price contracts and cost plus contracts. Some construction contracts may contain characteristics of both a fixed price contract and a cost plus contract, for example, in the case of a cost plus contract with an agreed maximum price.

Combining and Segmenting Construction Contracts

5. The requirements of this Income Computation and Disclosure Standard shall be applied separately to each construction contract except as provided for in paragraphs 6, 7 and 8 herein. For reflecting the substance of a contract or a group of contracts, where it is necessary, the Income Computation and Disclosure Standard should be applied to the separately identifiable components of a single contract or to a group of contracts together.

6. Where a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

7. A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:

(a) the group of contracts is negotiated as a single package;

(b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and

(c) the contracts are performed concurrently or in a continuous sequence.

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8. Where a contract provides for the construction of an additional asset at the option of the customer or is amended to include the construction of an additional asset, the construction of the additional asset should be treated as a separate construction contract when:

   (a) the asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or

   (b) the price of the asset is negotiated without having regard to the original contract price.

Contract Revenue

9. Contract revenue shall be recognised when there is reasonable certainty of its ultimate collection.

10. Contract revenue shall comprise of:

    (a) the initial amount of revenue agreed in the contract, including retentions; and

    (b) variations in contract work, claims and incentive payments:

        (i) to the extent that it is probable that they will result in revenue; and

        (ii) they are capable of being reliably measured.

11. Where contract revenue already recognised as income is subsequently written off in the books of accounts as uncollectible, the same shall be recognised as an expense and not as an adjustment of the amount of contract revenue.

Contract Costs

12. Contract costs shall comprise of :

    (a) costs that relate directly to the specific contract;

    (b) costs that are attributable to contract activity in general and can be allocated to the contract;

    (c) such other costs as are specifically chargeable to the customer under the terms of the contract; and

    (d) allocated borrowing costs in accordance with the Income Computation and Disclosure Standard on Borrowing Costs.

    These costs shall be reduced by any incidental income, not being in the nature of interest, dividends or capital gains, that is not included in contract revenue.

13. Costs that cannot be attributed to any contract activity or cannot be allocated to a contract shall be excluded from the costs of a construction contract.

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14. Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract. Costs that are incurred in securing the contract are also included as part of the contract costs, provided

    (a) they can be separately identified; and

    (b) it is probable that the contract shall be obtained.

    When costs incurred in securing a contract are recognised as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

15. Contract costs that relate to future activity on the contract are recognised as an asset. Such costs represent an amount due from the customer and are classified as contract work in progress.

Recognition of Contract Revenue and Expenses

16. Contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date.

17. The recognition of revenue and expenses by reference to the stage of completion of a contract is referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed.

18. The stage of completion of a contract shall be determined with reference to:

    (a) the proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs; or

    (b) surveys of work performed; or

    (c) completion of a physical proportion of the contract work.

    Progress payments and advances received from customers are not determinative of the stage of completion of a contract.

19. When the stage of completion is determined by reference to the contract costs incurred upto the reporting date, only those contract costs that reflect work performed are included in costs incurred upto the reporting date. Contract costs which are excluded are:

    (a) contract costs that relate to future activity on the contract; and

    (b) payments made to subcontractors in advance of work performed under the subcontract.

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20. During the early stages of a contract, where the outcome of the contract cannot be estimated reliably contract revenue is recognised only to the extent of costs incurred. The early stage of a contract shall not extend beyond 25 % of the stage of completion.

Changes in Estimates

21. The percentage of completion method is applied on a cumulative basis in each previous year to the current estimates of contract revenue and contract costs. Where there is change in estimates, the changed estimates shall be used in determination of the amount of revenue and expenses in the period in which the change is made and in subsequent periods.

Transitional Provisions

22.1 Contract revenue and contract costs associated with the construction contract, which commenced on or after 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard.

22.2 Contract revenue and contract costs associated with the construction contract, which commenced on or before the 31st day of March, 2016 but not completed by the said date, shall be recognised based on the method regularly followed by the person prior to the previous year beginning on the 1st day of April, 2016.

Disclosure

23. A person shall disclose:

(a) the amount of contract revenue recognised as revenue in the period; and

(b) the methods used to determine the stage of completion of contracts in progress.

24. A person shall disclose the following for contracts in progress at the reporting date, namely:—

(a) amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;

(b) the amount of advances received; and

(c) the amount of retentions.

D. Income Computation and Disclosure Standard IV relating to revenue recognition

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

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Scope

1 (1) This Income Computation and Disclosure Standard deals with the bases for recognition of revenue arising in the course of the ordinary activities of a person from

(i) the sale of goods;

(ii) the rendering of services;

(iii) the use by others of the person's resources yielding interest, royalties or dividends.

(2) This Income Computation and Disclosure Standard does not deal with the aspects of revenue recognition which are dealt with by other Income Computation and Disclosure Standards.

Definitions

2 (1) The following term is used in this Income Computation and Disclosure Standard with the meanings specified:

(a) **"Revenue"** is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of a person from the sale of goods, from the rendering of services, or from the use by others of the person's resources yielding interest, royalties or dividends. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meanings assigned to them in that Act.

Sale of Goods

3. In a transaction involving the sale of goods, the revenue shall be recognised when the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership. In a situation, where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership, revenue in such a situation shall be recognised at the time of transfer of significant risks and rewards of ownership to the buyer.

4. Revenue shall be recognised when there is reasonable certainty of its ultimate collection.

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5. Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim for escalation of price and export incentives, revenue recognition in respect of such claim shall be postponed to the extent of uncertainty involved.

Rendering of Services

6. Subject to Para 7, revenue from service transactions shall be recognised by the percentage completion method. Under this method, revenue from service transactions is matched with the service transaction costs incurred in reaching the stage of completion, resulting in the determination of revenue, expenses and profit which can be attributed to the proportion of work completed. Income Computation and Disclosure Standard on construction contract also requires the recognition of revenue on this basis. The requirements of that Standard shall mutatis mutandis apply to the recognition of revenue and the associated expenses for a service transaction. However, when services are provided by an indeterminate number of acts over a specific period of time, revenue may be recognised on a straight line basis over the specific period.

7. Revenue from service contracts with duration of not more than ninety days may be recognised when the rendering of services under that contract is completed or substantially completed.

The Use of Resources by Others Yielding Interest, Royalties or Dividends

8. (1) Subject to sub paragraph (2), interest shall accrue on the time basis determined by the amount outstanding and the rate applicable.

   (2) Interest on refund of any tax, duty or cess shall be deemed to be the income of the previous year in which such interest is received.

   (3) Discount or premium on debt securities held is treated as though it were accruing over the period to maturity.

9. Royalties shall accrue in accordance with the terms of the relevant agreement and shall be recognised on that basis unless, having regard to the substance of the transaction, it is more appropriate to recognise revenue on some other systematic and rational basis.

10. Dividends are recognised in accordance with the provisions of the Act.

Transitional Provisions

11. The transitional provisions of Income Computation and Disclosure Standard on construction contract shall m**utatis mutandis** apply to the recognition of revenue and the associated costs for a service transaction undertaken on or before the 31st day of March, 2016 but not completed by the said date.

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12. Revenue for a transaction, other than a service transaction referred to in Para 10, undertaken on or before the 31st day of March, 2016 but not completed by the said date shall be recognised in accordance with the provisions of this standard for the previous year commencing on the 1st day of April, 2016 and subsequent previous year. The amount of revenue, if any, recognised for the said transaction for any previous year commencing on or before the 1st day of April, 2015 shall be taken into account for recognising revenue for the said transaction for the previous year commencing on the 1st day of April, 2016and subsequent previous years.

Disclosure

13. Following disclosures shall be made in respect of revenue recognition, namely:—

    (a) in a transaction involving sale of good, total amount not recognised as revenue during the previous year due to lack of reasonably certainty of its ultimate collection along with nature of uncertainty;

    (b) the amount of revenue from service transactions recognised as revenue during the previous year;

    (c) the method used to determine the stage of completion of service transactions in progress; and

    (d) for service transactions in progress at the end of previous year:

        (i) amount of costs incurred and recognised profits (less recognised losses) upto end of previous year;

        (ii) the amount of advances received; and

        (iii) the amount of retentions.

E. Income Computation and Disclosure Standard V relating to tangible fixed assets

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

cope

1. This Income Computation and Disclosure Standard deals with the treatment of tangible fixed assets.

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Definitions

2 (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) **"Tangible fixed asset"** is an asset being land, building, machinery, plant or furniture held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.

(b) "**Fair value"** of an asset is the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meanings assigned to them in that Act.

Identification of Tangible Fixed Assets

3. The definition in clause (a) of sub-paragraph (1) of paragraph 2 provides criteria for determining whether an item is to be classified as a tangible fixed asset.

4. Stand-by equipment and servicing equipment are to be capitalised. Machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised.

Components of Actual Cost

5. The actual cost of an acquired tangible fixed asset shall comprise its purchase price, import duties and other taxes, excluding those subsequently recoverable, and any directly attributable expenditure on making the asset ready for its intended use. Any trade discounts and rebates shall be deducted in arriving at the actual cost.

6. The cost of a tangible fixed asset may undergo changes subsequent to its acquisition or construction on account of

(i) price adjustment, changes in duties or similar factors; or

(ii) exchange fluctuation as specified in Income Computation and Disclosure Standard on the effects of changes in foreign exchange rates.

7. Administration and other general overhead expenses are to be excluded from the cost of tangible fixed assets if they do not relate to a specific tangible fixed asset. Expenses which are specifically attributable to construction of a project or to the acquisition of a tangible fixed asset or bringing it to its working condition, shall be included as a part of the cost of the project or as a part of the cost of the tangible fixed asset.

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8. The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, shall be capitalised. The expenditure incurred after the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as revenue expenditure.

Self- constructed Tangible Fixed Assets

9. In arriving at the actual cost of self-constructed tangible fixed assets, the same principles shall apply as those described in paragraphs 5 to 8. Cost of construction that relate directly to the specific tangible fixed asset and costs that are attributable to the construction activity in general and can be allocated to the specific tangible fixed asset shall be included in actual cost. Any internal profits shall be eliminated in arriving at such costs.

Non- monetary Consideration

10. When a tangible fixed asset is acquired in exchange for another asset, the fair value of the tangible fixed asset so acquired shall be its actual cost.

11. When a tangible fixed asset is acquired in exchange for shares or other securities, the fair value of the tangible fixed asset so acquired shall be its actual cost.

Improvements and Repairs

12. An Expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is added to the actual cost.

13. The cost of an addition or extension to an existing tangible fixed asset which is of a capital nature and which becomes an integral part of the existing tangible fixed asset is to be added to its actual cost. Any addition or extension, which has a separate identity and is capable of being used after the existing tangible fixed asset is disposed of, shall be treated as separate asset.

Valuation of Tangible Fixed Assets in Special Cases

14. Where a person owns tangible fixed assets jointly with others, the proportion in the actual cost, accumulated depreciation and written down value is grouped together with similar fully owned tangible fixed assets.

15. Where several assets are purchased for a consolidated price, the consideration shall be apportioned to the various assets on a fair basis.

Transitional Provisions

16. The actual cost of tangible fixed assets, acquisition or construction of which commenced on or before the 31st day of March, 2016 but not completed by the said date, shall be recognised in accordance with the provisions of this standard. The

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amount of actual cost, if any, recognised for the said assets for any previous year commencing on or before the 1st day of April, 2015 shall be taken into account for recognising actual cost of the said assets for the previous year commencing on the 1st day of April, 2016 and subsequent previous years.

Depreciation

17. Depreciation on a tangible fixed **asset shall be computed in accordance with the provisions of the Act.**

Transfers

18. Income arising on transfer of a tangible fixed **asset shall be computed in accordance with the provisions of the Act.**

Disclosures

19. Following disclosure shall be made in respect of tangible fixed assets, namely:—

(a) description of asset or block of assets;

(b) rate of depreciation;

(c) actual cost or written down value, as the case may be;

(d) additions or deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of—

(i) Central Value Added Tax credit claimed and allowed under the CENVAT Credit Rules, 2004;

(ii) change in rate of exchange of currency;

(iii) subsidy or grant or reimbursement, by whatever name called;

(e) depreciation Allowable; and

(f) written down value at the end of year.

F. Income Computation and Disclosure Standard VI relating to the effects of changes in foreign exchange rates

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

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Scope

1. This Income Computation and Disclosure Standard deals with:

   (a) treatment of transactions in foreign currencies;

   (b) translating the financial statements of foreign operations;

   (c) treatment of foreign currency transactions in the nature of forward exchange contracts.

Definitions

2. (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

   (a) **"Average rate"** is the mean of the exchange rates in force during a period.

   (b) **"Closing rate"** is the exchange rate at the last day of the previous year.

   (c) **"Exchange difference"** is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency of a person at different exchange rates.

   (d) **"Exchange rate"** is the ratio for exchange of two currencies.

   (e) **"Foreign currency"** is a currency other than the reporting currency of a person.

   (f) **"Foreign operations of a person"** is a branch, by whatever name called, of that person, the activities of which are based or conducted in a country other than India.

   (g) **"Foreign currency transaction"** is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when a person:—

      (i) buys or sells goods or services whose price is denominated in a foreign currency; or

      (ii) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

      (iii) becomes a party to an unperformed forward exchange contract; or

      (iv) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

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(h) **"Forward exchange contract"** means an agreement to exchange different currencies at a forward rate, and includes a foreign currency option contract or another financial instrument of a similar nature;

(i) **"Forward rate"** is the specified exchange rate for exchange of two Currencies at a specified future date;

(j) **"Indian currency"** shall have the meaning as assigned to it in section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999);

(k) **"Monetary items"** are money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money. Cash, receivables, and payables are examples of monetary items;

(l) **"Non-monetary items"** are assets and liabilities other than monetary items. Fixed assets, inventories, and investments in equity shares are examples of non-monetary items;

(m) **"Reporting currency"** means Indian currency except for foreign operations where it shall mean currency of the country where the operations are carried out.

(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning assigned to them in the Act.

Foreign Currency Transactions Initial Recognition

3 (1) A foreign currency transaction shall be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

(2) An average rate for a week or a month that approximates the actual rate at the date of the transaction may be used for all transaction in each foreign currency occurring during that period. If the exchange rate fluctuates significantly, the actual rate at the date of the transaction shall be used.

Conversion at Last Date of Previous Year

4. At last day of each previous year:—

(a) foreign currency monetary items shall be converted into reporting currency by applying the closing rate;

(b) where the closing rate does not reflect with reasonable accuracy, the amount in reporting currency that is likely to be realised from or required to disburse, a foreign currency monetary item owing to restriction on remittances or the

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closing rate being unrealistic and it is not possible to effect an exchange of currencies at that rate, then the relevant monetary item shall be reported in the reporting currency at the amount which is likely to be realised from or required to disburse such item at the last date of the previous year; and

(c) non-monetary items in a foreign currency shall be converted into reporting currency by using the exchange rate at the date of the transaction.

(d) non-monetary item being inventory which is carried at net realisable value denominated in a foreign currency shall be reported using the exchange rate that existed when such value was determined.

Recognition of Exchange Differences

5. (i) In respect of monetary items, exchange differences arising on the settlement thereof or on conversion thereof at last day of the previous year shall be recognised as income or as expense in that previous year.

(ii) In respect of non-monetary items, exchange differences arising on conversion thereof at the last day of the previous year shall not be recognised as income or as expense in that previous year.

Exceptions to Paragraphs 3, 4 and 5

6. Notwithstanding anything contained in paragraph 3, 4 and 5; initial recognition, conversion and recognition of exchange difference shall be subject to provisions of section 43A of the Act or Rule 115 of Income-tax Rules, 1962, as the case may be.

Financial Statements of Foreign Operations

7. The financial statements of a foreign operation shall be translated using the principles and procedures in paragraphs 3 to 6 as if the transactions of the foreign operation had been those of the person himself.

Forward Exchange Contracts

8. (1) Any premium or discount arising at the inception of a forward exchange contract shall be amortised as expense or income over the life of the contract. Exchange differences on such a contract shall be recognised as income or as expense in the previous year in which the exchange rates change. Any profit or loss arising on cancellation or renewal shall be recognised as income or as expense for the previous year.

(2) The provisions of sub-para (1) shall apply provided that the contract:

(a) is not intended for trading or speculation purposes; and

(b) is entered into to establish the amount of the reporting currency required or available at the settlement date of the transaction.

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(3) The provisions of sub-para (1) shall not apply to the contract that is entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction. For this purpose, firm commitment, shall not include assets and liabilities existing at the end of the previous year.

(4) The premium or discount that arises on the contract is measured by the difference between the exchange rate at the date of the inception of the contract and the forward rate specified in the contract. Exchange difference on the contract is the difference between:

(a) the foreign currency amount of the contract translated at the exchange rate at the last day of the previous year, or the settlement date where the transaction is settled during the previous year; and

(b) the same foreign currency amount translated at the date of inception of the contract or the last day of the immediately preceding previous year, whichever is later.

(5) Premium, discount or exchange difference on contracts that are intended for trading or speculation purposes, or that are entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction shall be recognised at the time of settlement.

Transitional Provisions

9. (1) All foreign currency transactions undertaken on or after 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard.

(2) Exchange differences arising in respect of monetary items or non-monetary items, on the settlement thereof during the previous year commencing on the 1st day of April, 2016 or on conversion thereof at the last day of the previous year commencing on the 1st day of April, 2016 , shall be recognised in accordance with the provisions of this standard after taking into account the amount recognised on the last day of the previous year ending on the 31st March, 2016 for an item, if any, which is carried forward from said previous year.

(3) The financial statements of foreign operations for the previous year commencing on the 1st day of April, 2016 shall be translated using the principles and procedures specified in this standard after taking into account the amount recognised on the last day of the previous year ending on the 31st March, 2016 for an item, if any, which is carried forward from said previous year.

(4) All forward exchange contracts existing on the 1st day of April, 2016 or entered on or after 1st day of April, 2016 shall be dealt with in accordance with the

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provisions of this standard after taking into account the income or expenses, if any, recognised in respect of said contracts for the previous year ending on or before the 31st March,2016.

G. Income Computation and Disclosure Standard VII relating to government grants

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of account.

In case of conflict between the provisions of the Income Tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard deals with the treatment of Government grants. The Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, waiver, concessions, reimbursements, etc.

2. This Income Computation and Disclosure Standard does not deal with:—

   (a) Government assistance other than in the form of Government grants; and

   (b) Government participation in the ownership of the enterprise.

Definitions

3 (1) The following terms are used in the Income Computation and Disclosure Standard with the meanings specified:

   (a) **"Government"** refers to the Central Government, State Governments, agencies and similar bodies, whether local, national or international.

   (b) **"Government grants"** are assistance by Government in cash or kind to a person for past or future compliance with certain conditions. They exclude those forms of Government assistance which cannot have a value placed upon them and the transactions with Government which cannot be distinguished from the normal trading transactions of the person.

   (2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning assigned to them in the Act.

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Recognition of Government Grants

4 (1) Government grants should not be recognised until there is reasonable assurance that

(i) the person shall comply with the conditions attached to them, and (ii) the grants shall be received.

(2) Recognition of Government grant shall not be postponed beyond the date of actual receipt.

Treatment of Government Grants

5. Where the Government grant relates to a depreciable fixed asset or assets of a person, the grant shall be deducted from the actual cost of the asset or assets concerned or from the written down value of block of assets to which concerned asset or assets belonged to.

6. Where the Government grant relates to a non-depreciable asset or assets of a person requiring fulfillment of certain obligations, the grant shall be recognised as income over the same period over which the cost of meeting such obligations is charged to income.

7. Where the Government grant is of such a nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total Government grant, the same proportion as such asset bears to all the assets in respect of or with reference to which the Government grant is so received, shall be deducted from the actual cost of the asset or shall be reduced from the written down value of block of assets to which the asset or assets belonged to.

8. The Government grant that is receivable as compensation for expenses or losses incurred in a previous financial year or for the purpose of giving immediate financial support to the person with no further related costs, shall be recognised as income of the period in which it is receivable.

9. The Government grants other than covered by paragraph 5, 6, 7, and 8 shall be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate.

10. The Government grants in the form of non-monetary assets, given at a concessional rate, shall be accounted for on the basis of their acquisition cost.

Refund of Government Grants

11. The amount refundable in respect of a Government grant referred to in paragraphs 6, 8 and 9 shall be applied first against any unamortised deferred credit remaining in respect of the Government grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount shall be charged to profit and loss statement.

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12. The amount refundable in respect of a Government grant related to a depreciable fixed asset or assets shall be recorded by increasing the actual cost or written down value of block of assets by the amount refundable. Where the actual cost of the asset is increased, depreciation on the revised actual cost or written down value shall be provided prospectively at the prescribed rate.

Transitional Provisions

13. All the Government grants which meet the recognition criteria of para 4 on or after 1st day of April, 2016 shall be recognised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard after taking into account the amount, if any, of the said Government grant recognised for any previous year ending on or before 31st day of March,2016.

Disclosures

14. Following disclosure shall be made in respect of Government grants, namely:—

    (a) nature and extent of Government grants recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets during the previous year;

    (b) nature and extent of Government grants recognised during the previous year as income;

    (c) nature and extent of Government grants not recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets and reasons thereof; and

    (d) nature and extent of Government grants not recognised during the previous year as income and reasons thereof.

H. Income Computation and Disclosure Standard VIII relating to securities

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of account.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Part A

Scope

1. This part of Income Computation and Disclosure Standard deals with securities held as stock-in-trade.

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2. This part of Income Computation and Disclosure Standard does not deal with:

(a) the bases for recognition of interest and dividends on securities which are covered by the Income Computation and Disclosure Standard on revenue recognition;

(b) securities held by a person engaged in the business of insurance;

(c) securities held by mutual funds, venture capital funds, banks and public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013).

Definitions

3 (1) The following terms are used in this part of Income Computation and Disclosure Standard with the meanings specified:

(a) **"Fair value"** is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

(b) **"Securities"** shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and shall include share of a company in which public are not substantially interested but shall not include derivatives referred to in sub-clause (ia) of that clause (h).

(2) Words and expressions used and not defined in this part of Income Computation and Disclosure Standard but defined in the Act shall have the meaning respectively assigned to them in the Act.

Recognition and Initial Measurement of Securities

4. **A security on acquisition shall be recognised at actual cost.**

5. **The actual cost of a security shall comprise of its purchase price and include acquisition charges such as brokerage, fees, tax, duty or cess.**

6. **Where a security is acquired in exchange for other securities,** the fair value of the security so acquired shall be its actual cost.

7. Where a security is acquired in exchange for another asset, the fair value of the security so acquired shall be its actual cost.

8. Where unpaid interest has accrued before the acquisition of an interest-bearing security and is included in the price paid for the security, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion of the interest is deducted from the actual cost.

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Subsequent Measurement of Securities

9. At the end of any previous year, securities held as stock-in-trade shall be valued at actual cost initially recognised or net realisable value at the end of that previous year, whichever is lower.

10. For the purpose of para 9, the comparison of actual cost initially recognised and net realisable value shall be done categorywise and not for each individual security. For this purpose, securities shall be classified into the following categories, namely:-

    (a) shares;

    (b) debt securities;

    (c) convertible securities; and

    (d) any other securities not covered above.

11. The value of securities held as stock-in-trade of a business as on the beginning of the previous year shall be:

    (a) the cost of securities available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and

    (b) the value of the securities of the business as on the close of the immediately preceding previous year, in any other case.

12. Notwithstanding anything contained in para 9, 10 and 11, at the end of any previous year, securities not listed on a recognised stock exchange; or listed but not quoted on a recognised stock exchange with regularity from time to time, shall be valued at actual cost initially recognised.

13. For the purposes of para 9, 10 and 11 where the actual cost initially recognised cannot be ascertained by reference to specific identification, the cost of such security shall be determined on the basis of first-in-first-out method or weighted average cost formula.

Part B

Scope

1. This part of Income Computation and Disclosure Standard deals with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013).

Definitions

2 (1) The following terms are used in this part of Income Computation and Disclosure Standard with the meanings specified:

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(a) "**Scheduled Bank**" shall have the meaning assigned to it in clause (ii) of the Explanation to clause (viia) of sub-section (1) of section 36 of the Act.

(b) **"Securities"** shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contract (Regulation) Act, 1956 (42 of 1956) and shall include share of a company in which public are not substantially interested;

(2) Words and expressions used and not defined in this part of Income Computation and Disclosure Standard but defined in the Act shall have the meaning respectively assigned to them in the Act.

Classification, Recognition and Measurement of Securities

3. Securities shall be classified, recognised and measured in accordance with the extant guidelines issued by the Reserve Bank of India in this regard and any claim for deduction in excess of the said guidelines shall not be taken into account. To this extent, the provisions of Income Computation and Disclosure Standard VI on the effect of changes in foreign exchange rates relating to forward exchange contracts shall not apply."

I. Income Computation and Disclosure Standard IX relating to borrowing costs Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of account.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. (1) This Income Computation and Disclosure Standard deals with treatment of borrowing costs.

(2) This Income Computation and Disclosure Standard does not deal with the actual or imputed cost of owners' equity and preference share capital.

Definitions

2. (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) **"Borrowing costs"** are interest and other costs incurred by a person in connection with the borrowing of funds and include:

(i) commitment charges on borrowings;

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(ii) amortised amount of discounts or premiums relating to borrowings;

(iii) amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;

(iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements.

(b) **"Qualifying asset"** means:

(i) land, building, machinery, plant or furniture, being tangible assets;

(ii) know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;

(iii) inventories that require a period of twelve months or more to bring them to a saleable condition.

(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning assigned to them in the Act.

Recognition

3. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation shall be determined in accordance with this Income Computation and Disclosure Standard. Other borrowing costs shall be recognised in accordance with the provisions of the Act.

4. For the purposes of this Income Computation and Disclosure Standard, "capitalisation" in the context of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph 2means addition of borrowing cost to the cost of inventory.

Borrowing Costs Eligible for Capitalisation

5. Subject to paragraph 8, the extent to which funds are borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised on that asset shall be the actual borrowing costs incurred during the period on the funds so borrowed.

"6. Subject to Para 8, in respect of borrowing other than those referred to in Para 5, if any, the amount of borrowing costs to be capitalised shall be computed in accordance with the following formula namely :—

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

Where

A = borrowing costs incurred during the previous year except on borrowings referred to in Para 5 above;

B = (i) the average of costs of qualifying asset as appearing in the balance sheet of a person on the first day and the last day of the previous year;

(ii) in case the qualifying asset does not appear in the balance sheet of a person on the first day, half of the cost of qualifying asset; or

(iii) in case the qualifying asset does not appear in the balance sheet of a person on the last day of the previous year, the average of the costs of qualifying asset as appearing in the balance sheet of a person on the first day of the previous year and on the date of put to use or completion, as the case may be, excluding the extent to which the qualifying assets are directly funded out of specific borrowings;

C = the average of the amount of total assets as appearing in the balance sheet of a person on the first day and the last day of the previous year, other than assets to the extent they are directly funded out of specific borrowings;

Explanation — For the purpose of this paragraph, a qualifying asset shall be such asset that necessarily require a period of twelve months or more for its acquisition, construction or production.

Commencement of Capitalisation

7. The capitalisation of borrowing costs shall commence:

(a) in a case referred to in paragraph 5, from the date on which funds were borrowed;

(b) in a case referred to in paragraph 6, from the date on which funds were utilised.

Cessation of Capitalisation

8. Capitalisation of borrowing costs shall cease:

(a) in case of a qualifying asset referred to in item (i) and (ii) of clause (b) of sub-paragraph (1) of paragraph 2, when such asset is first put to use;

(b) in case of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph 2, when substantially all the activities necessary to prepare such inventory for its intended sale are complete.

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9. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part shall cease:—

   (a) in case of part of a qualifying asset referred to in item (i) and (ii) of clause (b) of sub- paragraph (1) of paragraph 2, when such part of a qualifying asset is first put to use;

   (b) in case of part of inventory referred to in item (iii) of clause (b) of sub-paragraph

   (1) of paragraph 2, when substantially all the activities necessary to prepare such part of inventory for its intended sale are complete.

Transitional Provisions

10. All the borrowing costs incurred on or after 1st day of April, 2016 shall be capitalised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard after taking into account the amount of borrowing costs capitalised, if any, for the same borrowing for any previous year ending on or before 31st day of March,2016.

Disclosure

11. The following disclosure shall be made in respect of borrowing costs, namely:—

   (a) the accounting policy adopted for borrowing costs; and

   (b) the amount of borrowing costs capitalised during the previous year.

J. Income Computation and Disclosure Standard X relating to provisions, contingent liabilities and contingent assets

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts.

In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard deals with provisions, contingent liabilities and contingent assets, except those:

   (a) resulting from financial instruments;

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(b) resulting from executory contracts;

(c) arising in insurance business from contracts with policyholders; and

(d) covered by another Income Computation and Disclosure Standard.

2. This Income Computation and Disclosure Standard does not deal with the recognition of revenue which is dealt with by Income Computation and Disclosure Standard - Revenue Recognition.

3. The term 'provision' is also used in the context of items such as depreciation, impairment of assets and doubtful debts which are adjustments to the carrying amounts of assets and are not addressed in this Income Computation and Disclosure Standard.

Definitions

4 (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) **"Provision"** is a liability which can be measured only by using a substantial degree of estimation.

(b) **"Liability"** is a present obligation of the person arising from past events, the settlement of which is expected to result in an outflow from the person of resources embodying economic benefits.

(c) **"Obligating event"** is an event that creates an obligation that results in a person having no realistic alternative to settling that obligation.

(d) "Contingent liability" is:

(i) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the person; or

(ii) a present obligation that arises from past events but is not recognised because:

(A) it is not reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(B) a reliable estimate of the amount of the obligation cannot be made.

(e) **"Contingent asset"** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or

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nonoccurrence of one or more uncertain future events not wholly within the control of the person.

(f) **"Executory contracts"** are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

(g) **"Present obligation"** is an obligation if, based on the evidence available, its existence at the end of the previous year is considered reasonably certain.

(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning respectively assigned to them in the Act.

Recognition Provisions

5. A provision shall be recognised when:

(a) a person has a present obligation as a result of a past event;

(b) it is reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised.

6. No provision shall be recognised for costs that need to be incurred to operate in the future.

7. It is only those obligations arising from past events existing independently of a person's future actions, that is the future conduct of its business, that are recognised as provisions

8. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is enacted.

Contingent Liabilities

9. A person shall not recognise a contingent liability.

Contingent Assets

10. A person shall not recognise a contingent asset.

11. Contingent assets are assessed continually and when it becomes reasonably certain that inflow of economic benefit will arise, the asset and related income are recognised in the previous year in which the change occurs.

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Measurement Best Estimate

12. The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the previous year. The amount of a provision shall not be discounted to its present value.

13. The amount recognised as asset and related income shall be the best estimate of the value of economic benefit arising at the end of the previous year. The amount and related income shall not be discounted to its present value.

Reimbursements

14. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when it is reasonably certain that reimbursement will be received if the person settles the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision.

15. Where a person is not liable for payment of costs in case the third party fails to pay, no provision shall be made for those costs.

16. An obligation, for which a person is jointly and severally liable, is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Review

17. Provisions shall be reviewed at the end of each previous year and adjusted to reflect the current best estimate. If it is no longer reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

18. An asset and related income recognised as provided in para 11 shall be reviewed at the end of each previous year and adjusted to reflect the current best estimate. If it is no longer reasonably certain that an inflow of economic benefits will arise, the asset and related income shall be reversed.

Use of Provisions

19. A provision shall be used only for expenditures for which the provision was originally recognised.

Transitional Provisions

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

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Disclosure

21 (1) Following disclosure shall be made in respect of each class of provision, namely:-

(a) a brief description of the nature of the obligation;

(b) the carrying amount at the beginning and end of the previous year;

(c) additional provisions made during the previous year, including increases to existing provisions;

(d) amounts used, that is incurred and charged against the provision, during the previous year;

(e) unused amounts reversed during the previous year; and

(f) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

(2) Following disclosure shall be made in respect of each class of asset and related income recognised as provided in para 11, namely:—

(a) a brief description of the nature of the asset and related income;

(b) the carrying amount of asset at the beginning and end of the previous year;

(c) additional amount of asset and related income recognised during the year, including increases to assets and related income already recognised; and

(d) amount of asset and related income reversed during the previous year.

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ANNEXURE – 2

Rule 11UAB - Determination of fair market value for inventory.

(1) For the purposes of clause (via) of section 28 of the Act, the fair market value of the inventory,—

(i) being an immovable property, being land or building or both, shall be the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of stamp duty in respect of such immovable property on the date on which the inventory is converted into, or treated, as a capital asset;

(ii) being jewellery, archaeological collections, drawings, paintings, sculptures, any work of art, shares or securities referred to in rule 11UA, shall be the value determined in the manner provided in sub-rule (1) of rule 11UA and for this purpose the reference to the valuation date in the rule 11U and rule 11UA shall be the date on which the inventory is converted into, or treated, as a capital asset;

(iii) being the property, other than those specified in clause (i) and clause (ii), the price that such property would ordinarily fetch on sale in the open market on the date on which the inventory is converted into, or treated, as a capital asset.

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ANNEXURE – 3

Rule – 11U Meaning of expressions used in determination of fair market value.

11U. For the purposes of this rule and rule 11UA,—

(b) "balance-sheet", in relation to any company, means,—

(i) for the purposes of sub-rule (2) of rule 11UA, the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company appointed under section 224 of the Companies Act, 1956 (1 of 1956) and where the balance-sheet on the valuation date is not drawn up, the balance-sheet (including the notes annexed thereto and forming part of the accounts) drawn up as on a date immediately preceding the valuation date which has been approved and adopted in the annual general meeting of the shareholders of the company; and

(ii) in any other case,—

(A) in relation to an Indian company, the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company appointed under the laws relating to companies in force; and

(B) in relation to a company, not being an Indian company, the balance-sheet of the company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company, if any, appointed under the laws in force of the country in which the company is registered or incorporated;**]**

(c) "merchant banker" means category I merchant banker registered with Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);

(d) "quoted shares or securities" in relation to share or securities means a share or security quoted on any recognized stock exchange with regularity from time to time, where the quotations of such shares or securities are based on current transaction made in the ordinary course of business;

(e) "recognized stock exchange" shall have the same meaning as assigned to it in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

(f) "registered dealer" means a dealer who is registered under Central Sales Tax Act, 1956 or General Sales Tax Law for the time being in force in any State including value added tax laws;

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(g) "registered valuer" shall have the same meaning as assigned to it in section 34AB of the Wealth-tax Act, 1957 (27 of 1957) read with rule 8A of Wealth-tax Rules, 1957;

(h) "securities" shall have the same meaning as assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);

(i) "unquoted shares and securities", in relation to shares or securities, means shares and securities which is not a quoted shares or securities;

(j) "valuation date" means the date on which the property or consideration, as the case may be, is received by the assessee.

Rule 11UA - Determination of fair market value.

(1) For the purposes of section 56 of the Act, the fair market value of a property, other than immovable property, shall be determined in the following manner, namely,—

(a) valuation of jewellery,—

(i) the fair market value of jewellery shall be estimated to be the price which such jewellery would fetch if sold in the open market on the valuation date;

(ii) in case the jewellery is received by the way of purchase on the valuation date, from a registered dealer, the invoice value of the jewellery shall be the fair market value;

(iii) in case the jewellery is received by any other mode and the value of the jewellery exceeds rupees fifty thousand, then assessee may obtain the report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date;

(b) valuation of archaeological collections, drawings, paintings, sculptures or any work of art,—

(i) the fair market value of archaeological collections, drawings, paintings, sculptures or any work of art (hereinafter referred as artistic work) shall be estimated to be price which it would fetch if sold in the open market on the valuation date;

(ii) in case the artistic work is received by the way of purchase on the valuation date, from a registered dealer, the invoice value of the artistic work shall be the fair market value;

(iii) in case the artistic work is received by any other mode and the value of the artistic work exceeds rupees fifty thousand, then assessee may obtain the report of registered valuer in respect of the price it would fetch if sold in the open market on the valuation date;

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(c) valuation of shares and securities,—

(a) the fair market value of quoted shares and securities shall be determined in the following manner, namely,—

(i) if the quoted shares and securities are received by way of transaction carried out through any recognized stock exchange, the fair market value of such shares and securities shall be the transaction value as recorded in such stock exchange;

(ii) if such quoted shares and securities are received by way of transaction carried out other than through any recognized stock exchange, the fair market value of such shares and securities shall be,—

(a) the lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date, and

(b) the lowest price of such shares and securities on any recognized stock exchange on a date immediately preceding the valuation date when such shares and securities were traded on such stock exchange, in cases where on the valuation date there is no trading in such shares and securities on any recognized stock exchange;

(b) the fair market value of unquoted equity shares shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner, namely:—

the fair market value of unquoted equity shares =(A+B+C+D - L)× (PV)/(PE), where,

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

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

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

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

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

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

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

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

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

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

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

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

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

PV= the paid up value of such equity shares;

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

(c) the fair market value of unquoted shares and securities other than equity shares in a company which are not listed in any recognized stock exchange shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of which such valuation.

(2) Notwithstanding anything contained in sub-clause (b) or sub-clause (c), as the case may be, of clause (c) of sub-rule (1):—

(A) the fair market value of unquoted equity shares for the purposes of sub-clause (i) of clause (a) of the Explanation to clause (viib) of sub-section (2) of section 56 shall be the value, on the valuation date, of such unquoted equity shares, as shall be determined under sub-clause (a), sub-clause (b), sub-clause (c) or sub-clause (e), at the option of the assessee, where the consideration received by the assessee is from a resident ; and

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under sub-clauses (a) to (e) at the option of the assessee, where the consideration received by the assessee is from a non-resident, in the following manner:—

(a) the fair market value of unquoted equity shares =(A-L)× [PV/PE], where,

A = book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

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

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

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

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

(iv) any amount representing provision for taxation, other than amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;

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

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

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

PV = the paid up value of such equity shares; or

(b) the fair market value of the unquoted equity shares determined by a merchant banker as per the Discounted Free Cash Flow method;

(c) where any consideration is received by a venture capital undertaking for issue of unquoted equity shares, from a venture capital fund or a venture capital company

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or a specified fund, the price of the equity shares corresponding to such consideration may, at the option of such undertaking, be taken as the fair market value of the equity shares to the extent the consideration from such fair market value does not exceed the aggregate consideration that is received from a venture capital fund or a venture capital company or a specified fund:

Provided that the consideration has been received by the undertaking from a venture capital fund or a venture capital company or a specified fund, within a period of ninety days before or after the date of issue of shares which are the subject matter of valuation.

Explanation.—For the purposes of this clause,-

(i) "specified fund" shall have the same meaning as assigned to it in clause (aa) of Explanation to clause (viib) of sub-section (2) of section 56;

(ii) "venture capital company", "venture capital fund" and "venture capital undertaking" shall have the same meaning assigned to them in clause (b) of Explanation to clause (viib) of sub-section (2) of section 56.

Illustration: If a venture capital undertaking receives a consideration of fifty thousand rupees from a venture capital company for issue of one hundred shares at the rate of five hundred rupees per share, then such an undertaking can issue one hundred shares at this rate to any other investor within a period of ninety days before or after the receipt of consideration from venture capital company.

(d) the fair market value of the unquoted equity shares determined by a merchant banker in accordance with any of the following methods:

(i) Comparable Company Multiple Method;

(ii) Probability Weighted Expected Return Method;

(iii) Option Pricing Method;

(iv) Milestone Analysis Method;

(v) Replacement Cost Methods;

(e) where any consideration is received by a company for issue of unquoted equity shares, from any entity notified under clause (ii) of the first proviso to clause (viib) of sub-section (2) of section 56, the price of the equity shares corresponding to such consideration may, at the option of such company, be taken as the fair market value of the equity shares to the extent the consideration from such fair market value does not exceed the aggregate consideration that is received from the notified entity:

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Provided that the consideration has been received by the company from the entity notified under clause (ii) of the first proviso to clause (viib) of sub-section (2) of section 56, within a period of ninety days before or after the date of issue of shares which are the subject matter of valuation.

(B) the fair market value of compulsorily convertible preference shares for the purposes of sub-clause (i) of clause (a) of the Explanation to clause (viib) of sub-section (2) of section 56 shall be the value, on the valuation date, as determined-

(i) in accordance with the provisions of sub-clause (b), sub-clause (c), or sub-clause (e) of clause (A), at the option of the assessee, or based on the fair market value of unquoted equity shares determined in accordance with sub-clause (a), sub-clause (b), sub-clause (c), or sub-clause (e) of clause (A), at the option of the assessee, where such consideration is received from a resident; and

(ii) in accordance with the provisions of sub-clauses (b) to (e) of clause (A), at the option of the assessee, or based on the fair market value of unquoted equity shares determined in accordance with sub-clauses (a) to (e) of clause (A), at the option of the assessee, where such consideration is received from a non-resident.

(3) Where the date of valuation report by the merchant banker for the purposes of sub-rule (2) is not more than ninety days prior to the date of issue of shares which are the subject matter of valuation, such date may, at the option of the assessee, be deemed to be the valuation date:

Provided that where such option is exercised under this sub-rule, the provisions of clause (j) of rule 11U shall not apply.

(4) For the purposes of clause (A) or clause (B) of sub-rule (2), where the issue price of the shares exceeds the value of shares as determined in accordance with -

(i) sub-clause (a) or sub-clause (b) of clause (A), for consideration received from a resident, by an amount not exceeding ten per cent. of the valuation price, the issue price shall be deemed to be the fair market value of such shares;

(ii) sub-clause (a) or sub-clause (b) or sub-clause (d) of clause (A), for consideration received from a non- resident, by an amount not exceeding ten per cent. of the valuation price, the issue price shall be deemed to be the fair market value of such shares.

Explanation.—For the purposes of this sub-rule, 'issue price' means the consideration received by the company for one share.]

Rule 11UAA - Determination of Fair Market Value for share other than quoted share.

For the purposes of section 50CA, the fair market value of the share of a company other than a quoted share, shall be determined in the manner provided in sub-clause (b) or sub-clause (c),as the case may be, of clause (c) of sub-rule (1) of rule 11UA and for this purpose the reference to valuation date in the rule 11U and rule 11UA shall mean the date on which the capital asset, being share of a company other than a quoted share, referred to in section 50CA, is transferred.

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Final Course
Study Material
(Modules 1 to 4)

Paper 4

Direct Tax Laws & International Taxation

[Direct Tax Laws as amended by the Finance Act, 2025]
Assessment Year 2026-27

Module – 2

(Relevant for May 2026, September 2026 and January 2027 examinations)

BOARD OF STUDIES (ACADEMIC)
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CHAPTER 9

ASSESSMENT OF VARIOUS ENTITIES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

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

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CHAPTER OVERVIEW

Taxation of companies

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

Special provisions relating to shipping companies

Alternate Minimum Tax for persons other than companies

Taxation of firms/LLPs and their partners

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

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- Default Regime u/s 115BAC
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Tax on income from transfer of carbon credits

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9.1 TAXATION OF COMPANIES

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

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

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

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

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

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

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

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

(2) Classes of Companies

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

  (1) **Domestic company** means

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[1]The Companies Act, 2013

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

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

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

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

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

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

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

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

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

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[2] Section 8 of the Companies Act, 2013

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

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

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

  (a) Government or

  (b) a Statutory Corporation or

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

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

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

Relevance of the above classification:

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

Domestic companies are taxed at

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

Section 406 of the Companies Act, 2013[3]

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

Surcharge

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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(1)	(2)	(3)		(4)
	Particulars	**Section 115BAB**		**Section 115BAA**
	availing the concessional rate of tax and exemption from MAT	(i)	without providing for deduction under any of the following sections:	
			Section	**Provision**
			10AA	Exemption of profits and gains derived from export of articles or things or from services by an assessee, being an entrepreneur from his Unit in SEZ.
			32(1)(iia)	Additional depreciation @20%, as the case may be, of actual cost of new plant and machinery acquired and installed by manufacturing undertakings.
			33AB	Deduction@40% of profits and gains of business of growing and manufacturing tea, coffee or rubber in India, to the extent deposited with NABARD in accordance with scheme approved by the Tea/Coffee/Rubber Board.
			33ABA	Deduction@20% of the profits of a business of prospecting for, or extraction or production of, petroleum or natural gas or both in India, to the extent deposited with SBI in an approved scheme or deposited in Site Restoration Account.
			35(1)(ii)/(iia)/(iii)	Deduction for payment to any research association, company, university etc. for undertaking scientific research or social science or statistical research.
			35(2AA)	Deduction of payment to a National Laboratory or University or IIT or approved specified person for scientific research
			35(2AB)	Deduction of in-house scientific research expenditure incurred by a company engaged in the business of bio-technology or in the business of manufacture or production of an article or thing.
			35AD	Investment-linked tax deduction for specified businesses.

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(1)	(2)	(3)			(4)
	Particulars	**Section 115BAB**			**Section 115BAA**
			35CCC	Deduction of expenditure incurred on notified agricultural extension project	
			35CCD	Deduction of expenditure incurred by a company on notified skill development project.	
			80C to 80U	Deductions from gross total income under Chapter VI-A other than the provisions of section 80JJAA or section 80M.	
		(ii)	without set-off of any loss or allowance for unabsorbed depreciation deemed so u/s 72A, where such loss or depreciation is attributable to any of the deductions listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further deduction for such loss shall be allowed for any subsequent year]		
		(iii)	by claiming depreciation u/s 32 determined in the prescribed manner (i.e., in respect of depreciation of any block of assets entitled to more than 40% shall be restricted to 40% on the written down value of such block of assets). However, additional depreciation u/s 32(1)(iia) cannot be claimed.		
		***Note* – *Additional points relevant in the context of section 115BAA*:** *(1) In case of a company opting for section 115BAA, total income should be computed without set-off of any loss carried forward or depreciation from any earlier assessment year, where such loss or depreciation is attributable to any of the deductions listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further deduction for such loss or depreciation shall be allowed for any subsequent year]* *(2) In the case of a person having a Unit in the IFSC, referred to in section 80LA(1A), which has exercised option for section 115BAA, deduction u/s 80LA would be allowed subject to fulfilment of the conditions specified in that section.* *(3) Since there is no time line within which option under section 115BAA can be exercised, a domestic company*			

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

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

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

Note *- For the purpose of point no.7(iv) in column (3) of the above table in relation to a company exercising option under section 115BAB, any machinery or plant which was used outside India by*

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any other person shall not be regarded as machinery or plant previously used for any purpose, if all the following conditions are fulfilled, namely:—

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

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

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

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

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

(i) Applicability of MAT

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

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

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

(b) Insurance companies, banking companies, companies engaged in generation or supply of electricity or any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company,

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shall for the purposes of this section, prepare its statement of profit and loss for the relevant previous year in accordance with the provisions of the Act governing such company **[Section 115JB(2)(b)].**

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

(i) the accounting policies,

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

(iii) the method and rates for calculating depreciation

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

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

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

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

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

[It may be noted that income-tax includes –

(1) interest;

(2) surcharge;

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

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

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

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

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

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

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

(fb) **Expenditure relatable to income accruing to foreign company:** The amount or amounts of expenditure relatable to income accruing or arising to an assessee, being a foreign company, from –

(A) the capital gains arising on transactions in securities; or

(B) the interest, dividend, royalty, or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII i.e., section 115A

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

(fc) **Notional loss on the units of business trust:** The amount representing-

- notional loss on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust; or
- notional loss resulting from any change in carrying amount of said units or
- loss on transfer of such units

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

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

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

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

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

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

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

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

The profit shall be reduced by the following amounts:

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

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

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

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

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

(iic) **Share of the assessee in the income of an AOPs or BOIs:** The amount of income, being the share of the assessee in the income of an AOPs or BOIs, on which no

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income-tax is payable in accordance with the provisions of section 86, if any such amount is credited to the statement of profit and loss;

(iid) **Income accruing to foreign company:** The amount of income accruing or arising to an assessee, being a foreign company, from, -

(A) the capital gains arising on transactions in securities; or

(B) the interest, dividend, royalty, or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII i.e., section 115A,

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

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

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

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

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

(C) gain on transfer of such units,

if any, credited to statement of profit and loss;

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

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

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

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

(B) company against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under section 7 or section 9 or section 10 of the Insolvency and Bankruptcy Code, 2016.

It may be noted that loss does not include depreciation.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sl. No	Items	Point of time
1	Changes in revaluation surplus of Property, Plant or Equipment (PPE) and Intangible assets (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realization/ disposal/ retirement or otherwise transferred
2	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109)	To be included in book profits at the time of realization/ disposal/ retirement or otherwise transferred
3	Remeasurements of defined benefit plans (Ind AS 19)	To be included in book profits every year as the re-measurements gains and losses arise
4	Any other item	To be included in book profits every year as the gains and losses arise

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

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

Appendix A of Ind AS 10 provides that any distributions of non-cash assets to shareholders in a demerger shall be accounted for at fair value. The difference between the carrying value of the assets and the fair value is recorded in the statement of profit and loss.

Correspondingly, the reserves are debited at fair value to record the distribution as a 'deemed dividend' to the shareholders. As there is a corresponding adjustment in retained earnings, this difference arising on demerger shall be excluded from the book profits.

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II. **In case of demerger [Sub-section (2B)]:** In the case of a resulting company, the property and the liabilities of the undertaking or undertakings being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computation of book profit of the resulting company under this section.

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

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

In the first year of adoption of Ind AS, the companies would prepare Ind AS financial statement for reporting year with a comparative financial statement for immediately preceding year. As per Ind AS 101, a company would make all Ind AS adjustments on the opening date of the comparative financial year. The entity is also required to present an equity reconciliation between previous Indian GAAP and Ind AS amounts, both on the opening date of preceding year as well as on the closing date of the preceding year.

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

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

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

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

However, the book profit of the previous year in which the asset or investment referred to in sub clauses (B) to (E) of clause (iii) of the *Explanation* is retired, disposed, realised or otherwise transferred shall be increased or decreased, as the case may

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be, by the amount or the aggregate of the amounts referred to in the said sub-clause relatable to such asset or investment **[First proviso to section 115JB(2C)].**

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

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

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

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

Transitional adjustments: Analysis

(i) The adjustments arising on account of transition to Ind AS from existing Indian GAAP is required to be recorded directly in Other Equity at the date of transition to Ind AS. These adjustments have to be made in the following manner:

(a) The book profit of the year of convergence and the following four previous years shall be increased or decreased with the transitional adjustments recorded directly in Other Equity excluding capital reserve and securities premium reserve and excluding the amounts referred in (A) to (F) (in the definition of Transition Amount), on the convergence date.

(b) Those adjustments recorded in other comprehensive income referred in (A) above (in the definition of Transition Amount) and which would subsequently be reclassified to the profit and loss, shall be included in book profits in the year in which these are reclassified to the profit and loss, therefore these amounts are excluded from the transition amount.

(c) Those adjustments recorded in other comprehensive income referred in (B) and (C) (in the definition of Transition Amount) above and which would never be subsequently reclassified to the profit and loss shall be included in book profits as specified hereunder:

Sl. No	Items	Point of time
1	Changes in revaluation surplus of Property, Plant or Equipment (PPE) and Intangible assets (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred
2	Gains and losses from investments in equity instruments designated at fair value through other	To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred

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

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

(I) **Property, Plant and Equipment (PPE) and intangible assets at fair value as deemed cost [referred in (D)(in the definition of Transition Amount) above]**

An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for an item of PPE or an intangible asset as mentioned in paragraphs D5 and D7 of Ind AS 101. In such cases the treatment shall be as under—

- The existing provisions for computation of book profits under section 115JB of the Act provide that in case of revaluation of assets, any impact on account of such revaluation shall be ignored for the purposes of computation of book profits. Further, the adjustments in retained earnings on first time adoption with respect to items of PPE and Intangible assets shall be ignored for the purposes of computation of book profits.
- Depreciation shall be computed ignoring the amount of aforesaid retained earnings adjustment.

Similarly, gain/loss on realization/ disposal/ retirement of such assets shall be computed ignoring the aforesaid retained earnings adjustment.

II. **Investments in subsidiaries, joint ventures and associates at fair value as deemed cost [referred in (E)(in the definition of Transition Amount) above]**

An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for investment in a subsidiary, joint venture or associate in its separate financial statements as mentioned in paragraph D15 of Ind AS 101. In such cases retained earnings adjustment shall be included in the book profit at the time of realisation of such investment.

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		III.	**Cumulative translation differences [referred in (F) (in the definition of Transition Amount) above]** • An entity may elect a choice whereby the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to Ind AS. Further, the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to Ind AS and shall include only the translation differences after the date of transition. • In such cases, to ensure that such Cumulative translation differences on the date of transition which have been transferred to retained earnings, are taken into account, these shall be included in the book profits at the time of disposal of foreign operations as mentioned in paragraph 48 of Ind AS 21.
(ii)	All other adjustments to retained earnings (recorded as other equity) at the time of transition (including for example, Decommissioning Liability, Asset retirement obligations, Foreign exchange capitalisation/decapitalization, Borrowing costs adjustments etc.) shall be included in book profits, equally over a period of five years starting from the year of first time adoption of Ind AS.		
(iii)	Section 115JB of the Act already provides for adjustments on account of deferred tax and its provision. Any deferred tax adjustments recorded in Reserves and Surplus on account of transition to Ind AS shall also be ignored.		

(v) Clarifications on computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) under section 115JB of the Income-tax Act, 1961 for Ind AS compliant companies [Circular No. 24/2017[4] dated 25.07.2017]

After amendment in section 115JB for computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) for Indian Accounting Standards (Ind AS) compliant companies, CBDT received representations from various stakeholders seeking clarifications on certain issues arising therefrom.

Accordingly, the CBDT has vide this circular, clarified these issues by way of the following FAQs:

Question 1: *The profit for the period may include Marked to market (MTM) gains/ losses on account of fair value adjustments on various financial instruments recognised through profit or loss (FVTPL). A situation may arise where the losses on account of fair value adjustments could be added back in view of clause (i) of Explanation 1 to section 115JB(2) of the Act.*

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

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Whether the losses on such instruments require any adjustment for computing book profits for the purposes of MAT?

Answer: Since MTM gains recognised through profit or loss on FVTPL classified financial instruments are included in book profits for MAT computation, it is clarified that MTM losses on such instruments recognised through profit or loss shall not require any adjustments as provided under clause (i) of *Explanation 1* to section 115JB(2) of the Act. However, in case of provision for diminution/ impairment in value of assets other than FVTPL financial instruments, the existing adjustment of clause (i) of *Explanation 1* to section 115JB (2) of the Act shall apply.

It is further clarified that for financial instruments where gains and losses are recognised through Other Comprehensive income (OCI), the amended provisions of MAT shall continue to apply.

Question 2: *For the purposes of section 115JB of the Act, what shall be the starting point for computing Book profits for Ind AS compliant companies? Whether Profit before other comprehensive income [Item number XIII in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013] or Total Comprehensive Income (including other comprehensive income) [Item number XV in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013] shall be the starting point?*

Answer: Starting point for computing Book profits for Ind AS compliant companies shall be Profit before other comprehensive income [Item number XIII in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013].

Question 3: *As per Explanation to Section 115JB(2C) of the Act, the convergence date is defined as the first day of the first Indian Accounting standards reporting period as defined in Ind AS 101. The Memorandum explaining the provisions of the Finance Bill 2017 mentions that the adjustment as on the last day of the comparative period is to be considered. It may be clarified as to what would be the appropriate manner for computation of transition amount on convergence date, 1st April i.e., at the start of the day or at the end of the day?*

Answer: In the first year of adoption of Ind AS, the companies would prepare Ind AS financial statement for reporting year with a comparative financial statement for immediately preceding year. As per Ind AS 101, a company would make all Ind AS adjustments on the opening date of the comparative financial year. The entity is also required to present an equity reconciliation between previous Indian GAAP and Ind AS amounts, both on the opening date of preceding year as well as on the closing date of the preceding year. The amounts as on start of the opening date of the first year of adoption should be considered for the purposes of computation of transition amount.

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For example, companies which adopt Ind AS with effect from 1st April 2025 are required to prepare their financial statements for the year 2025-26 as per requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st April 2024 and restate the financial statements for the comparative period 2024-25. In such a case, the first time adoption adjustments as of 31st March 2025 should be considered [i.e. the start of business on 1st April 2025 (or, equivalently, close of business on 31st March 2025)] for computation of MAT liability for previous year 2025-26 (Assessment year 2026-27) and thereafter.

Question 4: As per Indian GAAP, proposed dividend was required to be recognized in the financial statements for the year for which it pertained to even though these were declared in the subsequent year. Section 115JB of the Act already provides for adjustments for dividend for computation of book profit. As per Ind AS, the amount of proposed dividend is required to be recognized in the year in which it has been declared rather than the year for which it pertains to. Accordingly, on transition to Ind AS, the amount of proposed dividend for F.Y. 2024-25 which was recognized in profit and loss account in F.Y. 2024-25 is required to be reversed and credited to Retained Earnings. For the computation of MAT, whether these balances would form part of the transition amount and thus be adjusted over a period of 5 years?

Answer: Adjustment of proposed dividend shall not form part of the transition amount.

Question 5: *Under Ind AS, adjustments on the transition date may have a corresponding impact on deferred taxes. Should the deferred taxes on such amounts be considered for the purpose of transition amount?*

Answer: Any deferred taxes adjustments recorded on the transition date shall be ignored for the purpose of computing Transition Amount.

Question 6: *As mentioned in Question No.1, clause (i) of Explanation 1 to Section 115JB(2) of the Act provides for adjustments for computation of book profit for the amount or amounts set aside as provision for diminution in the value of any asset. Convergence date adjustments may include adjustment for Provision for Bad and Doubtful Debts (Expected Credit Loss adjustment) at the time of transition. Whether these adjustments would form part of the transition amount referred to in section 115JB(2C) of the Act?*

Answer: Adjustments relating to provision for diminution in the value of any assets other than the ones mentioned in Question Number 1 above, shall not be considered for the purpose of computation of the Transition Amount. Therefore, adjustments relating to provision for doubtful debts shall not be considered for the purpose of computation of the transition amount.

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Question 7: *Under Section 115JB of the Act, transition amount has been defined as the amount or the aggregate of the amounts adjusted in the 'Other Equity' (excluding capital reserve and securities premium reserve) on the convergence date. Whether changes in share application money on reclassification to 'Other Equity' would form part of the Transition Amount?*

Answer: Share application money pending allotment which is reclassified to Other Equity on transition date shall not be considered for the purpose of computing Transition Amount.

Question 8: *Under Ind AS, Investments in preference share is considered to be a liability and the corresponding dividend expense is debited to Profit and loss account as interest cost. Should such interest expenses on preference shares be deducted for the purpose of MAT computation?*

Answer: For the purpose of computation of MAT, profit/Transition Amount shall be increased by dividend/interest on preference share (including dividend distribution taxes) whether presented as dividend or interest.

Question 9: *How do we account for items such as equity component, if any, of financial instruments like Non-Convertible debentures (NCDs), Interest free loan etc. included in other equity as per Ind AS for the computation of transition amount under MAT?*

Answer: Items such as equity component of financial instruments like NCD's, Interest free loan etc. would be included in the Transition Amount.

Question 10: *Where revaluation/fair value adjustments have been made to items of Property, Plant & Equipment (PPE) under Ind AS, as per section 115JB of the Act, the book profit of the previous year in which the items of PPE are retired, disposed or realised shall be increased or decreased, as the case may be, by the revaluation amount relatable to such items of PPE. Whether the revaluation amount to be considered for adjustment should be the gross amount of the revaluation or the amount after adjustment of the depreciation on the revaluation amount?*

Answer: The book profit of the previous year in which the items of PPE are retired, disposed, realised or otherwise transferred shall be increased or decreased, as the case may be, by the revaluation amount after adjustment of the depreciation on the revaluation amount relatable to such asset. This has been explained by an illustration as under:

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Particulars	Erstwhile Indian GAAP	Ind-AS (considering fair value/ revaluation adjustment on PPE)	Fair Value/ Revaluation Adjustments and corresponding depreciation
WDV/Deemed Cost as on 1 April 2023	100	1000	900
Depreciation @10% for F.Y. 2023-24	10	100	90
WDV as on 1 April 2024	90	900	810
Depreciation @10% for F.Y. 2024-25	9	90	81
WDV as on 1 April 2025	81	810	729*
Sale value as on 1 April 2025	900	900	
Profit on sale credited to P&L	819	90	
Adjustment for MAT - revaluation amount after adjustment of the depreciation	0	729*	
Profit on sale to be considered for MAT	**819**	**819**	

Question 11: *How should adjustments for service concession arrangements be treated for the purpose of computation of book profit under MAT?*

Answer: Adjustments on account of Service Concession arrangements would be included in the Transition Amount and also on an ongoing basis.

Question 12: *Existing clause (iii) of explanation to section 115JB(2) of the Act provides for deduction of lower of the amount of loss brought forward or unabsorbed depreciation as per books of account for computation of book profits. In case where, on adjustment of transition amount, the losses as per books of account gets wiped off, whether deduction for the said amount would be available for assessment year 2026-27 onwards?*

Answer: For assessment year 2026-27, the deduction of lower of depreciation or losses shall be allowed based on the position as on 31st March 2025. For the subsequent periods, the position as per books of account drawn as per Ind AS shall be considered for computing lower of loss brought forward or unabsorbed depreciation.

Question 13: *How Capital Reserves or Securities Premium existing as per old Indian GAAP reclassified to Retained Earnings/ Other Reserves on Convergence date be treated for MAT purpose.*

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Answer: The Capital Reserves or Securities Premium existing as on the convergence date as per the erstwhile Indian GAAP which are reclassified to Retained Earnings/ Other Reserves under Ind AS and vice versa, shall not be considered for the purposes of Transition Amount.

It is further clarified, that even after such reclassifications, the amount of revaluation reserve shall continue to be considered as revaluation reserve for the purposes of computation of book profit and shall also include transfer to any other reserves by whatever name called or capitalised.

Question 14: *Companies which follow accounting year other than March 2026 ending for Companies Act purposes and are required to transition to Ind AS will have to prepare financial statements for MAT purposes for F.Y. 2025-26 partly under Indian GAAP and partly under Ind AS. How should such companies compute MAT on transition to Ind AS?*

Answer: In view of second proviso to section 115JB(2) of the Act, companies will be required to follow Indian GAAP for the pre-convergence period and Ind AS for the balance period.

For example, a Company following December ending will be required to prepare, accounts for MAT purposes under Indian GAAP for 9 months upto December 2025 and under Ind AS for 3 months thereafter. The transition amount will be calculated with reference to 1st January 2026.

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

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

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

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

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

in such manner as may be prescribed.

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

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

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

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

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

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

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

(viii) Allowability of carry forward of losses

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

(ix) Applicability of other provisions of the Act

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

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

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

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

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

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

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

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

Explanation 4A to section 115JB has been inserted with retrospective effect from 01.04.2001 to clarify that MAT provisions shall not be applicable to an assessee, being a foreign company, where its total income comprises solely of profits and gains from business referred to in section 44B or section 44BB or section 44BBA or section 44BBB and such income has been offered to tax at the presumptive rates specified in these sections.

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

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

ILLUSTRATION 1

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

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

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

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

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SOLUTION

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

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

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

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

II. Computation of book profit under section 115JB

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

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

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

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

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

IV. Computation of Minimum Alternate Tax

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

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

ILLUSTRATION 2

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

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SOLUTION

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

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

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

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

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

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

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

ILLUSTRATION 3

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

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

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

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

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

No.	Particulars	₹
1.	*Profit from unit established in special economic zone*	*5,00,000*
2.	*Share in income of an AOP as a member*	*1,00,000*
3.	*Income from units of UTI*	*75,000*
4.	*Long term capital gains on sale of building*	*3,00,000*

Other Information:

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

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

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

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

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

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

SOLUTION

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

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

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

Computation of MAT liability under section 115JB

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

Notes:

(1) It is only the specific items mentioned under *Explanation 1* to section 115JB, which can be adjusted from the net profit as per the Statement of Profit and Loss prepared

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as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified thereunder, the same cannot be adjusted for computing book profit:

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

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

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

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

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

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

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

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

Example:

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

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

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

(7) Where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, allowed against the tax payable under the provisions of section 115JB(1) exceeds the amount of such tax credit admissible against the tax payable by the assessee on its income in accordance with the other provisions of this Act, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

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

Example:

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

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

(5) Special provisions relating to income of shipping companies

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

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

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

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

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

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

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

Operating ships [Section 115VB]

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

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

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

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

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

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Meaning of "Qualifying company" [Section 115VC]

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

(a) it is an Indian company;

(b) the place of effective management of the company is in India;

(c) it owns at least one qualifying ship; and

(d) the main object of the company is to carry on the business of operating ships.

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

(a) the place where the board of directors of the company or its executive directors make their decisions; or

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

Meaning of "Qualifying ship" [Section 115VD]

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

(i) it is a seagoing ship or vessel ***or inland vessel, as the case may be,*** of 15 net tonnage or more;

(ii) ship is registered –

(a) under the Merchant Shipping Act, 1958; or

(b) outside India in respect of which a license has been issued by the Director-General of Shipping under section 406 or 407 of the Merchant Shipping Act, 1958; or

***inland vessel* is registered –**

(c) ***under the Inland Vessels Act, 2021.***

(iii) there is a valid certificate in force indicating the net tonnage of such a ship ***or inland vessel, as the case may be;***

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

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

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(ii) fishing vessels;

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

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

(v) harbour and river ferries;

(vi) offshore installations;

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

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

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

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

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

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

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

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

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

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

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

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

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Tonnage income [Section 115VF]

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

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

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

Computation of tonnage income [Section 115VG]

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

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

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

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

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

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

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

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

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

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

ILLUSTRATION 4

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

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

SOLUTION

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

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

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

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

(b) their respective shares are definite and ascertainable,

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

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

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

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

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

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

(i) its activities from operating qualifying ships; and

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

(a) shipping contracts in respect of –

(1) earnings from pooling arrangements i.e.

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

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

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

(b) Specific shipping trades, being, -

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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Treatment of common costs [Section 115VJ]

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

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

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

Depreciation [Section 115VK]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(iii) section 72(1) or

(iv) section 72A(1),

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

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

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

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

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

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

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

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

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

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

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

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

(II) Procedure for Option of Tonnage Tax Scheme

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(i) the qualifying company ceases to be so or

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

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

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

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

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

Renewal of tonnage tax scheme [Section 115VR]

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

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

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

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

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

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

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

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

(III) Conditions for Applicability of Tonnage Tax Scheme

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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Taxable amount =

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

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

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

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

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

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

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

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

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

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

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

ILLUSTRATION 5

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

(i) Relevant Shipping Income - ₹ 350 lakhs

(ii) Tonnage Income - ₹ 180 lakhs

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

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

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

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

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

SOLUTION

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

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

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

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

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

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

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

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Limit for charter in of tonnage [Section 115VV]

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

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

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

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

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

Maintenance and audit of accounts [Section 115VW]

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

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

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

Determination of tonnage [Section 115VX]

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

(2) "Valid certificate" means –

(i) in case of ships registered in India—

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

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

(ii) in case of ships registered outside India,

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

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

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

(IV) Amalgamation and Demerger of Shipping Companies

Amalgamation [Section 115VY]

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

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

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

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

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

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

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

Demerger [Section 115VZ]

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

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

(V) Other Provisions

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

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

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

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

Avoidance of tax [Section 115VZB]

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

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

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

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

(3) "Tax advantage" includes—

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

(b) the determination of any cost or expense allocated or apportioned,

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which has the effect of reducing the income or increasing the loss, as the case may be, from activities other than tonnage tax activities chargeable to tax.

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

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

Exclusion from tonnage tax scheme [Section 115VZC]

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

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

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

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

(6) Companies under Liquidation [Sections 178]

(i) Notice to Assessing Officer: Every person

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

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

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

(ii) Information of tax due by the Assessing Officer: The Assessing Officer, in his turn is bound after making such enquiries or calling for such information as he may deem fit, to notify to the

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liquidator, within three months from the date of receipt of the notice of appointment, of the amount which in his opinion would be sufficient to provide for any tax which is then or likely thereafter to become payable by the company.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

9.2 TAXATION OF OTHER ENTITIES

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

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

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

(ii) **Levy of AMT@18.5% on Adjusted Total Income:** Accordingly, where the regular income-tax payable by a person, other than a company, for a previous year computed as per the provisions of the Income-tax Act, 1961 (other than Chapter XII-BA) is less than the AMT

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payable for such previous year, the adjusted total income shall be deemed to be the total income of the person. Such person shall be liable to pay income-tax on the adjusted total income @ 18.5% **[Section 115JC(1)]**.

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

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

(2) section 10AA (SEZ); and

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

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

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

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

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

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

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

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

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

Tax credit for AMT [Section 115JD]

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

Where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India under section 90 or section 90A or section 91, allowed against the alternate minimum tax payable, exceeds the amount of the tax credit admissible against the regular income-tax payable by the assessee, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

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

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

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

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

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

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

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

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

Related Provisions

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

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

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

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

ILLUSTRATION 6

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

SOLUTION

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

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

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

Computation of Alternate Minimum Tax (AMT)

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

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

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

TAXATION OF FIRMS/LLPs AND THEIR PARTNERS

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

(i) Meaning of Firm/LLP

Under section 2(23) of the Income-tax Act, 1961, the terms 'firm', 'partner' and 'partnership' have the same meanings respectively as have been assigned to them under the Indian Partnership Act, 1932, but the expression 'partner' also includes any other person who being

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a minor, has been admitted to the benefits of an existing partnership. In addition, the definitions also include the terms limited liability partnership, a partner of limited liability partnership as they have been defined in the Limited Liability Partnership Act, 2008.

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

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

(ii) Residential Status of Firm/LLP

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

(iii) Tax Rate of Firm/LLP

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

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

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

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

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

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

(iv) Assessment as firm [Section 184]

- **Conditions to be fulfilled:**

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

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

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

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

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any such partner who is deceased. The certified copy of the instrument of partnership shall accompany the return of income of the firm of the previous year relevant to the assessment year.

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

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

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

  (a) Remuneration is to be allowed

  (b) Interest is to be allowed

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

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

They are as follows: -

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

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

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

(4) It should not exceed the permissible limit.

(1) Payment should be to a working partner:

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

Further, in order to be actively engaged in the affairs, a partner is not expected to be engaged in the whole of the affairs of the business of the firm, nor is he expected to know everything about the affairs of the business of the firm. For example, in a firm with many partners, one partner may be looking after purchases, another after sales

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and another after production and still another after administration, finance and accounts. It cannot be contended that just because they are not overall in charge, they cannot be considered as working partner.

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

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

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

Now, a question arises whether the names of individual working partners should be specified in the partnership deed or whether it is sufficient if the total remuneration payable to the working partners as a whole is indicated. One opinion is that it is not necessary that individual partners should be identified or designated. It will be sufficient to lay down an authorisation in the deed to the effect that remuneration will

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be payable to the class of working partners up to so and so percentage of the book profit. And further that, within such limits, the working partners shall share such remuneration in any ratio as may be agreed upon. In other words, this concept gives recognition to the working partners as a class and authorising remuneration for the class rather than identifying or designating individual working partners and authorising remuneration for each individual working partner. There is nothing in section 40(b) which prohibits this type of interpretation. However, in order to avoid litigation, it is better that the deed identifies and designates the working partners as well as the remuneration payable to them.

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

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

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

ILLUSTRATION 7

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

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SOLUTION

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

(4) It should not exceed the permissible limit:

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

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

Book Profit:

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

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

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For example, rent from house property, dividend, interest on bank deposit or government securities are not chargeable as income from business or profession under section 28. Therefore, if the profit and loss account of a firm contains these receipts, they have to be excluded while calculating the net profit.

In the same way, items which are to be disallowed under the various provisions from sections 28 to 44D will have to be eliminated. It naturally follows, therefore, that brought forward business losses will not be deducted while calculating book profit.

In simple terms, 'book profit' means income computed under the head "Profits and gains of business or profession" before deduction of partners remuneration. **Accordingly, unabsorbed depreciation can be set-off under section 32(2) against such income to arrive at the book profit, but not unabsorbed business loss under section 72.**

The above table shows the upper limits up to which deduction is allowed to firm in respect of the remuneration paid to its working partners. It does not mean that a firm is prohibited from paying remuneration beyond these limits. A firm can pay remuneration to working partners beyond these limits, but it will suffer disallowance in respect of such excess under section 40(b) and consequently pay tax on it @30%. If a firm pays remuneration to non-working partners, the same will be the result. However, the above limits apply to the remuneration paid to the group of all working partners in a firm taken together and not to each individual partner. Finally, it may be noted that section 40(b) does not compel a firm to pay remuneration to its working partners. It is purely at the discretion of the firm. However, once a firm pays remuneration to its working partners it will be subject to the restrictive provisions of section 40(b). It is also open to a firm to pay salary only to a few working partners and not all the working partners.

- **Interest payable to partners:** So far as allowability of interest paid by a firm to its partners under section 40(b) is concerned, the following conditions have been prescribed by section 40(b):

  (1) The interest payable by a firm to its partners should be **authorised by and in accordance with the partnership deed**.

  (2) The interest payable by a firm to its partners should **not be for a period falling prior to the date of such partnership deed** authorizing the payment of such interest.

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(3) The rate of interest payable to the partners **shall not exceed 12% simple interest per annum.**

An important question could be regarding the amount with reference to which this interest @12% will have to be calculated. For example, a partner may have contributed capital to the firm and in addition may also advance loan to the firm. The question would be whether the interest paid by the firm on capital would be allowable or that on the loan would be allowable. Moreover, some firms have an accounting system of maintaining current accounts of partners in addition to the capital accounts. When some balance is standing to the credit of a partner in such current account as well the question arises whether the interest paid on the balance in the current account will be allowable within the meaning of section 40(b).

In this regard, it may be noted that section 40(b) does not refer to nor does it make any distinction between the capital contributed by a partner to the firm, the loan advanced by a partner to the firm or the balance in the current account of a partner. Therefore, the **interest paid by a firm to its partners on the credit balance standing in all the accounts/whether in capital account, loan account or current account, shall be allowed as deduction to the firm under section 40(b).** The idea seems to be to allow interest on the funds employed in the firm by a partner.

As it happens, many a time, a partner may have debit balance in his current account and credit balance in his capital account or loan account. The question which would arise in such a situation could be whether the interest payable to such a partner at the rate of interest authorised by and in accordance with partnership deed will be reckoned with reference to the aggregate of the credit balance in the capital account and the loan account including the debit balance in the current account or whether it should be calculated on the net balance that is the aggregate of the credit balance in the capital account and in the loan account as reduced by the debit balance in the current account. It appears that in such a situation the equitable principle would be to allow interest reckoned with reference to the net balance. Alternatively, if interest is recovered from a partner on the debit balance in his account and interest is paid to the same partner on the credit balance in his account, the net amount paid to that partner would be subjected to the provisions of section 40(b). However, interest received from one partner cannot be set-off against interest paid to another partner.

The next issue which is to be considered here is the point of time at which interest should be credited to the partners' accounts. For example, a firm may adopt a policy of crediting interest quarterly to the credit of the partners' accounts. In such a case,

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the firm would be paying in effect interest on interest at the year end. This would amount to compounding interest quarterly. This is not permitted under section 40(b) because what that section contemplates is simple interest and simple interest here would mean interest which is calculated yearly or annually. Paying the interest on interest credited periodically during a year would be contrary to the concept of simple interest per annum.

- **Partner in a representative capacity**: If an individual is a partner in a firm in a representative capacity (that is on behalf and for the benefit of another person) and not in his personal capacity then, interest paid by the firm to such individual in his personal capacity and not as a representative capacity will not be subject to the conditions and ceiling as prescribed for disallowance. But interest paid by the firm to such individual as representative partner or person represented shall be subject to the conditions and ceiling as prescribed *[Explanation 1 to section 40(b)]*.

> ***Example:*** *X is a partner in a firm in a representative capacity for and on behalf of his HUF. Supposing the firm pays interest of ₹ 6,000 to X in his personal capacity and not in his capacity as the representative of HUF, it will be allowed as deduction and the prescribed ceiling will not apply. However, if such payment is made to X as a representative partner or if the firm has paid the interest directly to HUF, then the payment will be subject to the conditions and ceiling as prescribed.*

- **Interest received by a non-representative partner**: If interest is paid to an individual partner who is not the representative partner and the interest received by him is on behalf of or for the benefit of another person, then such interest payment shall be allowed without applying the ceiling limits *[Explanation 2 to section 40(b)]*.

> ***Example:*** *X is a partner of a firm in his individual capacity and is not a representative partner. Interest is paid by the firm to him in respect of a deposit made by his wife. This will be allowed as a deduction because such interest is received by him purely on behalf of another person.*

- ***TDS on salary, remuneration, commission, bonus or interest to partner****: Firm is responsible to deduct tax @10% on any sum in the nature of salary, remuneration, commission, bonus or interest paying to its partner.*

  The deduction of tax has to be made at the time of crediting such sum to the account of the partner (including the capital account) or at the time of its payment, whichever is earlier.

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No deduction of tax shall be made where such sum or the aggregate of such sums credited or paid or likely to be credited or paid to the partner of the firm does not exceed ₹ 20,000 during the financial year.

ILLUSTRATION 8

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2014. H, I and G were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to ₹ 1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2025 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2014, for the first time provided for payment of simple interest @12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2025.

The firm was dissolved on 31.3.2026 and the capital assets of the firm were distributed among the partners on 20.4.2026. The net profit of the firm for the year ended 31.3.2026 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was ₹ 3,50,000:

(i) Interest amounting to ₹ 1,00,000 paid to the partners on the balances standing to the credit of their Capital accounts from 1.4.2025 to 31.3.2026.

(ii) Interest amounting to ₹ 50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2025 to 31.3.2026.

(iii) Interest amounting to ₹ 20,000 paid to the Hindu undivided family of partner H @ 18% per annum.

(iv) Payment of ₹ 25,000 towards purchase of television sets (stock in trade) made by crossed cheque on 1.11.2025.

(v) ₹ 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.

(vi) Depreciation amounting to ₹ 15,000 (as per Income-tax Rules) on motor car bought and used exclusively for business purposes but registered in the name of partner 'H'.

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(vii) Depreciation under section 32(1)(ii) amounting to ₹ 37,500 of new machinery bought and installed for manufacture of pens on 1.11.2025 at a cost of ₹ 5,00,000.

(viii) Interest amounting to ₹ 25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

(a) Closing stock-in-trade was valued at ₹ 60,000 as per the method of lower of cost or net realizable value consistently followed by it. The net realizable value of the closing stock-in-trade was ₹ 65,000.

(b) Brought forward business loss relating to the assessment year 2025-26 was ₹ 50,000.

(c) The fair market value of the capital assets as on 20.4.2026 was ₹ 20,00,000 and the cost of their acquisition was ₹ 15,00,000.

Compute the total income of M/s. HIG for the Assessment Year 2026-27.

You are required to furnish explanations for the treatment of the various items given above.

SOLUTION

Computation of total income of M/s. HIG for the A.Y. 2026-27

Particulars	₹	₹
Net profit as per profit & loss account		3,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2025 to 30.9.2025 disallowed (total interest ₹ 1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added) **[Note (i)]**	50,000	
Interest to partners on current accounts from 1.4.2025 to 31.3.2026 – not authorized by the deed, hence disallowed **[Note (ii)]**.	50,000	
100% of ₹ 25,000 paid towards purchase of television sets otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed (being stock in trade, hence disallowed) **[Note (iv)]**.	25,000	

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Difference on account of valuation of closing stock-in-trade at net realisable value (₹ 65,000 less ₹ 60,000) **[Note (ix)]**	5,000	
Salary paid to working partners considered separately.	2,50,000	3,80,000
		7,30,000
Less: Additional depreciation on new machinery (₹ 5,00,000 x 20%) = ₹ 1,00,000. Only 50% is allowable as deduction. **[Note (vii)]**		50,000
		6,80,000
Less: Interest received from bank on fixed deposits considered separately		25,000
		6,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		
On first ₹ 6,00,000 @ 90%	5,40,000	
On the balance of ₹55,000 @ 60%	33,000	
	5,73,000	
(ii) Salary actually paid	2,50,000	
Deduction allowed being (i) or (ii), whichever is less		2,50,000
		4,05,000
Less: Business loss relating to A.Y. 2025-26 set off		50,000
Income from business		**3,55,000**
Income from other sources		
Interest received from bank on fixed deposits **[Note (viii)]**.		25,000
Total Income		**3,80,000**

Notes:

(i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2025 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2025. Interest for the period prior to 1.10.2025 is not allowed.

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(ii) The partnership deed of 1.10.2025 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT (2001) 251 ITR 704 (Ker)*, on identical facts, held that interest paid to the partners on their current account balances is not allowable.

(iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv). Also, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

(iv) Section 40A(3) provides for disallowances @100% of the expenditure incurred for an amount exceeding ₹ 10,000 otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed. Since the firm has made payment of ₹ 25,000 towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.

(v) Gold jewellery valued at ₹ 30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business. Since it has already been credited to profit and loss account, no further adjustment is required.

(vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775*.

(vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(iia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e., it is restricted to 10%. The balance additional depreciation can be claimed in the immediately succeeding financial year.

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(viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.

(ix) As per para 24 of ICDS II: Valuation of Inventories, closing stock has to be valued at net realizable value in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the net realizable value of ₹ 65,000. Since it has been valued at ₹ 60,000, being the cost, the balance ₹ 5,000 has to be added.

(x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per *Explanation 3* to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2025-26 is not considered for calculation of book-profit.

(xi) Section 9B would be attracted in the hands of M/s HIG in the A.Y. 2027-28, since capital assets are received by the partners on 20.4.2026, i.e., P.Y. 2026-27.

- **Computation of income of partner of a firm (PFAS)**: While computing the income of a partner including a minor partner of a firm, the following points have to be taken into consideration.

Share income exempt under section 10(2A): The partner's share in the total income of firm (PFAS) will be exempt in his hands and will not be included in his total income. His share in the total income of the firm will be calculated as follows: -

$$\text{Total income of firm} \times \frac{\text{Partner's share in profits of firm as per partnership deed}}{\text{Total profit of the firm}}$$

By virtue of this exemption, a partner of PFAS will not be taxed in respect of his share in the firm's income since the firm itself will be taxed as a separate entity @30%. There will be no allocation of income among the partners. On account of this exemption, he will not be entitled to set-off his share in the firm's loss against his other personal income.

Chargeability of remuneration and interest: Remuneration and interest received by a partner of a PFAS in accordance with the conditions prescribed under section 40(b) will be taxable in his hands as income from profits and gains of business or profession.

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If remuneration or interest paid to a partner is disallowed in the assessment of the firm due to the fact that they are not in accordance with the conditions prescribed under section 40(b) then the partner will not be taxed in respect of the amount disallowed because in such a case the firm itself will be liable to pay tax on the amount which has been disallowed in its assessment. In other words, if the firm is given the benefit of deduction of remuneration and interest paid to a partner then the liability to tax in respect of such amount will be that of a partner. If the firm is not given the benefit of deduction because of the non-compliance with the provisions of section 40(b) then the firm itself will be liable in respect of the amount and the partner will not be taxed in respect of it in his personal assessment. It is obvious that such remuneration or interest which has been disallowed in the hands of the firm but actually received by a partner will be assumed to be his share in the income of such firm and exemption under section 10(2A) will operate.

Suppose a portion of the remuneration and interest in the assessment of the firm is disallowed since they exceed the overall ceiling limit prescribed under section 40(b), the question arises as to how to allocate such disallowance in the hands of the partner. One reasonable basis is to assume that the remuneration and interest paid to the partners concerned has been disallowed in proportion to the gross remuneration and interest paid to them and the exemption of the disallowed sum should be available to the partners in the same proportion.

- **Assessment of firms – Some of the important issues to be considered by the Assessing Officer while framing assessment [Circular 12/2019, dated 19.6.2019]:**

  (i) While computing remuneration which is allowable to a working partner under section 40(b)(v), the term 'in accordance with the terms of the partnership deed' in clauses (ii) and (v) of section 40(b) implies that remuneration should not be undetermined or undecided. Hence, in all situations, partnership deed should form the basis for determination of remuneration payable to the working partners. Furthermore, in situations where the remuneration either so specified in the partnership deed or computed as per the method indicated therein falls short of the amount allowable under section 40(b)(v), it would be restricted to the figure computed on the basis of the partnership deed.

  (ii) While computing remuneration payable to the working partners under section 40(b)(v) of the Act, the remuneration should not exceed a particular aggregate amount which is based upon the figure of 'book profit'. *Explanation 3* to section 40(b) contains definition of 'book profit' for the purposes of determination of

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remuneration of the partners and provides that 'book profit' shall mean the net profit, as shown in the profit & loss account for the relevant previous year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while calculating the net profit. Therefore, while computing 'book profit' for purposes of section 40(b)(v), all incomes such as capital gain, interest, rental income, income from other sources etc. which do not fall under the head 'Profits and gains of business or profession', should be excluded.

(iii) Under section 185, any non-compliance by the firm or its partners with provisions of section 184 may result in denial of expenses such as remuneration, interest etc. payable to the partners which are otherwise allowable under the provisions of the Act.

(iv) Where firms try to inflate the profits eligible for deduction under section 80-IA by not claiming expenditure towards remuneration, salary, interest etc. which are payable to the partners, the Assessing Officers may examine these transactions in light of provisions of section 80-IA(10) which empower Assessing Officer to re-compute profit of the eligible business after excluding the profits of the related activity/business which produced the excessive profit.

- **Treatment of losses**: If PFAS incurs any loss, the firm alone can set off and forward such losses to be set off against income of the subsequent years. The firm will not be allowed to apportion its unabsorbed losses among its partners.

- **Set off of carry forward loss in case of change in the constitution of the firm [Section 78]**: If there is a change in the constitution of the firm, the loss of a retired/deceased partner can be carried forward by the firm only to the extent that it does not exceed such partner's share in the profits of the firm of the relevant previous year.

However, it is to be carefully noted that section 78 is applicable only in case there is a change in the constitution of the firm as result of retirement or death of a partner in the previous year. In other words, it does not apply when there is a change in the profit-sharing ratio or change in the constitution because of induction of a new partner. Similarly, section 78 **will not apply to set off and carry forward of unabsorbed depreciation etc.**

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Example: ABC & Co. is a firm with 3 partners – A, B & C having equal profit-sharing ratio. For the P.Y. 2025-26, the loss from business is ₹ 3,00,000 and unabsorbed depreciation is ₹ 1,50,000. Business loss and unabsorbed depreciation represents the amount after inter-source and inter-head set-off. C retires on 31.03.2026 from the firm. Firm can carry forward business loss of ₹ 2,00,000 (3,00,000 – 1,00,000) and unabsorbed depreciation of ₹ 1,50,000 for set-off against income of subsequent assessment years.

- **Liability of partner of LLP in liquidation [Section 167C]:** This section provides for the liability of partners of LLP in liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of such tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP. "Tax due", for the purpose of this section includes penalty, interest or any other sum payable under the Income-tax Act, 1961.

- **Assessment in case of change in constitution, succession and dissolution of a firm [Section 187 to 189A]**

  Change in constitution of a firm: Where at the time of making an assessment under section 143 or 144 it is found that a change has occurred in the constitution of a firm, assessment shall be made on the firm as constituted at the time of making the assessment.

  Meaning of change in constitution of the firm: It means

  (a) If one or more of the partners cease to be partners (other than a case where ceases to be a partner by way of demise of the partner) or one or more new partners are admitted, in such circumstances that <u>one or more</u> of the persons who were <u>partners of the firm before the change continue as partner or partners after the change</u>.

  (b) <u>All the partners of firm continue</u> to be the partner of the firm <u>but there is a change in their profit-sharing ratio</u> or change in shares of some of them.

  Succession of one firm by another: In a case where a firm carrying on a business or profession is succeeded by another firm; separate assessment will be made on the

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predecessor firm and the successor firm in accordance with the provisions of section 170 [Section 188].

Liability of partners: Where any tax, penalty or other sum payable by the firm for the relevant previous year is due, then every person being a partner of a firm and the legal representative of deceased partner during the previous year shall be jointly and severally liable along with the firm in respect of such sum [Section 188A].

Dissolution of firm or discontinuance of business: Where a firm is dissolved or business or profession is discontinued by the firm, the Assessing Officer shall make an assessment of the total income of the firm as if no discontinuance or dissolution has taken place and all the provisions of the Act relating to levy of a penalty or any other sum chargeable under this Act, shall be applicable accordingly [Section 189].

Every person who was at the time of dissolution or discontinuance a partner of a firm and the legal representative of deceased partner shall be jointly and severally liable for the amount of tax, penalty or other sum payable by the firm and all the provisions of the Act shall apply accordingly. If any proceedings have commenced in respect of any assessment year before dissolution or discontinuance, the proceeding may be continued against such persons (i.e., partner and legal representative) from that stage. The liability of legal representative is limited to the extent to which the estate is capable of meeting the liability.

Tax consequences on transfer of capital asset to a partner on dissolution or reconstitution of a firm *- Section 9B deals with taxability on receipt of capital asset or stock in trade or both by a partner from a firm on dissolution or reconstitution of firm. The taxability of receipt of money or capital asset or both by a partner on reconstitution of a firm is dealt with in section 45(4). Thus, in a case of reconstitution of firm, where a partner receives capital asset from the firm, the provisions of both section 9B and 45(4) are attracted in the hands of the firm. The taxation under these two provisions has to be worked out independently.*

Tax treatment on dissolution of firm is dealt with in section 9B and is not covered under section 45(4). For details, please refer Chapter 4: Capital Gains in Module 1

ILLUSTRATION 9

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-03-2025 after a search. The tax liability of the firm outstanding to be paid was determined at ₹ 15 lakhs. Out of three partners, one was declared insolvent on 18-03-2026 by the Court. The Assessing Officer, for recovering the demand,

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attached the Bank Accounts of other two partners and could recover an amount of ₹ 6 lakhs from the Account of one such partner. You are asked the following questions by the partners of the dissolved firm:

(i) About the liability of each of them to pay outstanding demand.

(ii) Whether the action of Assessing Officer to attach the Bank Account of partners to recover the tax demand of the dissolved firm is justified?

SOLUTION

As per section 189(3), every person who was at the time of dissolution, a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act relating to assessment of such tax or imposition of such penalty or other sum, shall apply. Therefore,

(i) the three partners (till one was declared as insolvent by the Court) are jointly and severally liable for making the payment of outstanding dues of ₹ 15 lakhs. After insolvency of one partner, the other two partners are jointly and severally liable to pay such demand.

(ii) Accordingly, the action of the Assessing Officer to attach the bank accounts of the partners for recovery of outstanding demand is correct and the amount of ₹ 6 lakhs recovered by attachment of the bank account of one of the partners is also in order.

- **Conversion of company into an LLP**

(i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 had incorporated the taxation scheme of LLPs in the Income-tax Act, 1961 on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

(ii) Under section 56 and section 57 of the Limited Liability Partnership Act, 2008, conversion of a private company or an unlisted public company into an LLP is permitted. Consequently, section 47(xiiib) has been inserted under the Income-tax Act, to provide that -

(1) any transfer of a capital asset or intangible asset by a private company or unlisted public company to an LLP; or

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(2) any transfer of a share or shares held in a company by a shareholder

on conversion of a company into an LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45, subject to fulfillment of certain conditions. This clause has been introduced to facilitate conversion of small private and unlisted public companies into LLPs. These conditions are as follows:

(1) the total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lakhs in any of the three preceding previous years;

(2) all the shareholders of the company immediately before conversion become partners of the LLP in the same proportion as their shareholding in the company;

(3) no consideration other than share in profit and capital contribution in the LLP arises to the shareholders;

(4) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion;

(5) The total value of assets as appearing in the books of account of the company in any of the three previous years preceding the previous year in which the conversion takes place, should not exceed ₹ 5 crores;

(6) all assets and liabilities of the company become the assets and liabilities of the LLP; and

(7) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.

(iii) However, if subsequent to the transfer, any of the above conditions are not complied with, the capital gains not charged under section 45 would be deemed to be chargeable to tax in the previous year in which the conditions are not complied with, in the hands of the LLP or the shareholder of the predecessor company, as the case may be [section 47A(4)].

(iv) Further, the successor LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company [section 72A(6A)].

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However, by virtue of section 72A(6B), the successor LLP can carry forward the loss of the predecessor company only to the extent of eight assessment years from the immediate succeeding assessment years in which such loss was first computed for the original predecessor company.

(v) However, if the entity fails to fulfill any of the conditions mentioned in (ii) above, the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions listed above.

(vi) The tax credit under section 115JAA for MAT paid by the company under section 115JB would not be allowed to the successor LLP [Section 115JAA(7)].

(vii) The actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion [*Explanation 2C* to section 43(6)].

(viii) The aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them [Section 32(1)(ii)].

(ix) The cost of acquisition of the capital asset for the successor LLP shall be deemed to be the cost for which the predecessor company acquired it. It would be further increased by the cost of improvement of the asset incurred by the predecessor company or the successor LLP [Section 49(1)].

(x) If the capital asset became the property of the LLP as a result of conversion of a company into an LLP, and deduction has been allowed or is allowable in respect of such asset under section 35AD, the actual cost would be taken as Nil [*Explanation 13* to section 43(1)].

However, where an asset, in respect of which deduction is claimed and allowed under section 35AD is deemed to be the income of the assessee in accordancel with the provisions of section 35AD(7B) (on account of being used for a purpose other than specified business under section 35AD), the actual cost of the asset to the assessee shall be actual cost to assessee as reduced by the amount of depreciation allowable had the asset been used for the purpose of business,

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calculated at the rate in force, since the date of its acquisition [Proviso to *Explanation 13* to section 43(1)]

(xi) If a company eligible for deduction under section 35DDA in respect of expenditure incurred under Voluntary Retirement Scheme (one-fifth of such expenditure allowable over a period of five years) is converted into an LLP and such conversion satisfies the conditions laid down in section 47(xiiib), then, the LLP would be eligible for such deduction from the year in which the transfer took place.

(xii) If a shareholder of a company receives rights in a partnership firm as consideration for transfer of shares on conversion of a company into a LLP, then the cost of acquisition of the capital asset being rights of a partner referred to in section 42 of the LLP Act, 2008 shall be deemed to be the cost of acquisition to him of the shares in the predecessor company, immediately before its conversion [Section 49(2AAA)].

TAXATION OF CO-OPERATIVE SOCIETIES

(i) General provisions: The expression "co-operative society" means a society registered under the Cooperative Societies Act, 1912 or under any other law for the time being in force in any State for the registration of co-operative societies [Section 2(19)].

For taxation, it is treated as a separate assessable entity. The profits of any business of insurance carried on by a co-operative society are to be computed in accordance with the rules set out in the First Schedule to the Act. Apart from this, the computation of income in the case of a co-operative society should also be made in the same way under each head of income as in the case of any other assessee. Entrance fees received by a co-operative society from its members is taxable as its income from business irrespective of the nature of the business carried on by the society as was held in *Co-operative Central Bank vs. C.I.T. (1965) 57 ITR 579.*

A member of a co-operative society to whom a building or a part thereof is allotted or leased under a house building scheme of the society must be deemed to be the owner of that building or part thereof under section 27(iii). Accordingly, the co-operative society is not liable to pay tax in respect of the income from the house property even though it may be the real owner according to official records and the tenant may have taken the building on lease. But where the tenant is not a member of the society or where the house is allotted to him otherwise than under a house building scheme of the society, the society will be liable to tax in respect of the income of the house property.

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(ii) **Deduction under section 80P:** Section 80P provides certain exemptions to co-operative societies. However, the exemption is not available to co-operative banks, other than primary agricultural credit societies and primary co-operative agricultural and rural development banks. *(Students may refer to the detailed discussion of this provision in Chapter 8 "Deductions from Gross Total Income".)*

(iii) **Option to exercise concessional rates of tax under section 115BAD or 115BAE:** Section 115BAA provides an option to an existing domestic company to pay tax at concessional rate of 22%, if it does not claim incentive/exemption and deduction as provided in said section. Section 115BAB provides that manufacturing domestic companies set up on or after 01.10.2019, which commence manufacturing or production by 31.03.2024 and do not avail of any specified incentive or deductions, may opt to pay tax at a concessional rate of 15%.

On similar lines, section 115BAD was inserted w.e.f. A.Y. 2021-22 to provide that a co-operative society resident in India has the option to pay tax at 22%, subject to fulfilment of certain conditions. Further, w.e.f. A.Y. 2024-25, section 115BAE has been inserted to provide an option to a manufacturing co-operative society set up on or after 01.04.2023, which commences manufacturing or production on or before 31.03.2024 and does not avail of any specified incentive or deductions, may opt to pay tax at a concessional rate of 15%. In both cases, surcharge would be levied @10% on such tax. However, it may be noted that deduction u/s 80P will not be available under the concessional tax regimes.

Sections 115BAE and 115BAD provides for concessional rates of tax and exemption from Alternate Minimum Tax (AMT) in respect of certain resident co-operative societies. The provisions of these two sections are tabulated hereunder -

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAE**	**Section 115BAD**
1.	**Applicability**	Co-operative society resident in India engaged in manufacturing/generation of electricity	Co-operative society resident in India
2.	**Rate of tax**	15%	22%
3.	**Rate of surcharge**	10%	10%
4.	**Effective rate of tax (including surcharge & HEC)**	**17.16%** [Tax@15% (+) Surcharge@10% (+) HEC@4%]	**25.168%** [Tax@22% (+) Surcharge@10% (+) HEC@4%]
5.	**Applicability of AMT**	Not applicable	Not applicable

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(1)	(2)	(3)	(4)
	Particulars	**Section 115BAE**	**Section 115BAD**
6.	**Manner of computation of tax liability**		
	Income on which concessional rate of tax is applicable	The rate of tax (i.e., **17.16%**) is applicable in respect of income derived from or incidental to manufacturing or production of an article or thing or generation of electricity. **[Read with point no.11 below, wherein the rate of 34.32% (i.e., Tax@30% + surcharge@10% + HEC@4%) would be applicable in specified circumstance]**	The rate of tax (i.e., **25.168%)** is notwithstanding anything contained in the Income-tax Act, 1961, but subject to the provisions of Chapter XII, other than section 115BAE
	Rate of tax on income covered under Chapter XII [for example, long-term capital gains chargeable to tax u/s 112 and 112A, short-term capital gains chargeable to tax u/s 111A]	Such income would be subject to tax at the rates mentioned in the said sections in Chapter XII. Surcharge@10% would be levied on tax computed on such income. HEC@4% would be levied on the income-tax plus surcharge.	Such income would be subject to tax at the rates mentioned in the said sections in Chapter XII. Surcharge@10% is leviable on tax computed on such income. HEC@4% would be levied on the income-tax plus surcharge.
	Rate of tax on other income in respect of which no specific rate of tax is provided in Chapter XII	The applicable tax rate is **25.168% (i.e., tax@22%, plus surcharge @10% plus HEC@4%),** if such income has neither been derived from nor is incidental to manufacturing or production of an article or thing or generating electricity (For example, income from house property and income from other sources). In respect of such income, **no deduction or allowance in respect of any expenditure or allowance** shall be allowed in computing such income.	The applicable tax rate is **25.168% (i.e., tax@22% plus surcharge@10% plus HEC@4%).** There is, however, **no restriction regarding claim of any deduction or allowance** permissible under the relevant provisions of the Act.

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(1)	(2)	(3)		(4)
	Particulars	**Section 115BAE**		**Section 115BAD**
	Rate of tax on STCG derived from transfer of a capital asset on which no depreciation is allowable under the Act	The applicable rate of tax is **25.168% (i.e., tax@22%, plus surcharge@10% plus HEC@4%).** There is, however, no restriction regarding claiming of deduction or allowance in this regard.		The applicable rate of tax is **25.168% i.e., tax @22%, plus surcharge @10% plus cess@4%.** There is no restriction regarding claiming of deduction or allowance in this regard.
7.	**Conditions to be fulfilled for availing concessional rate of tax and exemption from AMT**			
	Conditions to be fulfilled for availing concessional rate of tax and exemption from AMT	(i)	The co-operative society should be **set-up and registered on or after 1.4.2023.**	No time limit specified. Both existing co-operative society and new co-operative society can avail benefit.
		(ii)	It should **commence manufacturing or production of an article or thing or business of generating electricity on or before 31.3.2024**	Need not be engaged in a manufacturing or a production
		(iii)	It should **not be formed by splitting up or the reconstruction of a business already in existence**	No similar condition has been prescribed
		(iv)	It does **not** use any machinery or plant previously used for any purpose **[Refer Note at the end]**	No similar condition has been prescribed
		(v)	It should **not** be engaged in any business other than the business of manufacture or production of any article or thing and research in	No similar condition has been prescribed

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(1)	(2)	(3)		(4)
	Particulars	**Section 115BAE**		**Section 115BAD**
			relation to, or distribution of, such article or thing manufactured or produced by it.	
			Note – Business of manufacture or production of any article or thing shall include generation of electricity does **not** include business of – (1) Development of computer software in any form or in any media (2) Mining (3) Conversion of marble blocks or similar items into slabs (4) Bottling of gas into cylinder (5) Printing of books or production of cinematograph films (6) Any other business as may be notified by the Central Govt. in this behalf.	
8.	**Common conditions for both sections for availing the concessional rate of tax and exemption from AMT**	In case of a co-operative society opting for either section 115BAE or 115BAD, the total income should be computed-		
		(i)	without providing for deduction under any of the following sections:	
			Section	**Provision**
			10AA	Exemption of profits and gains derived from export of articles or things or from

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(1)	(2)	(3)			(4)
	Particulars	Section 115BAE			Section 115BAD
				services by an assessee from unit in SEZ.	
			32(1)(iia)	Additional depreciation @20%, as the case may be, of actual cost of new plant and machinery acquired and installed by manufacturing undertakings.	
			33AB	Deduction@40% of profits and gains of business of growing and manufacturing tea, coffee or rubber in India, to the extent deposited with NABARD in accordance with scheme approved by the Tea/Coffee/ Rubber Board.	
			33ABA	Deduction@20% of the profits of a business of prospecting for, or extraction or production of, petroleum or natural gas or both in India, to the extent deposited with SBI in an approved scheme or deposited in Site Restoration Account.	
			35(1)(ii)/ (iia)/(iii)	Deduction for payment to any research association, company, university etc. for undertaking scientific research or social science or statistical research.	
			35(2AA)	Deduction of payment to a National Laboratory or University or IIT or approved specified person for scientific research	
			35AD	Investment-linked tax deduction for specified businesses.	
			35CCC	Deduction of expenditure incurred on notified agricultural extension project	
			80C to 80U	Deductions from gross total income under Chapter VI-A other than the provisions of section 80JJAA.	
		(ii)	without set-off of any loss carried forward or depreciation from any earlier assessment year, if such loss or depreciation is attributable to any of the		

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(1)	(2)	(3)		(4)
	Particulars	**Section 115BAE**		**Section 115BAD**
			deductions listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further deduction for such loss shall be allowed for any subsequent year]	
		(iii)	by claiming depreciation u/s 32 determined in the prescribed manner (i.e., in respect of depreciation of any block of assets entitled to more than 40% shall be restricted to 40% on the written down value of such block of assets). However, additional depreciation u/s 32(1)(iia) cannot be claimed.	
		Note – Additional points relevant in the context of section 115BAD: (1) In the case of a person having a Unit in the IFSC, referred to in section 80LA(1A), which has exercised option for section 115BAD, deduction u/s 80LA would be allowed subject to fulfilment of the conditions specified in that section. (2) Since there is no time line within which option under section 115BAD can be exercised, a co-operative society having brought forward losses and depreciation on account of deductions listed in (i) above may, if it so desires, postpone exercise the option under section 115BAD to a later assessment year, after set off of the losses and depreciation so accumulated.		
9.	**Failure to satisfy conditions**	On failure to satisfy the conditions mentioned in point no. 7 and 8 above in any P.Y., the option exercised would be **invalid** in respect of the assessment year relevant to that previous year and subsequent assessment years; Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised for the assessment year relevant to that previous year and subsequent assessment years.		On failure to satisfy the conditions mentioned in point no. 8 above in any P.Y., the option exercised would be **invalid** in respect of the assessment year relevant to that previous year and subsequent assessment years; Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised

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(1)	(2)	(3)	(4)
	Particulars	**Section 115BAE**	**Section 115BAD**
			for the assessment year relevant to that previous year and subsequent assessment years.
10.	**Availability of set-off of AMT credit brought forward from earlier years**	No brought forward AMT credit	Brought forward AMT credit cannot be set-off against income u/s 115BAD. **Note** - If a co-operative society has b/f AMT credit, it can first exhaust the AMT credit, and thereafter opt for section 115BAD in a subsequent previous year.
11.	**Adjustments for transactions with persons having close connection**	If the Assessing Officer opines that the course of business between the co-operative society and any other person having close connection therewith is so arranged that the business transacted between them produces more than the ordinary profits to the co-operative society, he is empowered to take into account the amount of profits as may be reasonably deemed to have been derived therefrom, while computing profits and gains of such co-operative society.	No such requirement to make any adjustment
		In case the arrangement referred above involves a specified domestic transaction referred to in section 92BA, then, the amount of profits from such transaction would be determined by considering the arm's length price (ALP).	

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(1)	(2)	(3)	(4)
	Particulars	**Section 115BAE**	**Section 115BAD**
		The amount, being profits in excess of the amount of the profits determined by the Assessing Officer, shall be deemed to be the income of the person. **The income-tax on the income so deemed shall be subject to tax @ 34.32% (i.e., tax @ 30% + surcharge @10% +HEC @ 4%).** **Note** – The scope of "specified domestic transaction" referred to in section 92BA has been expanded to include within its ambit, any business transacted between such persons with close connection, where one such person is a co-operative society claiming benefit under section 115BAE.	
12.	**Exercise of option by the co-operative society within the prescribed time**	The beneficial provisions of this section would apply only if option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing **the first of the returns of income for any previous year** relevant to assessment year or any subsequent assessment year. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any previous year, it **cannot be subsequently withdrawn** for the same or any other previous year.	The beneficial provisions of this section would apply if option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing the return of income for any previous year relevant to assessment year or any subsequent A.Y. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any

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(1)	(2)	(3)	(4)
	Particulars	**Section 115BAE**	**Section 115BAD**
		Note – The option has to be exercised at the time of furnishing the **first of the returns of income** for any previous year. If a person fails to so exercise such option, it cannot be exercised thereafter for any subsequent previous year. ***Accordingly, co-operative societies who have already opted for concessional tax under section 115BAE will be governed by the provisions of section 115BAE and a fresh option cannot be exercised under section 115BAE from A.Y. 2025-26 onwards.***	previous year, it **cannot be subsequently withdrawn** for the same or any other previous year. **Note** – The option can be exercised even in a later year, but once exercised, cannot be withdrawn subsequently.

Note *- For the purpose of point no.7(iv) in column (3) of the above table in relation to a co-operative society exercising option under section 115BAE, any machinery or plant which was used outside India by any other person shall not be regarded as machinery or plant previously used for any purpose, if all the following conditions are fulfilled, namely:—*

(a) such machinery or plant was not, at any time previous to the date of the installation, used in India;

(b) such machinery or plant is imported into India from any country outside India;

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the Income-tax Act, 1961 in computing the total income of any person for any period prior to the date of installation of the machinery or plant by the person.

Further, where in the case of a person, any machinery or plant or any part thereof previously used for any purpose is put to use by the co-operative society and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used by the co-operative society, then, the condition specified that the co-operative society does not use any machinery or plant previously used for any purpose would be deemed to have been complied with.

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ILLUSTRATION 10

Transfer fees are received by a cooperative housing society from its incoming and outgoing members. Are such transfer fees liable to tax in the hands of the cooperative society?

SOLUTION

The issue under consideration is whether the transfer fees received by a co-operative housing society from its incoming and outgoing members is taxable or exempt on the principle of mutuality.

On this issue, the High Court, in *Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47*, observed that under the byelaws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on account of the principle of mutuality, since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Applying the rationale of the above ruling, transfer fees received by a co-operative housing society from its incoming and outgoing members would not be liable to tax in the hands of the co-operative society.

TAXATION OF INDIVIDUALS/HUF/AOPs OR BOIs

(1) Default Tax Regime [Section 115BAC]

Individuals/ Hindu Undivided Family (HUF)/ Association of Persons (AoPs) other than a co-operative society / Body of Individuals (BoIs) and Artificial Juridical Persons have to pay tax at concessional rates of tax provided under section 115BAC. The tax rates given under section 115BAC are the default tax rates unless the assessee exercises an option to shift out of the said regime. However, such persons have to forego certain exemptions and deductions under this regime. Alternatively, they can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

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I. Concessional tax rates under section 115BAC

Individuals/ HUF/ AoPs other than a co-operative society/ BoIs or artificial judicial persons (Assessment of Individuals/ AoPs/ HUFs are discussed later on under this chapter) other than those who exercise the option to opt out this regime under section 115BAC(6), have to pay tax in respect of their total income (other than income chargeable to tax at special rates under Chapter XII such as section 111A, 112, 112A, 115BB, 115BBJ etc.) at the following concessional rates, subject to certain conditions specified under section 115BAC(2) –

(i)	*Upto ₹4,00,000*	*NIL*
(ii)	*From ₹4,00,001 to ₹8,00,000*	*5%*
(iii)	*From ₹8,00,001 to ₹12,00,000*	*10%*
(iv)	*From ₹12,00,001 to ₹16,00,000*	*15%*
(v)	*From ₹16,00,001 to ₹20,00,000*	*20%*
(vi)	*From ₹20,00,001 to ₹24,00,000*	*25%*
(vii)	*Above ₹24,00,000*	*30%*

II. Conditions to be satisfied for availing concessional rates of tax: The following are the conditions to be satisfied for availing concessional rates of tax:

S. No.	Particulars
(1)	**Certain deductions/exemptions not allowable:** Section 115BAC(2) provides that while computing total income, the following deductions/exemptions would not be allowed:

Section	Exemption/Deduction
10(5)	Leave travel concession
10(13A)	House rent allowance
10(14)	Exemption in respect of special allowances or benefit to meet expenses relating to duties or personal expenses (other than those as may be prescribed for this purpose).
10(17)	Daily allowance or constituency allowance of MPs and MLAs
10(32)	Exemption in respect of income of minor child included in the income of parent
10AA	Tax holiday for units established in SEZ
16	(i) Entertainment allowance (ii) Professional tax
24(b)	Interest on loan in respect of self-occupied property
32(1)(iia)	Additional depreciation
33AB	Tea/Coffee/Rubber development account
33ABA	Site Restoration Fund

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	35(1)(ii),(iia), (iii) or 35(2AA)	Deduction in respect of contribution to - notified approved research association/ university/college/ other institutions for scientific research [Section 35(1)(ii)] - approved Indian company for scientific research [Section 35(1)(iia)] - notified approved research association/ university/college/other institutions for research in social science or statistical research [Section 35(1)(iii)] - An approved National laboratory/ university/IIT/ specified person for scientific research undertaken under an approved programme [Section 35(2AA)]
	35AD	Investment linked tax incentives for specified businesses
	35CCC	Deduction in respect of expenditure incurred on notified agricultural project
	80C to 80U	Deductions under Chapter VI-A (other than employers contribution towards NPS under section 80CCD(2), Central Government contribution towards Agnipath Scheme under section 80CCH(2) and deduction in respect of employment of new employees under section 80JJAA).
(2)	**Certain losses not allowed to be set-off:** While computing total income, set-off of any loss **-** (i) carried forward or depreciation from any earlier assessment year, if such loss or depreciation is attributable to any of the deductions referred to in (1) above; or (ii) under the head house property with any other head of income; would **not be** allowed.	
(3)	**Depreciation or additional depreciation:** Depreciation u/s 32 is to be determined in the prescribed manner. Depreciation in respect of any block of assets entitled to more than 40%, would be restricted to 40% on the written down value of such block of assets. Additional depreciation u/s 32(1)(iia), however, cannot be claimed.	
(4)	**Exemption or deduction for allowances or perquisite:** While computing total income, any exemption or deduction for allowances or perquisite, by whatever name called, provided under any other law for the time being force in India would not be allowed.	
(5)	In case of a person having a unit in IFSC referred to in section 80LA(1A), whose income is chargeable to tax under section 115BAC(1A), deduction under section 80LA would be allowed subject to fulfilment of the conditions specified in that section.	

Additional points:

(i) An employee whose income is chargeable to tax under section 115BAC(1A) would be entitled for -

- In case of salary income: Standard deduction under section 16(1)(ia) upto ₹ 75,000;

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- In case of income in the nature of family pension: A deduction of a sum equal to 33-1/3 per cent of such income or ₹ 25,000, whichever is lower;
- Deduction under section 80CCD(2) in respect of contribution made by any other employer: Upto 14% of salary;
- travelling allowance (i.e., allowance granted to meet the cost of travel on tour or transfer);
- daily allowance (i.e., allowance granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty);
- conveyance allowance (i.e., allowance granted to meet the expenditure incurred on conveyance in performance of duties of an office or employment of profit, where free conveyance is not provided by the employer); and
- exemption in respect of transport allowance granted to an employee who is blind or deaf and dumb or orthopedically handicapped with disability of the lower extremities of the body to the extent of ₹ 3,200 p.m.

(ii) An individual, being an employee paying tax as per section 115BAC, would not be entitled for exemption of perquisite of free food and non-alcoholic beverages provided by an employer through paid vouchers.

(iii) Loss or depreciation referred to in (2) above would be deemed to have been already given effect to and no further deduction for such loss or depreciation shall be allowed for any subsequent year.

Where income-tax on total income of the assessee is computed under this section and there is a depreciation allowance in respect of a block of asset from an earlier assessment year attributable to additional depreciation u/s 32(1)(iia), which has not been given full effect to prior to A.Y. 2024-25 and which is not allowed to be set-off in the A.Y.2024-25 due to section 115BAC, corresponding adjustment shall be made to the WDV of such block of assets as on 1.4.2023 in the prescribed manner i.e., the WDV as on 1.4.2023 will be increased by the unabsorbed additional depreciation not allowed to be set-off.

III. Time limit for exercising the option to shift out of the default tax regime

(i) In case of an assessee having no income from business or profession: Where such individual/HUF/AoP (other than a co-operative society)/BoI or Artificial Juridical person is **not** having income from business or profession, he/it can exercise an option to shift out/opt out of the default tax regime under this section and such option has to be exercised along with the return of income to be furnished under section 139(1) for a previous year relevant to the

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assessment year. In effect, such individual/HUF/AoP/BoI or Artificial Juridical person can choose whether or not to exercise the option of shifting out of the default tax regime in each previous year. He may choose to pay tax under default tax regime under section 115BAC in one year and exercise the option to shift out of default tax regime in another year.

(ii) **In case of an assessee having income from business or profession:** Such individual/HUF/AoP/BoI or Artificial Juridical person having income from business or profession has an option to shift out/ opt out of the default tax regime under this section and the option has to be exercised on or before the due date specified under section 139(1) for furnishing the return of income for such previous year and once such option is exercised, it would apply to subsequent assessment years.

Such person who has exercised the above option of shifting out of the default tax regime for any previous year shall be able to withdraw such option only once and pay tax under the default tax regime under section 115BAC for a previous year other than the year in which it was exercised.

Thereafter, such person shall never be eligible to exercise option under this section, except where such person ceases to have any business income in which case, option under (i) above would be available.

AMT liability not attracted: Individual/HUF/AoP/BoI or Artificial Juridical person paying tax under default tax regime under section 115BAC is **not** liable to alternate minimum tax u/s 115JC. Such person would not be eligible to claim AMT credit also.

Note: *It may be noted that in case of Individual/HUF/AoP/BoI or Artificial Juridical person not having income from business or profession, the total income and tax liability (including provisions relating to AMT, if applicable under normal provisions) may be computed every year both in accordance with the regular provisions of the Income-tax Act, 1961 and in accordance with the provisions of section 115BAC, in order to determine which is more beneficial and accordingly such person may decide whether to pay tax under default tax regime under section 115BAC or exercise the option to shift out and pay tax under normal provisions of the Act for that year.*

(2) Taxation of Individuals

The term "individual" as such has nowhere been defined in the Income-tax Act, 1961. Section 2(31), however, states that "person" *inter alia*, includes an individual. In the commonly understood sense of the term, an individual means a human being or a single person. The person may be major, minor, married or unmarried, possessing sound or unsound mind. All the same, he is assessable as an 'individual' and is liable to pay tax, if the total income earned by him during any previous year

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exceeds the prescribed limit exempted from tax. If an individual who is liable to pay tax for any year dies before he is assessed to tax, his executor, administrator or legal representative is treated as the individual assessee for purposes of assessment of the income of the deceased person.

(i) Tax rates

Individual assessee can pay tax at concessional rates under the default tax regime under section 115BAC (discussed above). However, he has to forego certain exemptions and deductions under this regime. Alternatively, he can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

[The slab rates for A.Y. 2026-27 applicable to an Individual/HUF/AOP/BOI/ Artificial Juridical Person exercising the option of shifting out of the default tax regime are discussed in Chapter 1 in Module 1]

(ii) Assessment of a non-resident individual

The scope of deemed income taxable in the hands of a non-resident as laid down in section 5 is explained in section 9(1) which extends the liability to tax of a non-resident individual in respect of income which although not actually accruing or arising in India deemed to be so accruing or arising, assumes significance in the assessment of non-resident individual. For better understanding of the provisions of section 9, students are advised to refer to *Chapter 21 - "Non-resident Taxation in Module 4 of the Study material.*

(iii) Special concessions in the case of individuals not being citizens of India

Although basically the law of income-tax is applicable alike to both citizens and non-citizens of India, and there is no difference in the general principles for computing the total income under the Income-tax Act, 1961, however, on a consideration of the peculiar circumstances in which a foreigner might come to or live in India, certain concessions and reliefs are granted to them under section 10(6). These have been discussed in detail in *Chapter 21 –"Non-resident Taxation in Module 4 of the Study material.*

(iv) Exemptions, reliefs and concessional rates of tax available to individuals

The tax exemptions and reliefs available under the Act to individuals in respect of income chargeable to tax fall under the following categories:

(a) Income altogether excluded from the total income, and on which in consequence, no income-tax is payable [Section 10].

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(b) Deductions from gross total income both in respect of income, a part of which is not chargeable to income-tax and payments made by the assessee, a part or the whole of which is deductible from the gross total income [Chapter VI-A]

However, certain exemptions and deductions are not available where an individual is paying tax as per the default regime under section 115BAC(1A).

(v) Rebate of tax and relief in certain cases

- **Income from association of persons or bodies of individuals:** If the assessee is a member of an association of persons or a body of individuals (other than a company, co-operative society or society) income-tax shall not be payable by him in respect of any portion of the amount receivable by him from the association or body on which tax has already been paid by the association or body at the maximum marginal rate or any higher rate [Section 86].

  Further, if the total income of AOP or BOI is not chargeable to income-tax, then the share of member shall be chargeable to tax as part of his total income. Thus, in such case, the share of member shall form part of his total income.

  For the purposes of this provision in the case of an association of persons which is assessable under section 67A, the members of the AOP whose shares in the income are indeterminate or unknown, will be entitled to receive equal shares in the income of the AOP and the individual share of such member will be determined accordingly.

- **Rebate of income-tax to an individual resident in India:** In order to provide tax relief to the individual tax payers, section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India.

  Rebate to resident individual paying tax under default tax regime u/s 115BAC

  (i) If the total income of the resident individual is chargeable to tax under section 115BAC and the total income of such individual ***does not exceed ₹ 12,00,000***, the rebate shall be equal to the amount of income-tax payable on his total income for any assessment year or an amount of ***₹ 60,000***, whichever is less.

  The amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee with which he is chargeable for any assessment year.

  It is further provided that the rebate shall not exceed the amount of income-tax computed as per the rates provided in section 115BAC.

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ILLUSTRATION 11

Mr. X aged 34 years and a resident in India, has a total income of ₹ 11,70,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2026-27 under default tax regime under section 115BAC.

SOLUTION

Computation of tax liability of Mr. X for A.Y. 2026-27

Particulars	₹
Tax on total income of ₹ 11,70,000	
5% of ₹ 4,00,000 i.e., from ₹ 4,00,000 to ₹ 8,00,000]	20,000
10% of ₹ 3,70,000 i.e., from ₹ 8,00,001 to ₹ 11,70,000	37,000
	57,000
Less: Rebate u/s 87A (Lower of tax payable or ₹ 60,000)	57,000
Tax Liability	**Nil**

(ii) If the total income of the resident individual is chargeable to tax under section 115BAC and the total income of such individual ***exceeds ₹ 12,00,000*** and income-tax payable on such total income exceeds the amount by which the total income is ***in excess of ₹ 12,00,000***, the rebate would be as follows.

Step 1 – Total income (-) ₹ 12 lakhs **(A)**

Step 2 - Compute income-tax liability on total income **(B)**

Step 3 - If **B > A**, rebate under section 87A would be a **B – A.**

The amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee.

It is further provided that the rebate shall not exceed the amount of income-tax computed as per the rates provided in section 115BAC.

ILLUSTRATION 12

Ms. Pallavi aged 32 years and a resident in India, has a total income of ₹ 12,18,000, comprising his salary income and interest on bank fixed deposit. Compute her tax liability for A.Y.2026-27 under default tax regime under section 115BAC.

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SOLUTION

Computation of tax liability of Ms. Pallavi for A.Y. 2026-27

Particulars	₹	
Step 1: Total Income of ₹ 12,18,000 - ₹ 12,00,000	18,000	**(A)**
Step 2: Tax on total income of ₹ 12,18,000		
Tax@15% of ₹ 18,000 + ₹ 60,000	62,700	**(B)**
Step 3: Since B > A, rebate u/s 87A would be B - A		
[₹ 62,700 - ₹ 18,000]	44,700	
	18,000	
Add: HEC@4%	720	
Tax Liability	**18,720**	

Rebate to a resident individual paying tax under optional tax regime (normal provisions of the Act)

If total income of such individual **does not exceed ₹ 5,00,000**, the rebate shall be equal to the amount of income-tax payable on his total income for any assessment year or an amount of **₹ 12,500**, whichever is less.

The amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee with which he is chargeable for any assessment year.

Rebate is, however, not available in respect of tax payable on long-term capital gains taxable u/s 112A.

- **Relief from taxation in respect of income from retirement benefit account maintained in a notified country [Section 89A]:** Where a specified person has income accrued in a specified account, such income shall be taxed in such manner and in such year as may be prescribed.

Meaning of certain terms:

Terms	Meaning
Specified account	An account maintained in a notified country by the specified person in respect of his retirement benefits and the income from such account is not taxable on accrual basis but is taxed by such country at the time of withdrawal or redemption.
Notified country	A country as notified by the Central Government. So far vide Notification No. 25/2022, dated 4.4.2022, Canada, USA and UK have been notified by the Central Government.

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Specified person	A person resident in India who opened a specified account in a notified country while being non-resident in India and resident in that country.

Accordingly, the CBDT has, vide Notification No.24/2022 dated 4.4.2022 inserted Rule 21AAA providing for taxation of income from retirement benefit account maintained in a notified country.

Option to be exercised by specified person - Where a specified person has income accrued in a specified account(s) during P.Y.2021-22 or thereafter, then, at the **option of the specified person**, such income would be included in the total income of the previous year relevant to the assessment year in which income from the said specified account(s) is taxed **at the time of withdrawal or redemption**, as the case may be, in the notified country. The option has to be exercised for all the specified accounts maintained by the specified person.

Exclusions from total income of specified person - Where the option has been exercised by a specified person, the total income of the specified person for the previous year in which income is taxable would **not** include the income which:

- has already been included in the total income of such specified person in any of the earlier previous years during which such income accrued and tax thereon has been paid under the Act; or
- was not taxable in India, in the previous year during which such income accrued, on account of,
  - such specified person being a non-resident, or resident but not ordinarily resident, during that previous year; or
  - application of the DTAA, if any.

Foreign tax, if any, paid on such income would be ignored for the purposes of computation of the foreign tax credit under Rule 128.

Option once exercised cannot be withdrawn - The option has to be exercised in the prescribed form, which has to be furnished electronically under digital signature or electronic verification code on or before the due date u/s 139(1). The option once exercised for a specified account(s) in respect of a previous year in the prescribed form would apply to all subsequent previous years and cannot be subsequently

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withdrawn for the previous year for which the option was exercised or any previous year subsequent to that previous year (except in case where the specified person becomes a non-resident in any subsequent previous year).

Consequences when specified person becomes non-resident in a subsequent previous year - In case the specified person, after exercising option in the prescribed form for any previous year, say, P.Y.2025-26, becomes a non-resident during any subsequent previous year, say, P.Y.2028-29, (referred to as the relevant previous year) then, the option exercised above would be deemed to have never been exercised with effect from the relevant previous year, i.e., from P.Y.2028-29. The income which has accrued in the specified account(s) during the previous year, beginning with the previous year in which option was exercised (P.Y.2025-26) till the previous year immediately preceding the relevant previous year (i.e., upto P.Y.2027-28) would be taxable during the previous year immediately preceding the relevant previous year (i.e., in the P.Y.2027-28). The tax on such income has to be paid on or before the due date for furnishing the return of income for the relevant previous year (due date for P.Y. 2028-29).

(vi) **Rates of Surcharge Applicable to Individuals**

Higher surcharge of 25% and 37% is leviable, where the total income of individuals/ HUF/AOPs/BoIs/artificial juridical persons exceeds ₹ 2 crores and ₹ 5 crores, respectively, and the individual has exercised the option to shift out of the default regime under section 115BAC. However, the higher surcharge rates would not be applicable on tax payable on dividend income or tax payable at special rates under section 111A, 112 and 112A. **Further, where an individual is paying tax as per the default regime under section 115BAC(1A), the maximum rate of surcharge is 25% for total income exceeding ₹ 2 crores.**

[Refer to Chapter 1: Basic Concepts in Module 1 of the Study Material, containing rates of surcharge for understanding the manner of computation of surcharge on capital gains, dividend and other income components of total income]

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(3) Taxation of Hindu Undivided Families

(i) Concept of HUF

A Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment under the Income-tax Act, 1961. It is included in the definition of the term "person" under section 2(31). The levy of income-tax is on "every person". Therefore, income-tax is payable by a HUF.

"Hindu undivided family" has not been defined under the Income-tax Act. The expression is, however, defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and daughters.

Some members of the HUF are called **co-parceners**. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (Karta) are called co-parceners. A Hindu Coparcenary includes those persons who acquire an interest in joint family property by birth. Earlier, only male descendants were considered as coparceners. With effect from 6th September, 2005, daughters have also been accorded coparcenary status. It may be noted that only the coparceners have a right to demand partition.

A daughter of coparcener by birth shall become a coparcener in her own right in the same manner as the son. Being a coparcener, she can claim partition of assets of the family. The rights of a daughter in coparcenary property are equal to that of a son. However, other female members of the family, for example, wife or daughter-in-law of a coparcener are mere members of the HUF and are not eligible for such coparcenary rights.

The existence of a HUF does not arise from a contract but arises from status. There need not be more than one male member or one female coparcener w.e.f. 6th September, 2005 to form a HUF. The Income-tax Act, 1961 also does not indicate that a HUF as an assessable entity must consist of at least two male members or two coparceners.

Under the Income-tax Act, 1961, Jain undivided families and Sikh undivided families would also be assessed as a HUF.

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The basic difference between the two schools of Hindu law with regard to succession is as follows:

Dayabaga school of law	Mithakshara school of law
Prevalent in West Bengal and Assam.	Prevalent in rest of India.
Nobody acquires the right, share in the property by birth as long as the head of family is living.	One acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living.
Thus, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Hence, the father and his brothers would be the coparceners of the HUF.	Thus, every child born in the family acquires a right/ share in the family property.

(ii) Assessment of Hindu Undivided family

The income of a HUF is to be assessed in the hands of the HUF and not in the hands of any of its members. This is because HUF is a separate and a distinct tax entity.

(iii) Assessment of HUF after partition of HUF [Section 171]

There are two types of partition. They are –

(a) **Total partition –** is a partition by which the entire family property is divided amongst the coparceners. After the total partition, the HUF ceases to exist as such.

(b) **Partial partition –** is a partition which is partial as regards either the persons constituting the joint family or as regards the properties belonging to the joint family or both. In case of a partial partition as regards persons constituting the joint family, some coparceners may separate from the joint family while the others might continue to remain as part of the joint family. In case of a partial partition as regards the property, there may be a division or severance of interest in respect of some part of the estate of the joint family, while the rest of the estate may continue to remain as property of the joint family.

Effect of partial partitions made after 31st December 1978: Partial partitions after 31st December 1978 are not recognized for tax purposes. If any partial partition has been effected after 31.12.1978, then no claim of such partial partition shall be recorded by the Assessing Officer. Such family will continue to be assessed as if no

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such partial partition has been effected. Every member of the HUF, immediately before such partial partition, and the HUF shall be jointly and severally liable for any tax, penalty, interest, fine or other sum payable under the Act. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partial partition.

When a claim of total partition of HUF has been made by any member of the HUF on behalf of the HUF, the Assessing Officer shall inquire into such claim. For this purpose, he shall give notice to all the members of the HUF. Thereafter, the Assessing Officer shall, on completion of inquiry, record a finding as to whether total partition has taken place and if so, the date when such partition was effected.

If partition has been effected in the previous year, the total income of the HUF for the previous year up to the date of partition shall be assessed as income of the HUF. Every member of the HUF, in addition to any tax for which he is separately liable, is jointly and severally liable for payment of tax on such assessed income of the HUF. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partition.

If partition has been effected after expiry of previous year, the total income of the HUF for the previous year shall be assessed as income of the HUF. Every member of the HUF is jointly and severally liable for payment of tax on such assessed income of the HUF.

If partition has already taken place: If the Assessing Officer finds after completion of the assessment of a HUF that the partition has already taken place, the Assessing Officer shall proceed to recover the tax from every person who was a member of the family before the partition.

Every such member of the HUF is jointly and severally liable for payment of tax on such assessed income of the HUF.

(iv) Computation of total income of HUF

The following points should be taken into consideration while determining the total income of HUF -

(a) Income from the transfer of a self-acquired property by an individual to his HUF for inadequate consideration or conversion of the self-acquired property into property of the HUF is not considered as the income of the HUF. It would be included in the income of the individual member who transferred the property to the HUF [Section 64(2)].

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(b) Section 10(2) exempts any receipt by an individual as a member of a HUF out of the family income.

(c) If a member of the HUF receives any fee or remuneration as a director or a partner in a company or firm as a consequence of the investment made in such concern out of the funds of the HUF, such fee/remuneration shall constitute income of the HUF. However, any such fee or remuneration earned by a member of a HUF as a director or partner for services rendered purely in his personal capacity, will be included in the income of the individual member and not the HUF.

(v) Tax rates

HUF can pay tax at concessional rates under the default tax regime under section 115BAC (discussed earlier). However, it has to forego certain exemptions and deductions under this regime. Alternatively, it can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

[The slab rates for A.Y. 2026-27 applicable to an Individual/HUF/AOP/BOI/ Artificial Juridical Person, exercising the option of shifting out of the default tax regime are discussed in Chapter 1 in Module 1].

(vi) Rates of surcharge applicable to HUF

Higher surcharge of 25% and 37% is leviable, where the total income of individuals/ HUF/ AOPs/BOIs/artificial juridical persons exceeds ₹ 2 crores and ₹ 5 crores, respectively and the HUF has exercised the option to shift out of the default tax regime. However, the higher surcharge would not be applicable on tax payable on dividend income and tax payable at special rates under section 111A, 112 and 112A. Further, where an HUF is paying tax as per the default regime under section 115BAC(1A), the maximum rate of surcharge is 25% for total income exceeding ₹ 2 crores. *[Refer to Chapter 1: Basic Concepts containing rates of surcharge for understanding the manner of computation of surcharge on capital gains, dividends and other income components of total income].*

(vii) Conversion of separate property into property of HUF

Generally, income from self-acquired property of an individual, who is a member of a HUF will be assessed as his personal income and not as the income of the family. However, the individual can convert his separate properties into the property of the HUF. There are no legal formalities to be complied with. These principles have been upheld by various judicial rulings.

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It naturally follows that once the assets belonging to the individual are impressed with the character of joint family property, the income arising therefrom, should be assessed as the income of the HUF. However, the deeming provisions of section 64(2) specifically provide that the entire income from the converted property is taxable as the income of the transferor. This provision applies not only to property converted in the above manner but also covers transfer of property by an individual, directly or indirectly, to the family otherwise than for adequate consideration, in other words, gifts. Accordingly, where an individual makes direct or indirect gift of his separate property to the Hindu Undivided family of which he is a member or if he transfers his separate property to his family for less than its fair market value, nothing would be taxable in the hands of HUF u/s 56(2)(x) and the provisions of section 64(2) will be attracted and the entire income from such separate property converted into HUF property will be included in the total income of the individual.

(viii) Business in the personal capacity of the Karta or member

Where the Karta or any member of a joint family carries on a business on his personal capacity, the income from any such business would constitute his personal income. It does not matter even if the business of the member and of the joint family are identical in nature and size. Suppose the capital for the individual's business is borrowed from the funds of the family what will be the position? Consider the following example.

Example: *A HUF consists of the Karta, his wife, two sons and daughter. The HUF runs a departmental store. One of the two sons is qualified in business administration and the other one is an automobile engineer. Together they start a garage for repairing all types of motor cars. The technical aspects are looked after by the engineer while the general administration is taken care of by the son qualified in business administration. For starting the business, the HUF has advanced an interest-free loan of ₹ 50,000. The business is yielding good profits. Now the question arises whether the income from the business should be assessed in the hands of the Hindu undivided family.*

It is obvious that the family, in providing the interest-free loan to the business of the brothers has suffered a detriment. However, the Delhi High Court has laid down the following proposition in this connection in the case of CIT vs. Charandass Khanna & Sons (1980) 123 ITR 194 (Delhi). If investment plays a minor role and it is primarily the personal efforts, specialised skill and enterprise of the individual coparceners which resulted in the new business being set up and the profits accruing, it may not essentially be said that the income belongs to the HUF. In the present case, the good profits are more due to the specialised skills acquired by the two sons in their respective fields. Of course, the capital, got from the

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family as interest free loan, has its role to play but it is nevertheless a minor one. Therefore, we can say that the income from the business set up by the brothers is assessable in their hands as individuals according to the agreed rate of sharing and not as the income of the family.

The Supreme Court has also upheld this principle in *K.S. Subbiah Pillai vs. CIT (237 ITR 11).* It was held that remuneration received on account of personal qualification and exercise of individual exertion was assessable as individual income and not as income of HUF. The following principles have been broadly applied by the Supreme Court for determining the character of the receipt by way of remuneration paid to a coparcener:

Remuneration received on account of personal qualification and exercise of individual exertion is assessable as individual's income and not as income of HUF.

(i) when the remuneration received by the coparcener though not in form but in substance was one of the modes of return made to the family because of investment of the family funds, it has to be assessed as the income of Joint Hindu Family.

(ii) when the remuneration is not paid to the detriment of the family funds, it is assessable as the income of recipient Karta or coparcener as an individual.

(iii) when it is a compensation for the services, skill or labour of the coparcener, it has to be assessed as the income of such a coparcener in his individual capacity.

Example: *The Karta of a HUF receives salary in his capacity as a treasurer and secretary of a bank. The HUF has furnished ₹ 1,00,000 as security deposit. Decide whether the salary can be assessed as the income of the HUF.*

The position of treasurer and secretary requires considerable personal skill and integrity on the part of the incumbent. It is true that the security deposit might have been furnished by the HUF, however, since the salary is paid to the Karta primarily for the exercise of his personal skill and integrity, it is to be assessed as his individual income.

Hence, students should carefully understand the following:

(a) Where the funds of a HUF are invested in a company or a partnership firm, the dividends or share of profits are generally taxable as the income of the family. In such a case the fee, salary, commission or other remuneration received by the Karta,

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or any member of the family, in his capacity as director or partner would also be taxable as income of the family. The reasons for this treatment are as follows:

(1) The income is earned by the detriment to the joint family funds.

(2) It is earned with the aid of joint family funds.

(3) There is real and sufficient connection between the investment of the joint family funds and the income by way of remuneration earned.

(b) However, where the income is earned by the Karta or any other member of the family by the exercise of the personal skill, the income should be assessed in their individual hands even if some detriment is caused to the family funds, say, by way of loan, guarantee etc. whose role is only secondary.

(ix) Members of HUF in Partnership firms

A Hindu undivided family can become a partner in a firm. However, since it has no separate legal entity of its own, its Karta alone can be partner in the firm representing the family. The coparcenary has no place in the partnership.

When the Karta of Hindu undivided family enters into a partnership with strangers, the member of the family does not, *ipso facto,* become partners in that firm. They have no right to take part in its management or to sue for its dissolution. The creditors of the firm are entitled to proceed against the joint family assets including the shares of the non-partner coparceners for their debts. This is because under Hindu Law, the Karta has the right when carrying on business to pledge the credit of the joint family to the extent of its assets. The liability on the part of other members of the HUF arises by reason of their status as coparceners and not by reason of any contract of partnership by them.

Partnership between Karta representing family and Coparcener: A Karta of a HUF representing the family on the one hand, and a member of that family in his individual capacity on the other, can enter into a valid partnership. An individual coparcener, while remaining joint, can possess, enjoy and utilise in any way he likes, property which is his individual property. Therefore, when he enters into partnership with the family, he retains his share and interest in the property of the family while he simultaneously enjoys the benefit of his separate property and fruits of its investment.

(x) Salary paid to Karta for managing the family's business

If remuneration is paid to the Karta of Hindu undivided family under a valid agreement which is *bona fide* and in the interest of and expedient for the business of the family and the

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payment is genuine and not excessive, such remuneration would be an expenditure laid out wholly and exclusively for the purpose of the business of the family and would be allowable as an expenditure.

(xi) Salary paid to member

A Hindu undivided family can be allowed to deduct salaries paid to member of the family if the payment is made as a matter of commercial or business expediency, but the service rendered must be to the family.

(xii) Gifts to HUF

Can an outsider make a gift to HUF? Under what circumstances will a gift made by an outsider be considered as a gift to the HUF? The answers to these questions are as follows:

(a) If the HUF to which such a gift is made consists of only one coparcener, then the gifted property can be held by the members of the family only as tenants-in-common, i.e., the income arising out of such gifted property can be assessed as income in the hands of the Association of Persons (AOP).

(b) If the HUF to which such a gift is made consists of minimum two coparceners, then the gifted property can be held by the members of the family as joint tenants and the income arising out of such gifted property can be assessed as income in the hands of the joint Hindu family.

Section 56(2)(x) provides that any sum of money or value of property received by a HUF without consideration would be chargeable to income-tax under the head "Income from other sources", if the aggregate value or in case of immovable property stamp duty value of the property exceeds ₹ 50,000 during a year. However, a sum received by a HUF from its relative, i.e., a member of the HUF, is exempt. *For details, refer Chapter 5 on "Income from other sources".*

ILLUSTRATION 13

Mr. Ram (aged 56) is Karta of his HUF. The HUF consists of himself, his wife and two sons viz. Mr. C (aged 28) and Minor D (aged 16). The HUF is assessed to income tax and has business income from the year 2015-16 onwards. The business income of HUF for the year ended 31.3.2026 is ₹ 5,00,000 (computed). Mr. Ram is employed in a private company and his salary income for the same period is ₹ 6,10,000 (computed).

You are requested to answer the following treating each of them as independent situations:

(i) Mr. C gave cash gift of ₹ 1,00,000 to the HUF of Mr. Ram. What would be the total income of HUF?

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(ii) The HUF has one house property fetching rent of ₹ 10,000 per month and some movable assets. There is a proposal to make a partial partition of HUF by allotting the house property to Mr. C. Is it advisable to do a partial partition?

(iii) Minor D earned ₹ 70,000 by use of his special skill and talent. How would his income be taxed?

(iv) A car owned personally by Mr. Ram was blended with HUF during the year. It was leased out for a monthly rent of ₹ 10,000 from 1-10-2025. How would this income be taxed?

SOLUTION

(i) Cash gift of ₹ 1 lakh by Mr. C, Ram's major son, to the HUF of Mr. Ram would not be taxable in the hands of the HUF, since gifts from a relative of the HUF does not fall within the scope of income taxable under section 56(2)(x). Since Mr. C, being Mr. Ram's son, is a member of Ram's HUF, he is a relative of the HUF. Hence, the total income of HUF would be ₹ 5 lakhs, being the business income computed.

Note *- Salary income of Mr. Ram, the Karta of the HUF, who is employed in a private company would be taxed in his individual hands, since the remuneration earned by the Karta on account of the personal qualifications and exertions and not on account of the investment of the family funds cannot be treated as income of the HUF.*

(ii) Partial partition (after 31.12.1978) is not recognized and the HUF, which has been hitherto assessed to tax, shall continue to be liable to be assessed as if no such partial partition has taken place [Section 171(9)].

The rental income in this case would continue to be assessed in the hands of the HUF, even after partial partition. Therefore, it is not advisable to do a partial partition.

(iii) Income of ₹ 70,000 earned by Minor D by use of his special skill and talent would be taxable in his individual hands. It will not be included in the hands of his parent by virtue of the exception to section 64(1A) contained in the proviso to section 64(1A).

(iv) As per section 64(2), where a member of the HUF blends his self-acquired property for inadequate consideration with the HUF, income derived therefrom is deemed to arise to the transferor-member and not to the HUF. In this case, Mr. Ram has blended his personal property (i.e., car) with the HUF.

Since there is no consideration in case of blending, the income from car computed in the prescribed manner, [which can be as per the presumptive provisions or lease rental of ₹ 60,000 (₹ 10,000 × 6 months) *less* depreciation] would be deemed as the income of Mr. Ram.

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(4) Taxation of AOP/ BOI and their members

Section 2(31) defines "person" as including "association of persons" or a "body of individuals". The expression association of persons is to be understood in its ordinary sense meaning there by a group or congregation of persons. The expression association of persons is of a wider connotation and scope than that of a body of individuals. An association of persons may have as its members not only individuals (including minors) but also companies, firms, joint families and other associations. When there is a group of persons formed for the promotion of an enterprise or when co-adventures join together in a common action, they are assessable as an association of persons. Ordinarily, there can be no association of persons in business unless the members of the group join together out of their own volition or will.

In order to constitute an association of persons, the members thereof must join any common purpose or common action and the object of the association must be to produce income. Mere receipt of income by a group of members in common will not make it an association unless income is earned by its own effort in common.

The co-owners, co-legatees and joint receivers joining for a **common purpose** or action would be assessable as an association of persons. For example, if the funds of a number of beneficiaries are put together and one business is carried on with the combined resources by the trustee, guardian or administrator, the business must be regarded as a single business assessable in the hands of an association of persons. However, section 26 specifically provides an exception to the assessment of co-owners as an association of persons. According to that section, where the shares of the co-owners in respect of income from house property are defined and ascertainable, the co-owners must be assessed not as an association of persons but individually even if the property may be owned and managed and developed jointly by the co-owners.

For the purpose of assessment, it is not necessary that the association should be legally constituted. In other words, it is not necessary that there must be mutual rights and obligations amongst the members enforceable in law. The illegality, invalidity or incorrectness in the constitution of an association does not in any way affect its liability to tax or its chargeability as a unit of assessment. A partnership which is illegal or otherwise void will have to be assessed as an association of persons. The question whether there is an association of persons or not depends upon the facts and circumstances of each case.

(i) Tax Rates

An AOP/BOI can pay tax at concessional rates under the default tax regime under section 115BAC (discussed earlier). However, it has to forego certain exemptions and deductions under this

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regime. Alternatively, it can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

[The slab rates for A.Y. 2026-27 applicable to an Individual/HUF/AOP/BOI/ Artificial Juridical Person, exercising the option of shifting out of the default tax regime are discussed in Chapter 1 in Module 1].

(ii) Computation of total income of AOPs/BOIs

1. Computation of total income in the case of an association of persons or body of individuals will be done in the same manner as in the case of any other assessee.
2. In computing the total income, interest, salary, bonus, commission, remuneration, by whatever name called, paid to members will not be allowed [Section 40(ba)]

However, in the case of payment of interest the following provisions will apply:

Explanation 1* below section 40(ba)*: If interest is paid by an AOPs/BOIs to any member who has also paid interest to the AOPs/BOIs then only that amount of interest paid by the AOPs/BOIs will be disallowed in its assessment which is in excess of the interest paid by the member to the AOPs/BOIs i.e., net interest shall be disallowed.

Explanation 2* below section 40(ba)*: If an individual is a member of an AOPs/BOIs in a representative capacity, on behalf of or for the benefit of another person, then interest paid by the AOPs/BOIs to such individual in his personal capacity will not be taken into account for the purpose of disallowance. However, interest paid by the AOPs/BOIs to such individual or *vice-versa* as representative member or interest paid by the AOPs/BOIs directly to the beneficiary will be taken into account for the purpose of disallowance.

Explanation 3* below section 40(ba)*: If interest is paid to a member who is not a member in a representative capacity, but such interest is received by him on behalf of or for the benefit of another person the interest payment will be allowed.

- **Computation of tax where shares of members in AOPs/BOIs are unknown [Section 167B]**: Tax on the total income would be computed as follows:

	Circumstances	Taxability
1.	If individual share of any member is not known	Tax will be levied at the maximum marginal rate. However, if total income of any member of AOPs/BOIs is taxable at a rate higher

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		than maximum marginal rate (for example, a foreign company which is a member), then total income of AOPs/BOIs shall be chargeable to tax at such higher rate of tax.
2.	If individual share of a member is known and	
	(a) total income of any member (excluding his share from AOPs/BOIs) exceeds the basic exemption limit [₹ 4,00,000 as per default regime under section 115BAC or ₹ 2,50,000/₹ 3,00,000/ ₹ 5,00,000 as per optional regime under normal provisions]	The AOPs/BOIs will pay tax at the maximum marginal rate. However, if total income of any member of AOPs/BOIs is taxable at a rate higher than maximum marginal rate (for example, a foreign company which is a member), then, total income of AOPs/BOIs shall be chargeable to tax as follows: • Portion of income attributable to such member shall be taxable at such higher rate as applicable to that member. • Balance income shall be taxable at the maximum marginal rate of tax.
	(b) no member has total income (excluding his share from AOPs/BOIs) exceeding the basic exemption limit [₹ 4,00,000 as per default regime under section 115BAC or ₹ 2,50,000/₹ 3,00,000/ ₹ 5,00,000 as per optional regime under normal provisions]	The AOPs/BOIs will pay tax as per the default regime under section 115BAC or optional regime as per normal provisions of Income-tax law applicable to an individual.

- **Rate of Surcharge applicable to AOP /BOI**

Higher surcharge of 25% and 37% is leviable, where the total income of AOP/BOI exceed ₹2 crores and ₹ 5 crores, respectively and they have exercised the option to shift out of the default tax regime.

Where an AOP is paying tax as per the default regime under section 115BAC(1A), the maximum rate of surcharge is 25% for total income exceeding ₹ 2 crores.

However, in respect of the following income, surcharge cannot exceed 15% both under the default regime and under the optional regime as per the normal provisions of the Act:

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- on tax payable at special rates under section 115AD on dividend income or short-term capital gains or long-term capital gains arising from the transfer of securities referred to in 115AD(1)(b);
- on tax payable on dividend income and tax payable at special rates under section 111A, 112 and 112A;
- where the AOP consists of only company as its member.

[Refer to Chapter 1: Basic Concepts in Module 1 containing rates of surcharge for understanding the manner of computation of surcharge on capital gains, dividends and other income components of total income and also refer Chapter 21: Non-resident Taxation in Module 4 for the table containing the rates of surcharge applicable to AOPs/BOIs (having any income under section 115AD)]

♦ **Assessment of share in the hands of member [Section 86]:**

A member's share in the total income of an AOPs/BOIs will be treated as follows:

- If an AOPs/BOIs has paid tax at the maximum marginal rate, or a higher rate, the member's share in the total income of the AOPs/BOIs will not be included in his total income.
- If the AOPs/BOIs has paid tax at regular rates applicable to an individual, the member's share in the income of the AOPs/BOIs computed under section 67A shall form part of his total income. However, the member will be allowed rebate under section 110 at the average rate in respect of such share.
- If the AOPs/BOIs has not paid tax on its total income, the member's share in the total income of the AOPs/BOIs will be included in his total income and taxed at regular rates.

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- **Computation of member's share in the total income of AOPs/BOIs [Section 67A]**: A member's share in the income of an AOPs/BOIs (wherein the shares of members are determinate and known) will be computed as follows:

  (a) Any interest, salary, bonus, commission, remuneration, etc. paid to a member during the previous year will be deducted from the total income of the association or body, and the balance will be apportioned among the members in proportion to their respective shares.

  (b) If the amount apportioned to a member as per (a) is a profit, any interest, salary, etc. paid to him by the association or body during the previous year will be added to that amount and the aggregate sum will be such member's share in the income of the AOPs/BOIs.

  (c) If the amount apportioned to a member as per (a) is a loss, any interest, salary, etc., paid to him by the association or body will be deducted from the amount of loss and the balance sum will be such member's share in the income of the AOPs/BOIs.

  The share of a member in the income/loss of the AOPs/BOIs will, for the purposes of assessment, be apportioned under the various heads of income in the same manner in which income/loss of the association has been determined under each head.

  Any interest paid by a member on capital borrowed by him for the purpose of investment in the AOPs/BOIs will be allowed as deduction while computing his share of income under the head "Profits and gains of business or profession."

- **Determination of tax where total income includes income on which no tax is payable [Section 110]:**

  If the total income of an assessee includes any income on which no income-tax is payable, the assessee would be entitled to a deduction, from the amount of income-tax with which he is chargeable on his total income, of an amount equal to the income-tax calculated at the average rate of income-tax on the amount on which no income-tax is payable.

- **Share of member of an AOPs/BOIs in the income of the AOPs/BOIs to be reduced from net profit for computing book profit for levy of MAT [Section 115JB]**

  (i) Under section 115JB, in the case of a company, if the tax payable on the total income computed as per the normal provisions of the Income-tax Act, 1961 is less than **15%** of its book profit, such book profit shall be deemed to be the total income of the company and the tax payable for the relevant previous year shall be **15%** of its book profit.

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(ii) *Explanation 1* below section 115JB(2) provides that the expression "book profit" means profit as shown in the statement of profit and loss account prepared in accordance with the provisions of the Companies Act or in accordance with the provisions of the relevant statute governing a company, as increased or reduced by certain adjustments, as specified thereunder.

(iii) Under section 86, no income-tax is payable on the share of a member of an AOPs/BOIs in the income of the AOPs/BOIs in certain circumstances. A company which is a member of an AOPs is also not required to pay tax in respect of its share in the income of the AOPs in such cases. However, prior to A.Y.2016-17, under section 115JB, a company which is a member of an AOPs was liable to MAT on such share also, since such income was not then excluded from the book profit while computing the MAT liability of the member. It may be noted that in a similar situation, where a company is a partner in a firm, the share in the profits of the firm is exempt in the hands of the partner as per section 10(2A) and no MAT is payable by the partner on such profits, since income to which any provision of section 10 applies, has to be reduced for computing book profit.

(iv) In order to ensure equity, clause (iic) in *Explanation 1* below section 115JB(2) has been inserted with effect from A.Y. 2016-17 to provide that the share of a member of an AOPs or BOIs, in the income of the AOPs or BOIs, on which no income-tax is payable in accordance with the provisions of section 86, should be reduced while computing book profit for levy of MAT under 115JB, if any such amount is credited to statement of profit and loss account. Consequently, clause (fa) has also been inserted in *Explanation 1* to add back the expenditures, if any, debited to the statement to profit and loss, corresponding to such income, while computing book profit for levy of MAT.

ILLUSTRATION 14

JK Associates is an Association of Persons (AOP) consisting of two members, J, aged 40 years and K, aged 37 years. Shares of the members are: 60% (J) and 40% (K). Income of the AOPs for the previous year 2025-26 is ₹ 11 lakhs.

J and K's income, other than income from AOP, amount to ₹ 2.50 lakhs and ₹ 2.90 lakhs, respectively.

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Compute tax liability of the AOP assuming that J exercises the option to shift out of the default regime and the AOP and its member K pays tax under default tax regime under section 115BAC(1A).

SOLUTION

Computation of tax of AOP is governed by section 167B. Tax on total income of AOP is computed as follows:

(i) If individual share of a member is known, and the total income of any member, excluding his share from such AOP, exceeds the basic exemption limit, then, the AOP will pay tax at the maximum marginal rate.

(ii) If individual share of a member is known and no member has total income (excluding his share from AOP) exceeding the basic exemption limit, then, the AOP will pay tax at the rates applicable to an individual.

Section 86 provides for assessment of share in the hands of members of AOP as follows:

A member's share in the total income of AOP will be treated as follows:-

(i) If an AOP has paid tax at the maximum marginal rate or a higher rate, the member's share in the total income of AOP will **not** be included in his total income and will be exempt.

(ii) If the AOP has paid tax at regular rates applicable to an individual, the member's share in the income of AOP will be included in his total income and he will be allowed rebate at the average rate of tax in respect of such share.

Tax Liability of J K Associates, AOP

Since none of the members have income, other than income from the AOP, exceeding the basic exemption limit, the AOP would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability would be follows:

₹ 4,00,000 – ₹ 8,00,000 @5%	₹ 20,000
₹ 8,00,001 – ₹ 11,00,000 @10%	₹ 30,000
	₹ 50,000
Add: Health & education cess @4%	2,000
Tax Liability	**52,000**

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Tax Liability of J and K

Particulars	J ₹	K ₹
Share of profit from AOP	6,60,000	4,40,000
Income from other sources	2,50,000	2,90,000
Total Income (A)	**9,10,000**	**7,30,000**
Tax liability	94,500	16,500
Add: Health and Education cess @ 4%	3,780	660
Total tax (B)	**98,280**	**17,160**
Average rate of tax [B/A x 100]	10.8%	2.351%
Total tax liability	98,280	17,160
***Less*: Rebate under section 86 read with section 110 in respect of share of profit from AOP** (share in AOP x Average rate of tax)	71,280	10,344
Tax liability of members	27,000	6,816
Tax Liability (Rounded off)	**27,000**	**6,820**

TAXATION OF LOCAL AUTHORITY

(i) General meaning

The expression "local authority" has not been defined by the Income-tax Act, 1961. A local authority is a person under section 2(31) of the Income-tax Act, 1961, and thus, constitutes a separate unit of assessment. It is chargeable to tax on its total income in respect of the previous year, computed in accordance with and under the basic provisions of the Act, which apply to other taxable entities and for all purposes of the Act, this entity is included in the term 'person'. All municipal corporations, or councils, committees, panchayat boards, port trusts, district boards and other authorities legally entitled to or entrusted by the Central or State Government with the control and/or management of a municipal or local fund are covered by the expression 'local authority'.

(ii) Exemptions

Under section 10(20), the income of a local authority which is chargeable to tax under the heads 'Income from house property,' 'Capital gains' and 'Income from other sources' accruing or arising to it anywhere in or outside India and income from a trade or business carried on by it which accrues or arises to it from the supply of a commodity or service with

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its own jurisdiction area or from the supply of water or electricity within or outside its own jurisdictional area are totally exempt from tax.

In other words, a local authority is taxable only in respect of the income arising to it from any business carried on by it provided that such income arises from the supply of any commodity or service, not being water or electricity outside its jurisdictional area, i.e., territorial limits.

A local authority is said to be resident at the place where the control and management of its affairs are situated, and its residential status is governed by section 6(4). A local authority in India is always resident in India, except where the control and management of its affairs is exercised wholly from outside India.

(iii) Tax rate

After total income, i.e., the income of a local authority chargeable to tax has been determined, the whole of it would attract tax at the rate applicable i.e., the one prescribed by the relevant Finance Act. There is no minimum amount exempt from tax in the case of a local authority. For income tax purposes, local authority is chargeable to tax at 30% on its total income of the previous year computed in accordance with the provisions of the Act, *plus* surcharge @ 12% if its total income exceeds ₹ 1 crore *plus* health and education cess @ 4%.

TAXATION OF MUTUAL CONCERNS

(i) General principles of mutuality –

(a) The first principle of mutuality is that no person can trade with himself or make income out of himself. A mutual association arises where persons forming a group associate together with a common object and contribute monies for achieving that object and divide the surplus amongst themselves in the character. The cardinal requirement in the case of mutual association is that all the contributors to the common fund must be entitled to participate in the surplus and all the participators to the surplus must be contributors to the common fund. In other words, there must be complete identity between the contributors and the participators.

(b) The participation in the surplus need not be immediate but it may assume the shape of a reduction in the future contribution or a division of the surplus on dissolution.

(c) It does not make any difference whether the persons joining together form an association or incorporate a company because the fact of incorporation does not destroy the identity of the contributors and participators.

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(d) Where there is mutuality, the fact that some members alone take advantage of the mutual enterprise would not affect the mutual character of the association.

(e) There is nothing in law which prohibits a mutual association from carrying on a trade so long as it is confined to its own members.

(f) It is not necessary that the surplus should be returned to every member of the association pro rata. The identification between the contributors and the participators should be regarded as one whole and not in relation to each individual.

(g) It is not necessary that all the activities of such an association should be mutual in character. There may be activities of a non-mutual character but the exemption from tax will apply to the surplus arising out of the mutual enterprise.

From the above principles we can conclude that one cannot trade with oneself and earn taxable profits thereby. Hence if there is a mutual concern, ordinarily there should be no tax on the profits arising out of mutual operations. But the Income-tax Act, 1961 provides for assessment of the income of a mutual concern in the following circumstances:

(1) Where the mutual concern is a mutual insurance society and the income is derived from the carrying on of any business of insurance.

(2) Where the mutual concern is a trade, professional or similar association and the income in question is derived from specific service performed for its members.

(ii) Insurance business

Under section 2(24)(vii) any surplus accruing to life as well as general mutual insurance concerns will fall within the definition of the word "income" and as such would be taxable as income from business. Section 44 expressly provides the profits and gains of any business of insurance including that carried on by a mutual insurance company or a cooperative society shall be computed not according to the provisions of the Act for computation of income under the various heads but according to the method prescribed in the Rules contained in the First Schedule to the Act. It is also provided that any expenditure which is not admissible under section 37 in computing the profits and gains of a business will be included to the profits and gains of life insurance business.

(iii) Trade and professional associations

A trade, professional or similar association may be a mutual concern. Section 28(iii) enacts that "income derived by a trade, professional or similar association from specific services performed for its members" shall be taxable as business profits. Under section 2(24)(v) any

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sum chargeable under section 28(iii) is deemed to be income. The object of these provisions seems to be to tax as profit the surplus arising from specific services rendered to members by a mutual trade, professional or similar association which otherwise may not be liable to tax in view of the general principles applicable to mutual concerns.

It may carefully be noted that a trade association is not the same thing as a trading association. A trade association means an association of tradesmen or businessmen for the protection or advancement of their common interests. Again clause (iii) of section 28 taxes the profit accruing only on specific services rendered by an association to its members. Any surplus arising to a mutual association in other way e.g. from entrance fees or members' periodic subscriptions would be outside the scope of this clause and would be non-taxable on the general principles stated above.

Since the surplus arising to trade, professional or similar association during the process of advancement of the common interest of the members is not includible in the taxable income it follows that the concerned expenditure will not also be allowed. Section 44A gives a benefit in this regard. It provides that in the case of such trade associations which did not distribute any parts of its income to its members, the amount of any deficit (deficiency) (excess of expenditure incurred for the advancement of the common interest of the members of the association over receipt from the members) would be deductible from the assessable income of the association to the maximum extent of 50% of such income.

This deficiency is to be deducted in the first instance from the assessable income under the head "Profits and gains of business or profession". If the deficiency exceeds such income the balance of deficiency can be set off against assessable income from any other head. The maximum limit of 50%, however, still operates. It should be noted that any adjustment of the deficiency is permissible only after effect has been given as provided in the Act to all losses, allowances etc., for the year in question or brought forward from earlier years.

(iv) Clubs

The consensus of judicial opinion is that any surplus accruing to a members' club from the subscriptions and charges for various conveniences paid by members is not income or profit at all, nor can a social club be deemed to trade as far as its dealings with its own members are concerned. The position would be the same even though the club may be incorporated as a company or registered as a society. But a club is taxable on the profit derived from subscriptions and charges paid by non-members and on the income derived from its capital assets. Where a club is an incorporated company carrying on business it may be taxable on the money received from its members as well as non-members in the course of its business.

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However, if the club is not a member's club but is a proprietary club i.e. if the club is owned by an outsider and not by the members themselves, the proprietor would be taxable on the profits earned by running the club. The position would not in any way be affected by the fact that the proprietor is a limited company and some of the shareholders are members of the club.

9.3 LIABILITY OF SUCCESSOR TO BUSINESS IN RESPECT OF TAX CHARGEABLE FROM THE PREDECESSOR [SECTION 170]

(1) **Assessment of successor and predecessor:** Where a person carrying on any business or profession is succeeded by another person who continues to carry on that business or profession, both the successor and the person who is succeeded to (hereinafter called the predecessor) shall be assessed in the following manner:

- the predecessor in business would be assessable in respect of the income of the previous year in which succession took place upto the date of succession;
- the successor would be assessable in respect of the income of that previous year after the date of succession.

Accordingly, the income of the year in which the succession takes place is to be apportioned between the predecessor and the successor with the share of each. The income must be computed separately and each must be granted the deductions and allowance applicable to him. The assessment on each of these persons must be separate and distinct.

(2) **Assessment when predecessor cannot be found:** Where the predecessor cannot be found, the assessment of

- the income of the previous year in which the succession took place up to the date of succession and
- of the one year preceding the previous year of succession

should be made on the successor in like manner and to the same extent as it would have been made on the predecessor, and all the provisions of the Act shall apply accordingly.

(3) **Assessment or reassessment or other proceedings during the pendency of succession:** In case there is succession, the assessment or reassessment or any other proceedings, made or initiated on the predecessor during the course of pendency of such

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succession, shall be deemed to have been made or initiated on the successor and all the provisions of this Act shall apply accordingly.

Meaning of the term "pendency": "Pendency" means the period

- commencing from the date of filing of application for such succession of business before the High Court or tribunal or the date of admission of an application for corporate insolvency resolution by National Company Law Tribunal (NCLT) and
- ending with the date on which the order of such High Court or tribunal or NCLT

is received by the Principal Commissioner or the Commissioner.

(4) **Recovery of sum payable by predecessor from the successor:** If the assessment has already been made on the predecessor for either or both of the years aforesaid, but the sum payable in pursuance of each assessment cannot be recovered from the predecessor or any person, the sum payable by the predecessor shall be payable and recoverable by the successor. Successor shall be entitled to recover the full amount of sum paid by him from the predecessor.

Under this section, the Assessing Officer is required to record a finding that the sum in respect of the income of the year of succession or the preceding year cannot be recovered from the predecessor, before seeking to recover such sum from the successor.

(5) **Predecessor income includes capital gain by virtue of succession:** The successor's liability to tax arises also in respect of any gain (e.g., capital gains) accruing to the predecessor from the transfer of the business or profession as a result of the succession. [*Explanation* to section 170].

9.4 TAX PLANNING CONSIDERATIONS IN RELATION TO BUSINESS

The scope of income liable to tax under the head "Profits and gains of business or profession" covered by sections 28 to 44D of the Income-tax Act, 1961 has been discussed earlier. The object of this part of the study material is to discuss from the angle of tax planning the various areas in which tax payer will have to take appropriate decisions to ensure that the incidence of tax in respect of his income chargeable under this head is reduced to the extent possible, by taking advantage of the various allowances, deductions and other tax concessions provided under the law.

For a new business, the spheres in which the question of tax planning is relevant are as follows:

(i) Form of the organization

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(ii) Nature of the business

(iii) Financial Structure

(iv) Acquisition of plant and machinery and other fixed assets

(v) Setting up and commencement of business

Each of these aspects will be considered briefly in the following paragraphs. In addition, there is lot of scope for planning with reference to the method of accounting to be employed and the various deductions and special incentives provided under the Income-tax Act, 1961.

(1) **Form of Business Organization:** The choice of the appropriate form of business organization will have to be thought of and decided by the person who intends to carry on business or profession at the beginning itself, because a change in the form of business organization after the commencement of the business, may attract liability to tax.

A new business can be organized under any of the following forms:

(i) Sole proprietorship

(ii) Hindu undivided family

(iii) Association of persons or Body of Individuals

(iv) Partnership firm/LLP

(v) Company

(vi) Co-operative society

The selection of a particular form of organization would depend not only on the tax aspect but on other considerations also, e.g., financial requirements and resources, requirement of limited liability and many other practical considerations.

However, depending upon the taxable status and level of tax liability of the owners, a selection can be made from the various forms available for setting up a new unit.

- ***Sole Proprietorship:*** In the case of a sole proprietorship concern, one of the important tax disadvantages would be that no allowance or relief would be available to the tax payer in computing his income from business in respect of even a reasonable amount of remuneration attributable to the services rendered by him for carrying on the business. As a result, the taxable income arrived at would be a larger amount than what it would have been if it had been the case of, say, a firm paying remuneration to partners, such remuneration is allowable subject to the limits specified in section 40(b)(v). The taxable income from

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business would get reduced and correspondingly, the incidence of tax would also be reduced.

Under sole proprietorship, the entire income of a business unit gets assessed in the hands of the same person along with other income, while the entire loss and other allowances shall be available for set off in his hands against other income. This may have some advantage in the initial years, after which the possibility of converting it into company/firm may be considered; on such conversion, the questions of possible capital gains tax, etc., will have to be considered.

- ***Hindu Undivided Family:*** The Hindu undivided family as a unit of taxation continues to exist for the purpose of carrying on business as well and there is a large number of cases where business is carried on by the members of the family on behalf on the family. Since the law does not specifically provide for the disallowance of such expenses, it is advantageous to carry on a business through the HUF wherever possible. The income of the family is computed and first taxed in the hands of the family at the rates applicable to it. The income of the family may, thereafter, be divided amongst the members of the family and the members, in such cases, do not attract any liability to tax in view of the specific exemption granted under section 10(2) of the Income-tax Act, 1961. Thus, if a business is carried on by a Hindu undivided family, the advantages which are available in the case of a company could be fully availed of and in addition, the members of the family would not become liable to tax when they receive any portion of the family's income.

Individual or HUF having income from business or profession has an option to shift out/ opt out of the default tax regime under this section and the option has to be exercised on or before the due date specified under section 139(1) for furnishing the return of income for such previous year and once such option is exercised, it would apply to subsequent assessment years.

Such person who has exercised the above option of shifting out of the default tax regime for any previous year shall be able to withdraw such option only once and pay tax under the default tax regime under section 115BAC for a previous year other than the year in which it was exercised.

Thereafter, such person shall never be eligible to exercise option under this section, except where such person ceases to have any business income in which case, option under (i) above would be available. *(Please refer to the detailed discussion on section 115BAC given in earlier paras of this Chapter)*

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- ***Partnership Firm/LLP:*** All firms and LLPs will be taxed at a flat rate of **30%**. If the total income exceeds ₹ 1 crore, surcharge @12% would be attracted. Further, health and education cess @4% would be applicable. There will be no basic exemption and the entire income will be taxed. In computing the taxable income of a firm, certain prescribed deductions in respect of interest and remuneration have to be allowed. The share income of a firm in the hands of the partners of the firm which is separately assessed as such is fully exempt under section 10(2A).

  TDS Liability on Partnership Firm: As per section 194T, partnership firm is required to deduct tax at source @10% on any sum paid to partners, such as salary, remuneration, commission, bonus, or interest. No deduction is required if the sum or aggregate of such sum does not exceed ₹ 20,000 during the financial year.

Note: An Individual, HUF or a partnership firm (but not an LLP), who is a resident carrying on eligible business can declare income on presumptive basis as per the provisions of section 44AD @8% of gross receipts or 6% in case gross receipts are received by an account payee cheque/bank draft/use of ECS through bank account/through any other electronic mode as may be prescribed on or before the due date of filing return of income].

The prescribed electronic modes are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

An assessee, being a resident in India, carrying on notified profession can declare income on presumptive basis@50% of gross receipts as per the provisions of section 44ADA. In such a case, they need not get their books of account audited as per section 44AB.

ILLUSTRATION 15

Mr. Gavaskar sought voluntary retirement from a Government of India Undertaking and received compensation of ₹ 40 lakhs on 28th February, 2025. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of ₹ 15 lakhs, which would carry interest at 8% p.a. Gavaskar's wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of ₹ 5 lakhs. Mr. Gavaskar would like to draw a monthly remuneration of ₹ 40,000 and also interest @ 10% p.a. on his capital in the business. Mr. Gavaskar has approached you for a tax efficient structure of the business.

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Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required.

SOLUTION

The selection of the form of organisation to carry on any business activity is essential in view of the differential tax rates prescribed under the Income-tax Act, 1961 and specific concessions and deductions available under the Act in respect of different entities. For the purpose of formulating advice as to the tax efficient structure of the business, it is necessary for the tax consultant to consider the following issues:

(i) In the case of sole proprietary concern, interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1) as the expenditure is of personal nature. On the other hand, in the case of partnership firm, both interest on capital and remuneration payable to partners are allowable under section 37(1) subject to the conditions and limits laid down in section 40(b). The partnership should be evidenced by an instrument and the individual share of partners should be specified in the instrument. Remuneration and interest should however, be authorised by the instrument of partnership and paid in accordance with such instrument. Such interest and salary shall be taxable in the hands of partners to the extent the same is allowed as deduction in the hands of the firm under section 40(b). Interest to partners can be allowed upto 12% on simple interest basis, while the limit for allowability for partners' remuneration is based on book profit under section 40(b). As per section 40(b)(v), partners' remuneration shall be allowed to the extent of aggregate of -

(a) On the first ₹ 6,00,000 of book profit or in case of loss – ₹ 3,00,000 or @90% of book profits, whichever is more

(b) On the balance of book profit – at the rate of 60%

Note

However, if the firm is eligible to declare presumptive taxation under section 44AD, 8% of gross receipts or 6% of gross receipts, as the case may be, would be deemed as its income. All deductions under section 30 to 37 are deemed to be allowed. No deduction is allowable, including deduction for partner's remuneration and interest on capital.

(ii) Partner's share in the profits of firm is not taxed in the hands of the partners by virtue of section 10(2A).

(iii) If a proprietary concern is formed, the salary of Mrs. Gavaskar shall be allowed as deduction under section 37(1).

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(iv) The possibility of invoking section 40A(2) cannot be ruled out as salary is payable to a relative, who is an interested person within the meaning of section 40A(2). However, it can be argued successfully that salary of ₹ 5 lakhs is justified in view of her long experience as marketing manager of a multinational company and the fair market value of services to be rendered by her to the concern.

(v) An issue arises as to whether remuneration of Mrs. Gavaskar would be includible in the total income of Mr. Gavaskar. Under section 64(1)(ii), remuneration of the spouse of an individual working in a concern in which the individual is having a substantial interest shall be included in the total income of the individual. However, the clubbing provision does not apply if the spouse possesses technical or professional qualification and the income is solely attributable to the application of his or her technical or professional knowledge and experience. Further, technical or professional qualification would not necessarily mean the qualifications obtained by degree or diploma of any recognized body [*Batta Kalyani vs. CIT (1985) 154 ITR 0059 (AP)*]. The experience of Mrs. Gavaskar as a marketing manager in a multinational company for 15 years may reasonably be considered as a professional qualification for this purpose.

(vi) If Mrs. Gavaskar joins the proprietary concern or partnership concern of her husband as employee, remuneration of ₹ 5 lakhs shall be taxed in her hands under the head "salary". Standard deduction u/s 16(ia) of ₹ 50,000 (under optional tax regime) and ₹ 75,000 (under default tax regime) would be allowed.

(vii) If she joins as partner in the business, remuneration shall be taxed in her hand as business income under section 28 to the extent such remuneration is allowed in the hands of the firm under section 40(b).

(viii) For individuals, tax can be computed as per slab rates provided under the default regime under section 115BAC(1A). Alternatively, he can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year. However, where he exercises the option of shifting out of the default regime for any previous year, he would be able to withdraw such option only once.

The surcharge rate is also depended on the total income and the highest surcharge would be 37% where total income exceeds ₹ 5 crores and the assessee has opted to shift out of the default tax regime whereas under default regime highest rate of surcharge would be 25%. Health and Education cess @ 4% on income-tax plus surcharge, if applicable, is attracted in all the cases. Whereas for partnership firms' tax is levied at a flat rate of 30%. Surcharge @12% would be attracted only if total income exceeds ₹ 1 crore.

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If a sole proprietary concern is formed, Mr. Gavaskar has an option to pay income-tax in respect of his total income (other than income chargeable to tax at special rates under Chapter XII) as per the default regime under section 115BAC or as per the optional regime under the normal provisions of Income-tax Act.

- ***Company:*** For any large venture requiring substantial investment and recourse to borrowed funds from banks and institutions, ordinarily the form of a limited company will have to be adopted. Within the company form of organisation, however, several alternatives exist. On the basis of the ownership and control, a company can either be organised as a widely held company, i.e. a company in which the public are substantially interested within the meaning of section 2(18) of the Income-tax Act, 1961. Alternatively, it can be organised as a closely held company. Depending upon the choice of the form of organisation of the company, the following important tax consequences would have to be considered from the view point of tax planning:

  (i) The provisions of section 79 regarding restrictions on carry forward of losses in the event of substantial change in the shareholding of the company also become applicable if the company is one in which the public are not substantially interested. This aspect would assume particular significance in the case of closely held companies where losses are made and shareholdings are transferred before such losses are fully absorbed.

  (ii) Also, MAT provisions are applicable to companies. It so happens that in case of companies enjoying tax holiday benefits still have to pay tax under MAT provisions, credit of which also cumulated for number of years without being used causing significant outflow of funds in the initial years.

  Thus, it can be seen that the concept of deemed dividend under section 2(22)(e) and the provisions of section 79 do not apply to a widely held company.

  Place of Effective Management (PoEM) framework is introduced to determine the tax payable by a foreign company that for all purposes is managed from India and yet does not pay tax domestically. Many Indian companies that have traditionally used holding companies and subsidiaries overseas for various reasons are assessing how they may be affected and are racing to put new structures in place before they come under scrutiny. These provisions provide for a foreign company to be a resident of India, if the company's place of effective management is in India. If a company's POEM is situated in India; it will be treated as Indian resident. Its global income will be taxable in India.

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Rate of tax: The income-tax rate on foreign companies is higher at **35%** *plus* surcharge @2% (if total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore) and @ 5%, if the total income exceeds ₹ 10 crore as against 30%/25%, as the case may be (*plus* surcharge @7%, if total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore and @12%, if total income exceeds ₹ 10 crore) on domestic companies.

Concessional Tax Regimes under section 115BAA and section 115BAB: Section 115BAA provides for concessional rate of tax @22% (plus surcharge@10% and HEC@4%) for domestic companies, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc. Domestic Companies have to exercise the option to be governed by section 115BAA. Once the company exercises such an option under section 115BAA in a year, it would continue to be governed by the special provision u/s 115BAA thereafter and cannot opt for regular provisions in any subsequent year.

Section 115BAB provides for concessional rate of tax @15% (plus surcharge@10% plus HEC@4%) to manufacturing or electricity generating domestic companies set up and registered on or after 1.10.2019, and commences manufacturing or generating electricity on or before 31.3.2024, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc. The option for section 115BAB could be exercised by the domestic companies in the **very first year** in which the eligible company is set up, failing which it cannot exercise such an option in the future years. Accordingly, companies who have already opted for concessional tax under section 115BAB will be governed by the provisions of section 115BAB and a fresh option cannot be exercised under section 115BAB from A.Y. 2025-26 onwards. The company who has exercised such an option under section 115BAB, it would continue to be governed by the special provisions u/s 115BAB thereafter and cannot opt for regular provisions in any subsequent year.

It may be noted that companies exercising option under section 115BAA or section 115BAB are not liable to minimum alternate tax under section 115JB.

These two sections, namely sections 115BAA and 115BAB have already discussed earlier in detail in this chapter.

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ILLUSTRATION 16

ABC Ltd., a pharmaceutical company incorporated in the year 2016-17, purchased a new plant and machinery for ₹ 10 lakhs on 01-04-2025. The total income of the company for Assessment Year 2026-27 before allowing additional depreciation in respect of new plant and machinery is ₹ 20 lakhs. ABC Ltd. has not opted for the concessional tax regime under section 115BAA or 115BAA so far. Compute the tax liability of ABC Ltd. for A.Y. 2026-27 assuming its turnover for the previous year 2023-24 was ₹ 350 crores. Ignore the provisions of MAT.

SOLUTION

Computation of tax liability of ABC Ltd. for A.Y. 2026-27 under regular provisions of the Act

Particulars	₹
Total Income before allowing additional depreciation	20,00,000
Less: Additional Depreciation u/s section 32(1)(iia)[₹10 lakh x 20%]	2,00,000
Total Income	18,00,000
Applicable Tax Rate (since turnover of P.Y. 2023-24 ≤ ₹ 400 crores)	25%
	4,50,000
Add: Health & Education cess@4%	18,000
Tax Liability	**4,68,000**

Computation of tax liability of ABC Ltd. for A.Y. 2026-27 under section 115BAA

Particulars	₹
Total Income before allowing additional depreciation	20,00,000
Less: Additional Depreciation u/s section 32(1)(iia) [Not allowable as deduction while computing income u/s 115BAA]	-
Total Income	20,00,000
Applicable Tax Rate	22%
Tax payable	4,40,000
Add: Surcharge@10%	44,000
	4,84,000
Add: Health & Education cess@4%	19,360
Tax Liability	**5,03,360**

Since tax liability under the regular provisions of the Act is lower than the tax liability under the provisions of section 115BAA, it would be beneficial for ABC Ltd. not to opt for section 115BAA.

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- ***Co-operatives:*** The co-operative form of business organisation, i.e., a co-operative society would also be advantageous from the tax angle and, in addition to the general benefits flowing from the co-operative form the society, can claim deduction in respect of the reasonable amount of remuneration payable to the members of the society for their services rendered, including the amount of commission, if any, payable to them and the interest on the deposits or loans given by them. The co-operative society is entitled to a further tax benefit arising from section 80P under which the income of a co-operative society is exempted from tax under different circumstances depending upon the nature of the income and/or the amount thereof. In addition to the various tax concessions which are available to all assessees, the co-operative society stands to gain substantially by virtue of the special benefits available to it under section 80P. The profits of the society remaining after payment of tax would be distributed by it amongst its members in the form of dividends subject to the relevant legislation.

  However, it may be noted that benefit under section 80P has been withdrawn in respect of all co-operative banks, other than primary agricultural credit societies (i.e. as defined in Part V of the Banking Regulation Act, 1949) and primary co-operative agricultural and rural development banks (i.e. societies having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities). This is for the purpose of treating co-operative banks at par with other commercial banks, which do not enjoy similar tax benefits.

  Concessional tax regimes under section 115BAD and section 115BAE: Section 115BAD provide that a co-operative society resident in India has the option to pay tax at 22%, subject to fulfilment of certain conditions. Section 115BAE provides an option to a manufacturing co-operative society set up on or after 01.04.2023, which commences manufacturing or production on or before 31.03.2024 and does not avail of any specified incentive or deductions, to opt to pay tax at a concessional rate of 15%. Co-operative societies who have already opted for concessional tax under section 115BAE will be governed by the provisions of section 115BAE and a fresh option cannot be exercised under section 115BAB from A.Y. 2025-26 onwards. In both cases, surcharge would be levied @10% on such tax.

  Sections 115BAE and 115BAD provide for concessional rates of tax and exemption from Alternate Minimum Tax (AMT) in respect of certain resident co-operative societies.

From the above analysis of various forms of the organisation and their treatment for income-tax purposes, it may be appreciated that the provisions of the taxation laws have a considerable

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influence on the entrepreneurs in their choice of particular form of the organisation that they should establish.

(2) **Nature of the business:** Besides the form of organisation, the choice of the nature of the business also calls for appropriate planning with reference to the various special benefits available under the taxation laws to the particular kinds of industries which are not available to other kinds. Some of these benefits are of such a substantial nature that they constitute one of the major factors in the determination of the nature of the business.

Broadly, business for this purpose may be divided into two categories - trading and manufacturing business. There could be a third category involving a combination of both. Deduction is available under section 10AA to units established in SEZ. Deduction is available to units established in Special Economic Zones during P.Y. 2020-21 where letter of approval, required to be issued in accordance with the provisions of the SEZ Act, 2005, has been issued on or before 31st March, 2020 and the manufacture or production of articles or things or providing services has begun on or before 31st March, 2021 or such other date after 31st March, 2021, as notified by the Central Government. In such case, the SEZ has deemed to have commenced manufacture or production in the P.Y.2019-20 and would be eligible for benefit of deduction under section 10AA.

A taxpayer carrying on manufacturing or industrial activities would be in a position to avail of the various concessions such as depreciation allowance, benefit of amortisation under sections 32, 35ABA, 35ABB, 35D and 35E.

Tax holiday benefit under section 80-IAC would be available in case of eligible start-up, under section 80-IBA in case of developing and building housing projects and under section 80LA in case of offshore banking unit and IFSC located in Special Economic Zone.

Section 35AD of the Act also extends investment linked tax deduction to taxpayers with respect to the capital expenditure incurred for setting up and operation of specified businesses.

While deciding the nature of the business, the benefit of tax exemption or concessional treatment available in respect of certain types of income such as agricultural income, new industrial undertakings, ships, business of repairs to ocean going vessels, business of exploration, etc. of mineral oils, etc. should also be taken into account.

(3) **Sources of Funds or Financial Structure:** Broadly speaking, the choice in the matter of financing a new unit or business would be between capital and borrowings. New units being set up by existing units or companies would have the possibility of using retained profits. In the case of a company, the means of finance are as follows:

(i) Share capital.

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(ii) Debentures.

(iii) Other borrowed moneys.

(iv) Generation of funds through profits.

While the return on share capital is a charge on the profits after tax, the return on loans to the lenders is a charge on the profits before tax. Thus, recourse to borrowings would offer a tax advantage which will be reflected in a higher rate of return on the owner's capital.

(4) Acquisition of 'Fixed Assets': Apart from other considerations relevant in the context, the consequences may require a careful choice between buying or leasing some or more of the fixed assets. Assets can be bought or hired. If these are bought and are depreciable, e.g., building, plant and machinery and furniture, the assessee can claim depreciation on the cost over the years. The entire cost can be claimed as deduction against the profit. If hired, however, the charge for hire becomes an admissible deduction. Having regard to the fact that the acquisition of an asset requires a larger immediate outlay than what is necessary in the case of hiring, the company may opt for hiring in some cases rather than for straight acquisition. For example, taking the business premises on rent rather than purchasing the same may be a better proposition.

But in the case of plant and machinery, two additional considerations may arise. New plant and machinery in certain industries may enable a company to claim deduction on account of depreciation and additional depreciation which may outweigh other considerations. Similarly, if there can be a new industrial undertaking, substantial tax benefits may be available by way of tax holiday benefit, etc. but that would require employment of new plant and machinery to a large extent. These considerations may prompt an assessee to make two choices—(i) not to hire plant and machinery but to purchase them and (ii) not to purchase second hand plant and machinery but to purchase them new.

In appropriate cases, the assessee may go in for second hand imported plant and machinery, satisfying the conditions laid down. In cases where an assessee opts to go for old plant and machinery, the limit regarding the use of old plant and machinery, as laid down in Section 80-IAC should be taken into consideration. Difficulties may arise in applying the 20% limit for the value of old plant or machinery for the purpose of section 80-IA etc. since the concept of value to be adopted for this purpose has not been spelt out in the law and it is not clear whether such value should refer to the cost or market value or the written down value as per books or as per income-tax records. Particular care will have to be taken while planning for such a situation.

The assessee engaged in the specified business mentioned in section 35AD can avail the benefit of deduction of capital expenditure incurred wholly and exclusively of the purpose of such specified business. Capital expenditure incurred prior to commencement of business shall be allowed as

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deduction during the previous year in which the assessee commences operation of the specified business if, such expenditure incurred is capitalized in the books of accounts of the assessee on the date of commencement of its operation. However, such deduction is not available in respect of capital expenditure incurred on acquisition of any land, goodwill or financial instrument. In case the deduction under this section is claimed, no deduction shall be allowed under Chapter VI-A under "Deduction in respect of certain incomes" in relation to the specified business for the same or any other assessment year.

Interest on borrowed capital

Under clause (iii) of section 36(1), deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession". As per the proviso to section 36(1)(iii), any amount of interest paid, in respect of capital borrowed for acquisition of an asset for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

ICDS IX on Borrowing Costs deals with the treatment of borrowing costs. It requires borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalized as part of the cost of that asset.

Qualifying asset has been defined to mean –

- land, building, machinery, plant or furniture, being tangible assets;
- know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
- inventories that require a period of twelve months or more to bring them to a saleable condition.

This ICDS requires capitalization of specific borrowing costs (in respect of funds borrowed specifically for the purpose of acquisition, construction or production of a qualifying asset) and general borrowing costs. In case of qualifying assets being tangible and intangible assets, the capitalization shall commence from the date on which funds were borrowed and cease when such asset is first put to use.

This ICDS also provides the formula for capitalization of borrowing costs when funds are borrowed generally and used for the purpose of acquisition, construction or production of a qualifying asset. For this restricted purpose, a qualifying asset shall be such asset that necessarily require a period of 12 months or more for its acquisition, construction or production. In this case, the capitalization of borrowing costs shall commence from the date on which funds were utilized.

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(5) **Setting up and commencement of production:** Setting up of business in the context of the Income-tax Act, 1961 is a concept entirely confined to that Act. It is not the same as the commencement of the business and these two concepts have been clearly distinguished for income-tax purpose. Between the date of the setting up and date of commencement, there may be an interregnum during which the assessee may be incurring expenses of a revenue nature.

Under the taxation laws, the expenditure incurred prior to the date of setting up is not normally admissible for income-tax purposes. But if those are incurred on and from the date of setting up, but before commencement of the business, they may be allowed as deduction for tax purposes provided of course they are revenue in nature and are incurred wholly and exclusively for the purposes of business.

It is now practically well settled by various judicial rulings that a business is set up as soon as it is ready to commence production and it is not necessary that actual production should be so commenced. Thus, in the case of a company established for manufacturing cement, the business is set up as soon as acquiring of limestone is commenced even if at that time the plant and machinery may not have been installed so that actual manufacturing operations may commence.

A tax planner should accordingly fix the setting up date in such a manner that the company gets the maximum scope for allowability of expenses incurred contemporaneously to the date of setting up remembering that if those are incurred prior to the setting up date those are inadmissible as direct deductions while, if such expenses are of a revenue nature and they are wholly and exclusively incurred for business purpose, and are incurred subsequent to the date of setting up, they will be admissible as normal deductions. The following examples may be noted:

(a) Such expenditure may be allowed as revenue expenditure. Expenditure by way of brokerage, legal charges, etc. for arranging long term loans, interest on borrowing— *India Cement Ltd. vs. CIT 60 ITR 52 (SC).*

(b) Such expenditure may form part of the cost of assets on which depreciation may be available – *Challapalli Sugars Ltd. vs. CIT 98 ITR 167 (SC).*

In this context, the provisions of *Explanation 8* to Section 43(1) to the effect that any interest paid or payable in connection with the acquisition of an asset, which is relatable to any period after such asset is first put to use cannot be capitalised, are relevant.

(c) Such expenditure may constitute preliminary expenditure and may be eligible for amortisation over a five year period under section 35D.

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(d) Such expenditure, if being of a capital nature and if not falling under any of the three categories noted above may be disallowed and there may not be relief either on account of depreciation or amortisation.

(6) **Tax planning for business deductions — Some general considerations:** There are several matters which affect the assessee's ability to deduct various expenses for income-tax purposes. Some of the principal considerations to be borne in mind planning for business deductions, are given below:

Successful tax planning for business deductions pre-supposes a clear and thorough understanding of the various statutory provisions governing the deductions and an awareness of the statutory rights as well as various restrictions and conditions governing such rights. The general considerations applicable to tax planning in the field of business deductions, revolve round their-

(a) allowability.

(b) year of allowability

(c) extent of allowability (disallowing provisions if any), and

(d) carry-forward to future years.

Often, the question of expenditure being capital or revenue and the consequences attaching to the likely treatment eventually may also be an important part of the tax planning exercise. This aspect has been discussed at a later stage.

One of the important aspects of tax planning would be to see that the maximum deduction or allowance is obtained in the earliest possible time for the purpose of determination of taxable income. Therefore, while deciding about incurring of capital and revenue expenditure, the assessee should consider the tax treatment of such expenditures and the period within which the benefit of deduction or amortisation would be obtained so that he can estimate and work out cash flow position over a period of time. While tax considerations play a major role in investment decisions, the general principles of financial management and their effect on investment decisions should not be ignored.

The tax planner should keep in mind the advantage arising out of minimising the expenditure, especially in the initial years of a business, so that the profits may be maximised and the assessee may be in a position to avail of the various tax incentives like depreciation as also the tax holiday provisions.

Normally, deduction for expenditure is allowable in the year in which it is incurred or paid depending on the method of accounting followed, viz, mercantile or cash. In other words, the

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expenditure to be claimed as deduction should be claimed in the relevant year. Where the assessee follows the cash system of accounting, the allowance in respect of expenses would be available only when the moneys in respect of them are actually paid by the assessee. Whereas in the case of mercantile system of accounting, if a business liability has definitely arisen in the accounting year, a deduction should be allowed. Where accounts are kept on a mercantile basis, if an expenditure is claimed on the ground that it is legally deductible, it can be claimed in the year in which the liability for the expenditure is incurred even though the payment itself is made in a subsequent year. If an assessee following mercantile system fails to claim an expense in the year in which it accrues he loses the right to claim it as a deduction altogether. He cannot claim or make any attempt to reopen the accounts of the earlier year to which the expense relates.

The Supreme Court's decision in *C.I.T. vs. Gemini Cashew Sales Corporation (1967) 65 ITR 643* emphasizes the principle that if the liability to make the payment has arisen during the previous year, it must be appropriately regarded as the expenditure of that year and merely because the payment in respect of the expenditure is made in the subsequent year, the assessee would not be entitled to claim deduction in respect thereof in the subsequent year. As pointed out earlier, this is subject to the provisions of section 43B.

Normally, deduction can be claimed by the assessee only in respect of those expenses and losses which have been actually incurred by the assessee during the previous year, i.e. after the business is set up. However, there are some exceptions to this rule and a tax planner should be aware of the exceptions and make use of them in appropriate cases. For example, expenditure incurred on scientific research before the commencement of the business — capital or revenue during the three years immediately preceding the commencement of the business and coming within the scope of the *Explanation* to sections 35(1)(i) and 35(1)(ii), capital expenditure incurred prior to commencement of specified business allowed as deduction in the year of commencement of business, in case capitalized under section 35AD, preliminary expenses incurred before commencement of the business and coming within the scope of section 35D, expenditure on prospecting for minerals coming within the scope of section 35E, are cases where the assessee could claim deduction in respect of the expenditure even though the expenditure was not incurred during the previous year.

Similarly, the expenditure in respect of which deduction is claimed by the assessee should not be in the nature of capital expenditure. This is again subject to the statutory exceptions contained in provisions like section 35 and 35AD. Again, subject to the statutory exceptions, the expenditure should be incurred wholly and exclusively for the purpose of the business.

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Various other expenses incurred prior to the commencement of commercial operations may, in appropriate cases, be accumulated and capitalised by being spread over the cost of various assets constructed or acquired during the pre-production period. If this is done on a proper basis, the cost of the various assets including the indirect expenses capitalised can be depreciated for tax purposes to the extent that the cost relates to assets which are themselves depreciable for income-tax purposes. This is a matter which the tax planner should bear in mind in order to ensure that expenses incurred during the construction period are properly accounted and allocated.

Specific deductions under the Income-tax Act, 1961

The Income-tax Act, 1961 lists several specific deductions. A deduction falling under each category is allowable subject to the conditions and limitations, if any which may be specified. At times the restrictive conditions apply to expenditure which is prima facie suspect as, for example, transactions with relatives or associates or within the same group coming within the scope of section 40A(2). While planning for business deductions, due regard must be had to these limitations.

In addition to the specific provisions the omnibus provision in section 37 also enables an assessee to claim deduction in respect of expenditure laid out 'wholly and exclusively for the purpose of the business' the tax planner has to take into consideration the principles emerging from the innumerable relevant judicial rulings while availing of the facility of deduction under this provision. Any expenditure incidental to business, may be deducted except those prohibited by any provision of the Act.

Ordinarily, an expenditure which is specifically provided for should be claimed under the relevant section rather under the omnibus provision. To justify the deduction under the residual clause, all that is required is that the expenditure must have been incurred wholly and exclusively and it is not necessary to prove that the expenditure was also incurred 'necessarily' or 'reasonably". The expenditure must have been incurred 'for the purpose of business'. These words are wider than the phrase "for the purpose of earning profits". A specific quid *pro quo* is not essential. It is not necessary to show that the expenditure resulted in commensurate benefit or advantage either during the same year or subsequently.

An expenditure is liable to be disallowed if it is either of a personal nature or of a capital nature. The question whether a particular expenditure is of a personal nature must be judged by reference to the assessee himself and not any other person.

Capital or Revenue: Generally speaking, an expenditure is regarded as being of a capital nature, if it results in the acquisition of an asset or of an advantage or benefit of an enduring nature.

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- The test with regard to the nature of the expenditure-capital or revenue - is to be applied with reference to its purpose rather than its effect. The test must be applied by reference to the assessee himself and not any other person. For instance, a company must be obliged to construct pipelines for the purpose of its business but under conditions whereby the pipelines ultimately become the property of a municipal corporation rather than the company itself. In such a case, although the pipelines undoubtedly constitute tangible assets the expenditure may not be regarded as of a capital nature, since the assets do not belong to the company but to some other person. There are many judicial rulings to support this view. A leading case that maybe referred to in this context is *Lakshmiji Sugar Mills Co. P. Ltd. vs. CIT (1971) 82 ITR 376 (SC)].*

- If the purpose of the expenditure is to secure a commercial advantage, rather than acquisition of a capital asset, it is likely to be allowed as revenue expenditure even though the advantage may endure for an indefinite period. However, this rule is by no means inflexible or capable of universal application. Conversely, if the purpose of the expenditure is the acquisition of an advantage or benefit of an enduring nature the expenditure is liable to be treated as capital expenditure even if the period or durability of the asset acquired as the result of the expenditure is very short. For example, if a company making shoes acquires knives and lasts, whose life is only three years, the expenditure may nevertheless be regarded as capital expenditure.

- In applying the various case laws on the subject of distinction between capital and revenue, it should be recognised that circumstances do change and the law normally keeps pace with such changing circumstances. The expenditure that was regarded as capital expenditure resulting in long-term benefit during the relatively *laissez faire* days of the 19th century may not perhaps, be regarded as capital expenditure in the context of the rapid technological changes which are the feature of industrial life today. The decision of the Supreme Court in *Shahzada Nund & Sons vs. CIT 108 ITR 358* also supports this view. A tax planner would do well to keep track of the various cases reported from time to time so as to keep himself informed of the trend of judicial thinking in this regard.

In this context, the requirements spelt out in the various income computation and disclosure standards have also to be kept in mind while considering the point in time of deductibility of expenditure.

- ***Expenditure specifically allowed:*** The Income-tax Act, 1961 specifically allows many types of expenditure such as depreciation, expenditure on scientific research, expenditure on know-how, preliminary expenses, bad debts etc. The Act prescribes several conditions and restrictions for

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the allowance of such expenditure. The tax-planner should take care to see that all the prescribed conditions are complied with so that deductions may not be denied.

Note - A company who has opted for the special provisions under section 115BAA or 115BAB would, however, not be eligible to claim deduction on account of, *inter alia*, additional depreciation and contribution for scientific research to companies/research association/IITs.

- ***Other business expenses:*** As already explained earlier, section 37(1) deals with the various items of expenses which are otherwise not covered by the provisions of Section 30 to 36 of the Income-tax Act, 1961 and specifically provides that all expenses which are incurred wholly and exclusively (though not necessarily) for the purpose of the business or profession carried on by the assessee would be deductible in computing the assessee's business income. In order to qualify for deduction under this provision, the following important conditions will have to be fulfilled:

  (i) The expenditure should have been incurred by the assessee in the ordinary course of his business or profession;

  (ii) The expenditure should be of a revenue nature and should not be of capital nature;

  (iii) The expenditure should not be of a personal nature;

  (iv) The expenditure should not be covered by any other provisions of sections 30 to 36 for purposes of allowance and it should not also be covered by any of the provisions of disallowance contained in sections 40 to 44D; and

  (v) The expenditure should not be one which is in the nature of an appropriation of income or diversion of profits by an overriding title. It should not also be one in respect of which deduction is permissible under Chapter VI-A of the Income-tax Act, 1961 from the gross total income of the assessee.

- ***Commercial expediency:*** The concept of 'commercial expediency' helps a tax payer in insisting that a reasonable view is taken of his right to deduct normal expenditure. The trend in judicial thinking has also recognised this concept. This concept reflects the fact that it is virtually impossible for the legislation to list all possible deductions to which an assessee would be entitled in computing his taxable income and therefore the fact that a business has to be run by the assessee himself under normal commercial conditions must be recognised in determining the allowability of certain expenditure. The test of commercial expendiency should be applied from the point of view of a normal prudent businessman, by

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reference to modern concepts of business responsibility and not by reference to the subjective standards of the revenue department.

A claim on the ground of commercial expediency is subject to the under-noted conditions and limitations:

(a) If the expenditure is covered by one of the express provisions in the Act, it must conform to the requirements stipulated therein.

(b) An expenditure which is expressly disallowed under the Act cannot be claimed on grounds of commercial expediency.

(c) An expenditure cannot be claimed on grounds of commercial expediency if it is improper or illegal. It may be commercially expedient to pay a bribe or incur a penalty but this does not mean that the bribe or penalty would be normally deductible for tax purposes.

There is also a distinction between a payment made for a violation or breach of law and payment made for a breach of contract. Courts have taken the view that where the payments are not in the nature of penalties for infraction of any law but made in pursuance of the exercise of an option given in a particular scheme and where the assessee opts for it out of commercial expediency and business consideration, it could be allowed as deduction.

(7) **Tax planning in case of losses:** The provisions of sections 70, 71 and 72 of the Income-tax Act, 1961 regulate the manner in which losses incurred in the business carried on by any tax payer will have to be dealt with for tax purposes. The consideration to be given by tax payers in the matter of taking the full benefit of set-off of losses permissible under the law is as important as the considerations for tax planning which are taken into account in regard to business expenses or claiming the maximum allowances and deductions particularly in view of the fact that the provisions of set-off of losses offer valuable scope for planning.

Under section 73, losses incurred in speculation business are to be set off only against the income from the business of speculation, if any, which the assessee may derive in the same year or in the subsequent four years. In view of the prohibition in the matter of set-off of losses incurred in speculation business, it would be in the interest of the assessee to avoid indulging in the business of speculation if it is likely to result in losses and there is no possibility of setting it off against future speculation profits within the specified period. Where the business of speculation carried on by the assessee is not profitable, he could discontinue the business of speculation in the same line so that the quantum of losses could be reduced and the assessee could resort to speculation in any other profitable field thereby taking the benefit of exception provided under the law.

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The Supreme Court, in *CIT vs. Shantilal P. Ltd. (1983) 144 ITR 57,* held that a transaction cannot be described as a 'speculative transaction' within the meaning of section 43(5), where there is a breach of a contract and on a dispute between the parties, damages are awarded as compensation by an arbitration award. However, where there is no dispute and damages on a pre-determined basis are payable under the contract, without actual delivery of the goods contracted for, the transaction would be a speculative one. If any loss arises out of such a speculative transaction, such speculation loss would not be available for adjustment against other business profits, if any.

Loss from specified business referred to in section 35AD can be carried forward indefinitely under section 73A for set-off against income from the same or any other specified business. Such loss cannot, however, be set-off against income from non-specified business or income under any other head.

The assessee should exercise his right to set off of brought forward loss at the first available opportunity. The Madras High Court, in *Tyresoles (India) vs. CIT [1963] 49 ITR 515,* held that where losses sustained are not set off against the profits of the immediately succeeding year or years, they cannot be set off against profits at a later date. This has been followed by the Punjab and Haryana High Court in *B.C.S. Kartar Chit Fund and Finance Co. (P.) Ltd. vs. CIT [1989] 79 CTR (P & H) 232.* Hence, as a matter of proper tax planning, the assessee should exercise the right under section 72 in the immediately succeeding year/years when the profits allow such a set off.

It is also significant to note that, under section 79, a closely held company will be entitled to claim the benefit of carry forward and set-off of losses, only if shares carrying at least 51% of the voting power is held on the last day of the previous year by the same persons who held such shares on the last day of the previous year in which the loss was incurred. In case of a closely held company, being an eligible start up referred to in section 80-IAC, the loss incurred in any year prior to the previous year (say, in P.Y.2021-22) can be carried forward for set-off against the income of the relevant previous year (i.e., P.Y.2025-26), if shares carrying at least 51% of the voting power is held on the last day of the previous year (i.e., as on 31.3.2026) by the same persons who held such shares on the last day of the previous year in which the loss was incurred (i.e., as on 31.3.2022). In the alternative, all shareholders of such company holding shares carrying voting power on the last day of the previous year in which the loss was incurred (i.e., as on 31.3.2022), should continue to hold those shares on the last day of the previous year in which the loss is to be set-off (i.e., as on 31.3.2026) and such loss should have been incurred during the ten years beginning from the date of incorporation of such company. This benefit will not be denied, if the change has occurred on account of death of a shareholder or on account of transfer by a

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shareholder to his relative by way of a gift. This benefit will also not be denied if the change in shareholding of an Indian company, which is a subsidiary of a foreign company, is the result of an amalgamation or demerger. However, this is subject to the condition that 51% shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or resulting foreign company. Further, the benefit of carry forward and set-off would not be denied to accompany, where a change in the shareholding takes place in a previous year pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

It should be kept in mind that section 79 applies to carry forward and set off of losses and not to the benefit of deduction in respect of unabsorbed depreciation.

Loss Returns: In the context of discussion on losses it would be relevant to point out that the tax planner would do well to keep in mind the implications of the provisions of section 139(3) read with section 80.

If an assessee is to get the benefit of the determination of the loss and its carry forward under section 72(1) or 73(2) or 73A(2) or 74(1) or 74A(3), he should file a return voluntarily within the period specified in section 139(1).

However, filing of return within the period specified in section 139(1) is not necessary for carry forward of loss from house property under section 71B and unabsorbed depreciation.

Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1) as a pre-condition for availing benefit of deductions under any provision of Chapter VI-A under the heading "C.-Deductions in respect of certain incomes".

9.5 OTHER PROVISIONS RELATED TO VARIOUS ENTITIES

(1) Tax on income from life insurance business

Section 115B provides for a concessional rate of tax for taxing the profits and gains derived from the business of life insurance. Under these provisions, in the case of an assessee whose total income includes any profits and gains derived from the business of life insurance computed in accordance with the First Schedule to the Income-tax Act, 1961, the income-tax payable shall be the aggregate of –

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(i) the amount of income-tax calculated on the **income from life insurance business** included in total income at the rate of **12½%** and

(ii) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of profits and gains from the life insurance business.

Income accruing or arising to a company from life insurance business referred to in section 115B would not be subject to MAT. [Section 115JB(5A)].

Taxation of income/loss of non-life insurance business: Rule 5 of the First Schedule to the Income-tax Act, 1961 provides that the profits and gains of non-life insurance business would be the profit before tax and appropriations as disclosed in the profit and loss account prepared in accordance with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999, subject to following adjustment -

- expenditure or allowances not allowable under sections 30 to 43B,
- any provision for diminution in the value of investment debited to profit and loss account has to be added back,
- any gain or loss on realization of investments not credited or debited to profit and loss account, shall be added or deducted, as the case may be, and
- reserve for unexpired risk as prescribed shall be allowed.

(2) Special Rates of tax in respect of certain specified income or assets

♦ **Tax on income from GDRs purchased in foreign currency or capital gains arising from transfer of such GDRs [Section 115ACA]**

(i) **Eligible assessee [Section 115ACA(1)(a)/(b)]**-This section applies to resident individuals who are employees of an Indian company engaged in specified knowledge based industry or service, or employee of its subsidiary engaged in specified knowledge based industry or service.

(ii) **Eligible income and special rate of tax [Section 115ACA(1)(a)/(b)] -** Where the total income includes the following income namely –

(a) income by way of dividends in respect of Global Depository Receipts of an Indian company engaged in specified knowledge based industry or service, purchased by an eligible assessee in foreign currency issued in accordance with such employees' stock option scheme as the Central Government may specify in this behalf,

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(b) income by way of long-term capital gains arising from the transfer of the aforesaid Global Depository Receipts,

Then, the aforesaid income will be taxed at the following rates:

- at the rate of **10%** in respect of income by way of interest or dividend referred to in (a) above; and
- at the rate of **12.5%** in respect of long-term capital gain from the transfer of above bonds or GDRs.

(iii) **No deduction is allowed [Section 115ACA(2)]-** In the case of the aforesaid resident employee, no deduction shall be allowed under any provisions of this Act, where the gross total income consists only of income by way of dividend from Global Depository Receipts.

However, where the gross total income includes dividend income or long term capital gain from such Global Depository Receipts, the deduction under any provisions of the Act shall be allowed only on that portion of gross total income which does not include such income from the Global Depository Receipts.

(iv) **No benefit of first and second proviso of section 48 [Section 115ACA(3)]-** The first and second provisos to section 48 relating to the computation of capital gains shall not apply in case of transfer of Global Depository Receipts of an Indian company purchased by the resident employee in foreign currency. In other words, no indexation will be available even if the assets are long term capital assets.

(v) **Meaning of certain terms:**

S. No.	Term	Meaning
1.	**Global Depository Receipts**	Any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India or in an International Financial Services Centre and issued to investors against the issue of – (i) ordinary shares of issuing company, being a company listed on a recognized stock exchange in India; or (ii) foreign currency convertible bonds of issuing company; (iii) ordinary shares of issuing company, being a company incorporated outside India, if such depository receipt or certificate is listed and traded on any International Financial Services Centre

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2.	**Specified knowledge-based industry or service**	(i) information technology software; (ii) information technology service; (iii) entertainment service; (iv) pharmaceutical industry; (v) bio-technology industry; and (vi) any other industry or service, as may be notified by the Central Government
3.	**Subsidiary**	The term includes subsidiary incorporated outside India
4.	**Information technology service**	Any service which results from the use of any information technology software over a system of information technology products for realising value addition
5.	**Overseas Depository Bank**	A bank authorised by the issuing company to re-issue Global Depository Receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.

- **Concessional Taxation Regime for royalty income in respect of patent developed and registered in India [Section 115BBF]**

(i) The Finance Act, 2016 introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development.

(ii) The purpose of the concessional taxation regime is for encouraging entities to retain and commercialise existing patents and for developing new innovative patented products.

(iii) Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture, and exploitation of patents in India.

(iv) The nexus approach has been recommended by the OECD under Action Plan 5 in Base Erosion and Profit Shifting (BEPS) project. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. The provisions of section 115BBF are accordingly in line with such approach.

(v) **Concessional rate of tax -** Section 115BBF provides that where the total income of the eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be **taxable at the rate of 10% (plus applicable surcharge and cess).** For this purpose, developed means at-least 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

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(vi) **No expenditure is allowed -** No deduction for any expenditure or allowance in respect of such royalty income shall be allowed under the Act.

(vii) **Option of concessional rate to be exercised before due date under section 139(1) -** The eligible assessee has to exercise the option for taxation of income by way of royalty in respect of a patent developed and registered in India in accordance with the provisions of section 115BBF in the prescribed manner, on or before the due date specified under section 139(1) for furnishing the return of income for the relevant previous year.

(viii) **Not eligible to opt for concessional taxation under this section for 5 assessment years -** Where an eligible assessee opts for taxation of income by way of royalty in respect of a patent developed and registered in India for any previous year in accordance with section 115BBF, and the assessee offers the income for taxation for any of the five assessment years relevant to the previous year succeeding the previous year not in accordance with section 115BBF(1),then the assessee shall not be eligible to claim the benefit of section 115BBF for five assessment years subsequent to the assessment year relevant to the previous year in which such income has not been offered to tax in accordance with section 115BBF(1).

(ix) **Non-applicability of MAT provisions -** Further, the amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF would not be subject to MAT under section 115JB. The same would be reduced while arriving at the book profit. Consequently, the related expenditure would be added back for arriving at the book profit.

(x) **Meaning of certain terms**

S. No.	Term	Meaning
1	**Eligible assessee**	Eligible assessee **means**: • A person resident in India, • who is the true and first inventor of the invention and • whose name is entered on the patent register as the patentee in accordance with Patents Act, 1970. Eligible assessee **includes:** every such person, being the true and the first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent.
2	**Royalty**	"Royalty", in respect of a patent, means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient

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		chargeable under the head "Capital gains" or consideration for sale of product manufactured with the use of patented process or the patented article for commercial use) for the— (1) transfer of all or any rights (including the granting of a licence) in respect of a patent; or (2) imparting of any information concerning the working of, or the use of, a patent; or (3) use of any patent; or (4) rendering of any services in connection with the activities referred to in (1) to (3) above.
3	**Lumpsum**	"Lump sum" includes an advance payment on account of such royalties which is not returnable

(3) Tax on income from transfer of Carbon credits [Section 115BBG]

(i) Carbon credits is an incentive given to an industrial undertaking for reduction of the emission of GHGs (Green House gases).

(ii) A reduction in emissions entitles the entity to a credit in the form of a Certified Emission Reduction (CER) certificate. The CER is tradable and its holder can transfer it to an entity which needs Carbon Credits to overcome an unfavourable position on carbon credits.

(iii) To bring clarity on the issue of taxation of income from transfer of carbon credits and to encourage measures to protect the environment, section 115BBG provides that where the total income of the assessee includes any income from transfer of carbon credit, such income shall be taxed at a concessional rate of **10%** (plus applicable surcharge and cess)

(iv) **No expenditure is allowed -** No expenditure or allowance in respect of such income shall be allowed under the Act.

(v) **Meaning of "Carbon credits":** Carbon credits in respect of one unit shall mean reduction of one ton of carbon dioxide emissions or emissions of its equivalent gases which is validated by the United Nations Framework on Climate Change and which can be traded in market at its prevailing market price.

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SIGNIFICANT SELECT CASES

S.No.	Case Law	
1.	***Secunderabad Club v. CIT [2023] 457 ITR 263 (SC)***	
	Issue	**Facts, Analysis and Decision**
	Does the principle of mutuality apply to interest income derived from fixed deposits made with the banks by the clubs if such banks are members of the club?	**Facts of the case:** The assessee-club deposited surplus funds as term deposits with various banks (who were the club members). It claimed interest earned on said deposits as exempt from income-tax applying the principle of mutuality. **Analysis:** The principle of mutuality works on the triple test, namely- (i) Complete identity between the contributors and participators; (ii) Action of the participators and contributors must be in furtherance of the mandate of the associations or the Clubs. The mandate of the Club is a question of fact that has to be determined from the Memorandum or Articles of Association, Rules of Membership, Rules of the Organization, etc., and must be construed broadly. (iii) There must be no scope for profiteering by the contributors from a fund made by them, which could only be expended or returned to themselves. Applying the above principles to the facts of the case, it was observed that in relation to transactions, namely, the deposit of surplus funds earned by the club, in banks which are members of the club, the principle of mutuality applies till the stage of deposit of funds and would lose its application, once the funds are deposited as fixed deposit in the banks. This is because the funds would be exposed to commercial banking operations, which means that the deposits could be used for lending to

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		third parties and earning a higher interest thereon by paying a lower interest rate on the fixed deposits to the club. The bank utilising the funds of the club deposited in fixed deposit receipts for their banking business would completely rupture the "privity of mutuality", and as a result, the element of complete identity between the contributors and participators would be lost. Consequently, the first condition for the claim of mutuality is not satisfied. If the surplus fund is not applied for the common purpose of the club or towards the benefit of the members of the club directly but is invested with a third party who has the right to utilise the said funds, subject to payment of interest on it and repayment of the principal when desired by the club, then, in such an event, the club loses its control over the said funds. Furthermore, as the bank utilises the fixed deposit amounts for its banking business, the club's identity with the funds is compromised. The bank's ability to derive profits by lending the amount at a higher interest rate, while paying a lower rate of interest on the fixed deposit made by the club, further disrupts the essential identicality between contributors and participators in the mutual relationship. Conversely, when a club provides its facilities to members who contribute to its income, the principle of mutuality applies due to the identity between contributors and participants. However, where the same facilities are offered to non-members or the public to generate additional income, it transforms into a commercial transaction, and the principle of mutuality no longer applies. For the triple test to apply to the different and varied transactions of the club, it is necessary

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		to lift the veil and discern the nature of each transaction: whether there is third-party intervention, which is the reason for earning the income, or it is an income generated between the members and the club, as such, i.e., only between the members of the club. When the transactions of the club are viewed in the aforesaid prism, then, in each of the transactions, whether the principle of mutuality would apply has to be discerned. **Decision:** Accordingly, the Supreme Court held that the interest income earned on fixed deposits made with the banks by the appellant club has to be treated like any other income from other sources within the meaning of section 2(24). Conversely, if any income is earned by the club through its assets and resources from persons who are not members of the club, such income would also not be covered under the principle of mutuality. It would be liable to be taxed under the provisions of the Income-tax Act.
2.	***ITO v. Venkatesh Premises Co-operative Society Ltd. (2018) 402 ITR 670 (SC)***	
	Issue	**Decision**
	Are non-occupancy charges, transfer charges, common amenity fund charges received by co-operative societies from its members exempt on the basis of the doctrine of mutuality?	The doctrine of mutuality is based on the common law principle that a person cannot make a profit from himself. Accordingly, the transfer charges, non-occupancy charges common amenity fund charges and other charges received by a co-operative society from its members are exempt owing to application of the doctrine of mutuality.
3.	***CIT v. Govindbhai Mamaiya (2014) 367 ITR 498 (SC)***	
	Issue	**Analysis and Decision**
	Where land inherited by three brothers is compulsorily acquired by	Three brothers inherited a property consequent to demise of their father. A part of this bequeathed

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	the State Government, would the resultant capital gain be assessed in the status of "Association of Persons" (AOP) or in their individual status?	land was acquired by the State Government and compensation was paid for it. In this case, the property in question came to the assessees' possession through inheritance i.e., by operation of law. It is not a case where any 'association of persons" was formed by volition of the three brothers. Further, even the income earned in the form of interest is not because of any business venture of the three assessees, but is the result of the act of the Government in compulsorily acquiring the said land. Thus, the basic test to be satisfied for making an assessment in the status of AOP is absent in this case. Hence, the income from asset inherited by the legal heirs is taxable in their individual hands and not in the status of AOP.
4.	***Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470 (SC)***	
	Issue	**Analysis and Decision**
	Can interest u/s 234B and 234C be levied where a company is assessed on the basis of book profits u/s 115JB?	Section 115JB(5) provides that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted. Therefore, if a company defaults in payment of advance tax in respect of tax payable u/s 115JB, it would be liable to pay interest under sections 234B and 234C.
5.	***Madras Gymkhana Club v. DCIT (2010) 328 ITR 348 (Mad.)***	
	Issue	**Analysis and Decision**
	Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?	The assessee-club providing facilities like gym, library, etc., to its members earned interest from fixed deposits which it had made by investment of its surplus funds with its corporate members. Interest earned from investment of surplus funds in the form of fixed deposits with institutional members does not satisfy the

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		principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore, taxable.
6.	***Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47 (Bom)***	
	Issue	**Analysis and Decision**
	Can transfer fees received by a co-operative housing society from its incoming and outgoing members be exempt on the ground of principle of mutuality?	Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business. Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.
7.	***CIT v. Anil Hardware Store (2010) 323 ITR 368 (HP)***	
	Issue	**Analysis and Decision**
	In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?	The manner of fixing the remuneration of the partners has been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other ventures and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down; the assessee-firm is entitled to deduct the remuneration paid to the partners u/s 40(b)(v)

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8.	***CIT v. Trans Asian Shipping Services (P) Ltd (2016) 385 ITR 637 (SC)***	
	Issue	**Analysis and Decision**
	Can income derived by an Indian shipping company from slot charter arrangement in other ships be computed applying the special provisions under Chapter XII-G of the Income-tax Act, 1961, relating to Tonnage Tax Scheme, in spite of non-fulfillment of the condition of holding a valid certificate in respect of such ships indicating its net tonnage in force?	The requirement of producing a certificate would not apply when entire ship is not chartered and the arrangement pertains only to purchase of slots, slot charter etc. The legal fiction created by section 115VG(4) is to be given proper meaning. Accordingly, income from slot charter arrangement in other ships can be computed applying the special provisions under Chapter XII-G. ***Note:*** *As per section 115VG(4), for the purposes of Chapter XII-G, the tonnage shall mean the tonnage of a ship or inland vessel, as the case may be, indicated in the certificate referred to in section 115VX and includes the deemed tonnage computed in the prescribed manner. The manner has been prescribed in Rule 11Q of the Income-tax Rules, 1962.* *Further, the Explanation to section 115VG(4) provides that for the purposes of this sub-section, 'deemed tonnage' shall be the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.* *Rules 11Q(1) provides that for the purpose of Explanation to section 115VG(4), deemed tonnage in respect of an arrangement of purchase of slots and slot charter shall be computed on the following basis:* *2.5 TEU = 1 Net Tonnage (1NT)* *Where TEU is Twenty-foot Equivalent Unit (Container of this size)*

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9.	***CIT v. Metal and Chromium Plater (P) Ltd. [2019] 415 ITR 123 (Mad)***	
	Issue	**Analysis and Decision**
	Should capital gains exempt under section 54EC, which forms part of the net profit in the statement of profit and loss of the assessee-company, be taken into account for calculation of tax on book profits as per section 115JB?	Capital gains which forms part of the net profit in the statement of profit and loss of the assessee-company, in respect of which exemption under section 54EC is available while computing total income under the regular provisions of the Income-tax Act, 1961, should not be taken into account for calculation of minimum alternate tax on book profits under section 115JB. ***Note –*** *The following is an extract of Circular No.13/2001 dated 9.11.2001, issued by the CBDT at the time of insertion of section 115JB in the Income-tax Act, 1961 -* *"It may be emphasised that the new provision of section 115JB is a self-contained code. Sub-section (1) lays down the manner in which income-tax payable is to be computed. Sub-section (2) provides for computation of "book profit". Sub-section (5) specifies that save as otherwise provided in this section, all other provisions of this Act shall apply to every assessee, being a company mentioned in that section. In other words, except for substitution of tax payable under the provision and the manner of computation of book profit, all the provisions of the tax including the provision relating to charge, definitions, recoveries, payment, assessment, etc., would apply in respect of the provisions of this section."* *The CBDT Circular clarifies that except for substitution of tax payable under the provision and manner of computation of book profit, all other provisions relating to charge, definitions, recoveries, payment, assessment, etc., would apply in respect of section 115JB. Therefore, "book profit" for levy of MAT has to be computed in the manner laid down under*

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		section 115JB i.e., by making the adjustments as specified in the Explanations contained therein to the net profit as per the statement of profit and loss. This implies that exemptions and deductions available under the regular provisions of the Act would not be available unless expressly provided for in the Explanations to section 115JB [For example, income exempt under section 10, 11 and 12 of the Income-tax Act, 1961 have to be deducted while computing book profit for levy of MAT, if credited to the statement of profit and loss, by virtue of specific provision in clause (ii) of Explanation 1 below section 115JB(2)]. Therefore, it appears that the intent of sub-section (5) is to make applicable other provisions like payment of advance tax, interest under sections 234B and 234C, return filing, penal and prosecution provisions under the Income-tax Act, 1961 etc. to a case where tax is computed under section 115JB. The Madras High Court has, however, in this case interpreted sub-section (5) of section 115JB to also permit adjustment for exemption under section 54EC while computing MAT, even though the same is not expressly provided for in the Explanations to section 115JB.

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TEST YOUR KNOWLEDGE

Questions

1. *XYZ Ltd. is engaged in the manufacture of textile since 01-04-2009. Its Statement of Profit & Loss shows a profit of ₹ 700 lakhs after debit/credit of the following items:*

   (a) *Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 is ₹ 50 lakhs.*

   (b) *Employer's contribution to EPF of ₹ 2 lakhs and Employees' contribution of ₹ 2 lakhs for the month of March 2026 were remitted on 30th June, 2026.*

   (c) *The company appended a note to its Income Statement that industrial power tariff concession of ₹ 2.5 lakhs was received from the State Government and credited the same to Statement of P & L.*

   (d) *The company had provided an amount of ₹ 25 lakhs, being sum estimated as payable to workers based on agreement to be entered with the workers union towards periodical wage revision once in 3 years. The provision is based on a fair estimation of wages and reasonable certainty of revision once in 3 years.*

   (e) *The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31-03-2026 was ₹ 200 lakhs.*

   (f) *A debtor who owed the company an amount of ₹ 40 lakhs was declared insolvent and hence, was written off by debit to Statement of Profit and loss.*

   (g) *Sundry creditors include an amount of ₹ 50 lakhs payable to A & Co, towards supply of raw materials, which remained unpaid due to quality issues. An agreement has been made on 31-03-2026, to settle the amount at a discount of 75% of the outstanding. The amount waived is credited to Statement of Profit and Loss.*

   (h) *The opening and closing stock for the year were ₹ 200 lakhs and ₹ 255 lakhs, respectively. They were overvalued by 10%.*

   (i) *Provision for gratuity based on actuarial valuation was ₹ 500 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 300 lakhs.*

   (j) *Commission of ₹ 1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIB of the Act.*

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(k) The company has purchased 500 tons of industrial paper as packing material at a price of ₹ 30,000/ton from PQR, a firm in which majority of the directors are partners. PQR's normal selling price in the market for the same material is ₹ 28,000/ton.

Additional Information:

(i) There was an addition to Plant & Machinery amounting to ₹ 50 lakhs on 10-06-2025, which was used for more than 180 days during the year. Additional depreciation has not been adjusted in the books.

(ii) Normal depreciation calculated as per Income-tax Rules, 1962 is ₹ 80 lakhs.

(iii) The company had credited a sub-contractor an amount of ₹ 10 lakhs on 31-03-2025 towards repairing a machinery component. The tax so deducted was remitted on 31-12-2025.

(iv) The company has collected ₹ 7 lakhs as GST from its customers and paid the same on the due dates. However, on an appeal made, the High Court directed the Department to refund ₹ 3 lakhs to the company. The company, in turn, refunded ₹ 2 lakhs to the customers from whom the amount was collected and the balance of ₹ 1 lakh is still lying under the head "Current Liabilities".

Compute total income and tax liability for A.Y. 2026-27. Ignore MAT provisions and the provisions of section 115BAA.

***Note** - The turnover of XYZ Ltd. for the P.Y.2023-24 was ₹ 405 crore.*

2. Parik Hospitality Limited is engaged in the business of running hotels of 3-star category. The company's Statement of Profit and Loss for the previous year ended 31st March 2026 shows a profit of ₹ 152 lakhs after debiting or crediting the following items:

(a) Payment of ₹ 0.25 lakh and ₹ 0.30 lakh in cash on 3rd December 2025 and 10th December 2025, respectively, for purchase of raw corn to Mr. Raja, an agriculturist, and Mr. Khalid, a spice trader for purchase of masala used for corn products, respectively.

(b) Contribution towards employees' pension scheme notified by the Central Government under section 80CCD for a sum of ₹ 3 lakhs calculated at 12% of aggregate of basic salary and dearness allowance (forming part of retirement benefits) payable to the employees in terms of employment.

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(c) *Payment of ₹ 6.50 lakhs towards transportation of various materials procured by one of its hotels to M/s. Bansal Transport, a partnership firm, without deduction of tax at source. The firm opts for presumptive taxation under section 44AE and has furnished a declaration to this effect. It also furnished its Permanent Account Number in the tender document.*

(d) *Profit of ₹ 12 lakhs on sale of a plot of land to Avimunya Limited, a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by Parik Hospitality Limited on 1st June 2024.*

(e) *Contribution of ₹ 2.50 lakhs to Indian Institute of Technology with a specific direction for use of the amount for scientific research programme approved by the prescribed authority.*

(f) *Expense of ₹ 10 lakhs on foreign travel of two directors for a collaboration agreement with a foreign company for a brewery project to be set up. The negotiation did not succeed, and the project was abandoned.*

(g) *Fees of ₹ 1 lakh paid to independent directors for attending Board meeting without deduction of tax at source under section 194J.*

(h) *Depreciation charged ₹ 10 lakhs.*

(i) *₹ 10 lakhs, being the additional compensation received from the State Government pursuant to an interim order of Court in respect of land acquired by the State Government in the previous year 2023-24.*

(j) *Dividend received from a foreign company ₹ 5 lakhs in which it holds 15% of the equity share capital.*

Additional information:

(i) *As a corporate debt restructuring, the bank has converted unpaid interest of ₹ 10 lakhs upto 31st March 2025 into a new loan account repayable in five equal annual installments. The first installment of ₹ 2 lakhs was paid in March 2026 by debiting new loan account.*

(ii) *Depreciation as per Income-tax Act, 1961 ₹ 15 lakhs.*

(iii) *The company received a bill for ₹ 2 lakhs on 31st March 2026 from a supplier of vegetables for supply made in March 2026. The bill was omitted to be recorded in the books in March 2026. The bill was paid in April 2026 and the necessary entry was made in the books then.*

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(iv) Dividend of ₹ 7 lakhs is distributed on 25.09.2026 to its shareholders.

Compute total income of Parik Hospitality Limited for the Assessment Year 2026-27 indicating the reason for treatment of each item assuming that the company is not eligible for deduction u/s 35AD. Ignore the provisions relating to minimum alternate tax and the provisions of section 115BAA.

3. Hyper Ltd. engaged in diversified activities, earned a profit of ₹ 14,25,000 after debit/credit of the following items to its statement of profit and loss for the year ended on 31.3.2026:

(a)	*Items debited to Statement of Profit and Loss*	*₹*
	Provision for loss of subsidiary	*85,000*
	Provision for income-tax demand	*1,05,000*
	Depreciation	*3,60,000*
	Interest on deposit credited to buyers on 31.3.2026 for advance received from them, on which tax was deducted in April 2026 and was deposited on 31.7.2026	*1,00,000*
(b)	*Items credited to Statement of Profit and Loss*	
	Long term capital gain on sale of equity shares on 5.10.2025 on which securities transaction tax was paid at the time of acquisition and sale	*3,60,000*
	Income from units of UTI (Gross)	*75,000*

The company provides the following additional information:

(i) Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation allowable as per Income-tax Rules is ₹ 2,80,000.

(iii) Brought forward Business Loss/Unabsorbed Depreciation:

F.Y.	Amount as per books		Amount as per Income-tax	
	Loss ₹	Depreciation ₹	Loss ₹	Depreciation ₹
2022-23	2,50,000	3,00,000	2,00,000	2,50,000
2023-24	Nil	2,70,000	1,00,000	1,80,000
2024-25	3,50,000	3,15,000	1,20,000	2,10,000

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You are required to:

(i) compute the total income of the company for the assessment year 2026-27 giving the reasons for treatment of items and

(ii) examine the applicability of section 115JB of the Income-tax Act, 1961, and compute book profit and the tax credit to be carried forward.

Assume the tax rate applicable to Hyper Ltd for the P.Y. 2025-26 is 30%. Ignore the provisions of section 115BAA.

4. *The profit as per the Statement of profit and loss of XYZ Ltd., an Indian company, for the year ended 31.3.2026 is ₹ 190 lakhs arrived at after making the following adjustments:*

	Particulars	₹ (in lakhs)
(i)	Depreciation on assets	100
(ii)	Reserve for currency exchange fluctuation	50
(iii)	Provision for tax	40
(iv)	Proposed dividend	120

Following further information are also provided by company:

(a) Provision for tax includes ₹ 2 lakhs of interest payable on income-tax.

(b) Depreciation includes ₹ 40 lakhs towards revaluation of assets.

(c) Amount of ₹ 50 lakhs credited to statement of P & L was drawn from revaluation reserve.

(d) Balance of statement of profit and loss shown in balance sheet at the asset side as at 31.3.2025 was ₹ 30 lakhs which includes unabsorbed depreciation of ₹ 10 lakhs.

Compute the book profit under section 115JB for the year ended 31.3.2026.

5. *Mr. Harish, aged 66, running business as a proprietor furnishes the particulars of his income for the year ended 31.03.2026 as under:*

(a) Net Profit of ₹ 3,65,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the Profit & Loss Account:

(i) Personal travelling expenses of ₹ 12,750.

(ii) Purchase of furniture for shop on 13.6.2025 of ₹ 25,000 but charged in shop expenses.

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(b) *He owns a house with two floors constructed with the financial assistance of HDFC, out of which ground floor is used by him for self-use and first floor was let out on rent for ₹ 8,500 p.m. from April 2025. The municipal tax paid for the whole house was of ₹ 2,500 and interest paid on housing loan for the construction was ₹ 52,000. Both the floors of the house are identical.*

(c) *He deposited insurance premium on the life of self of ₹ 12,500, wife ₹ 13,500, son and daughter of ₹ 28,000, repaid housing loan of ₹ 50,000 and paid ₹ 55,000 by credit card for health insurance of himself and his family.*

Compute the total income and the amount of tax liability of Mr. Harsh on such income for the Assessment Year 2026-27 assuming that he has exercised the option to shift out of the default tax regime under section 115BAC.

6. *PQR LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2019-20 for production of washing machines. The unit fulfills all the conditions of section 10AA of the Income-tax Act, 1961. During the financial year 2024-25, it has also set up a warehousing facility in a district of Tamil Nadu for storage of agricultural produce. It fulfills all the conditions of section 35AD. Capital expenditure in respect of warehouse amounted to ₹ 75 lakhs (including cost of land ₹ 10 lakhs). The warehouse became operational with effect from 1st April 2025 and the expenditure of ₹ 75 lakhs was capitalized in the books on that date.*

Relevant details for the financial year 2025-26 are as follows:

Particulars	₹
Profit of unit located in SEZ	40,00,000
Export sales of above unit received in India in convertible foreign exchange on or before 30.9.2026	80,00,000
Domestic sales of above unit	20,00,000
Profit from operation of warehousing facility (before considering deduction under Section 35AD).	1,05,00,000

Compute income tax (including AMT under Section 115JC) liability of PQR LLP for Assessment Year 2026-27.

7. *Victory Polyfibres, a partnership firm, has earned a gross total income of ₹ 300 lakhs for the year ended 31-3-2026. The firm has not undertaken any international transaction or specified domestic transaction during the said year.*

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The above income includes a profit of ₹ 220 lakhs from an undertaking having a turnover of ₹ 80 crores. This is the fifth year and deduction under section 80-IA is available to the extent of ₹ 200 lakhs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7-12-2026, after seeking clarifications from tax experts.

Advise the assessee-firm by working out the total income and tax payable, where the return is filed on 31-10-2026 or when the same is filed on 7-12-2026.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income? You may ignore interest under section 234A, 234B, 234C and 234F while making the computation in support of your advice.

8. *T and Q are individuals, aged 28 years and 30 years respectively, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March 2026, the Profit and Loss account of the business is as under:*

		Figures are in ₹ '000s	
Cost of goods sold	4,250	Sales	4,900
Remuneration to:		Dividend from Indian companies	25
T	130	Long term capital gains (computed)	640
Q	170		
Employees	256		
Interest to:			
T	48.3		
Q	35.7		
Other expenses	111.7		
GST penalty due	39		
Net profit	524.3		
	5,565		**5,565**

Additional information furnished:

(i) Other expenses included:

(a) wrist watches costing ₹ 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;

(b) employer's contribution of ₹ 6,000 to the Provident Fund for the month of November, 2025 was paid on 14th January 2026.

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(c) ₹ 30,000 was paid in cash to an advertising agency for publicity.

(ii) Outstanding GST penalty was paid on 15th October 2026. The penalty was imposed for non-filing of returns and statements by the due dates.

T and Q had, for this year, income from other sources of ₹ 3,60,000 and ₹ 2,32,000 respectively.

Required to:

(i) Compute the total income of the AOPs for the assessment year 2026-27; and

(ii) Discuss the tax implication for that year in the hands of the individual members.

9. The assessee, Pandey Co-operative Housing Society, is a registered co-operative housing society, formed with the objective of maintaining the property owned by it, to effect repairs and maintenance of the common property of the members, and to confer to the members, the usual rights and privileges. For the assessment year 2026-27, the assessee has received ₹ 3 lakhs as transfer fees from the transferor members and like amount from the transferees, who at the time of transfer, were not members of the society. Discuss the eligibility to tax the aforesaid receipts in the hands of the assessee.

10. M/s. Beta & Co., a partnership firm in India, is engaged in development of software and providing IT enabled services through two units, one of which is located in a notified Special Economic Zone (SEZ) in Noida (commenced operations from 01.04.2013) and the other located in a domestic tariff area (DTA). The particulars relating to previous year 2025-26 furnished by the assessee are as follows:

Total Turnover: SEZ unit ₹ 210 lakhs; DTA unit ₹ 90 lakhs

Export Turnover: SEZ unit ₹ 150 lakhs received in India in convertible foreign exchange on or before 30.9.2025; DTA unit ₹ 50 lakhs

Profit: SEZ unit ₹ 50 lakhs; DTA unit ₹ 40 lakhs.

Amount debited to Statement of Profit and Loss and credited to Special Economic Zone Re-Investment Reserve Account ₹ 20 lakhs.

Considering that the firm has no other income during the year, compute the tax liability of the firm for the A.Y. 2026-27 by integrating, analysing and applying the relevant provisions of income-tax law.

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11. *Lambda Ltd. is engaged in the manufacture of fabrics since 01-04-2013. Its Statement of Profit and Loss for the previous year ended 31st March, 2026 shows a profit of ₹ 750 lakhs after debiting or crediting the following items:*

    (a) *Depreciation charged on the basis of useful life of assets as per Companies Act is ₹ 52 lakhs.*

    (b) *Industrial power tariff concession of ₹ 4.80 lakhs, received from Maharashtra State Government was credited to Statement of profit and loss.*

    (c) *The company had provided ₹ 18 lakhs, being sum fairly estimated as payable with reasonable certainty, to workers on agreement to be entered with the workers union towards periodical wage revision once in every three years.*

    (d) *Dividend received from a US company ₹ 12 lakhs.*

    (e) *Loss ₹ 17 lakhs, due to destruction of a machine worth ₹ 24 lakhs by fire due to short circuit and ₹ 3 lakh received as scrap value. The insurance company did not admit the claim of the company on charge of gross negligence.*

    (f) *Provision for gratuity based on actuarial valuation was ₹ 320 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 160 lakhs.*

    (g) *Advertisement charges ₹ 2.30 lakhs, paid by cheque for advertisement published in the souvenir of a political party registered with the Election Commission of India.*

    (h) *Long term capital gain ₹ 3 lakhs on sale of equity shares on 12.4.2025 on which Securities Transaction Tax (STT) was paid at the time of acquisition and sale.*

    Additional Information:

    (i) *Normal depreciation computed as per Income-tax Rules is ₹ 71 lakhs (after giving effect to the scrap value).*

    (ii) *GST ₹ 8 lakhs collected from its customers was paid by the company on the due dates. On an appeal, the High Court directed the GST department to refund ₹ 3 lakhs to the company. The company in turn refunded ₹ 2 lakhs to the customers from whom it was collected and the balance ₹ 1 lakh is still lying under the head "Current Liabilities".*

    Compute the total income of Lambda Ltd. for the A.Y. 2026-27 by analyzing and applying the relevant provisions of income-tax law. Briefly explain the reasons for treatment of each

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item. Ignore the provisions relating to Minimum Alternate Tax. Assume that the company has not opted for section 115BAA.

12. *X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms.*

The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June 2025 to authorise payment of remuneration of ₹ 1 lakh per month to each working partner and simple interest at 15% per annum on partners' capital. X, Y and Z are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March 2026 shows a net profit of ₹ 10 lakhs after debiting/crediting the following:

(a) *Interest amounting to ₹ 5 lakhs each was paid to partners on the balances standing to their capital accounts from 1st June, 2025 to 31st March 2026.*

(b) *Remuneration to the partners including partner in representative capacity ₹ 30 lakhs.*

(c) *Interest amounting to ₹ 2 lakhs paid to Z on loan provided by him in his individual capacity at 16% interest.*

(d) *Royalty of ₹ 5 lakhs paid to partner X, who is a professional script writer, for use of his scripts as per agreement between the firm and X. The same is authorized by partnership deed.*

(e) *Two separate payments of ₹ 18,000 and ₹ 15,000 made in cash on 1st February, 2026 to Altaf, a hairdresser, against his bill for services rendered in January, 2026 and two payments of ₹ 19,000 and ₹ 10,000 made in cash on 1st February and 2nd February, 2026, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2026.*

(f) *Amount of ₹ 5 lakhs provided in the books on 31st March 2026 as liability for remuneration to Shreya, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June 2026.*

(g) *Amount of ₹ 6 lakhs provided as gratuity for the year on the basis of actuarial valuation. Gratuity actually paid to one retired employee during the year is ₹ 1.50 lakhs.*

(h) *Interest of ₹ 1.20 lakhs received on income-tax refund under section 244(1A) in respect of A.Y. 2025-26.*

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Compute the total income of the firm for the assessment year 2026-27 stating the reasons for treatment of each item.

13. *The following are the particulars relating to two Indian companies, namely, Alpha Ltd. and Beta Ltd., which are subject to tax audit u/s 44AB, for A.Y.2026-27 –*

Particulars	Alpha Ltd.	Beta Ltd.
Date of setting up/ registration	1.4.2020	1.3.2024
Main object	Manufacture of steel	Manufacture of leather
Place	Vaishali, Bihar	Ranipet, Tamil Nadu
Turnover of P.Y. 2023-24	₹ 251 crores	-
Turnover of P.Y. 2024-25	₹ 401 crores	-
Turnover of P.Y. 2025-26	₹ 270 crores	₹ 120 crores
Value of new plant and machinery installed and put to use on 1.11.2025	₹ 8 crore	₹ 5 crore
Gross Total Income of P.Y.2025-26	₹ 5 crore	₹ 5 crore
No. of new employees employed on the date of setting up/registration of the company	50	750
No. of new employees employed as on 1.4.2023	750	-
Monthly emoluments to 750 employees employed in the respective companies as mentioned above, by ECS through bank account:		
250 employees	₹ 20,000 per employee	₹ 21,000 per employee
250 employees	₹ 25,000 per employee	₹ 25,000 per employee
250 employees	₹ 28,000 per employee	₹ 27,000 per employee

From the above details -

(i) Compute the tax liability of Alpha Ltd. and Beta Ltd. for A.Y.2026-27. Alpha Ltd. has not opted for any concessional rates earlier and want to avail the beneficial tax rates under the special provisions of the Income-tax Act, 1961 in the P.Y. 2025-26. Beta Ltd. has already opted for the concessional tax rates under section 115BAB and wants to continue the same in P.Y. 2025-26. Assume that the gross total income reflects the computation under the special provisions.

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(ii) Would it be beneficial for Alpha Ltd. to opt for beneficial tax rates in P.Y. 2025-26 instead of paying tax under regular provisions of the Income-tax Act, 1961? Examine.

Answers

1. Computation of Total Income of XYZ Ltd. for the A.Y.2026-27

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
Profit as per Statement of profit and loss		7,00,00,000
***Add*: Items debited but to be considered separately or to be disallowed**		
(a) Depreciation as per Companies Act, 2013	50,00,000	
(b) Employees' contribution to EPF	2,00,000	
[Since employees' contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per *Explanation 2* below to section 36(1)(va). Since the same has been debited to Statement of profit and loss, it has to be added back for computing business income].		
(b) Employer's contribution to EPF	Nil	
[As per section 43B, employers' contribution to EPF is allowable as deduction since the same has been deposited on or before the due date of filing of return under section 139(1). Since the same has been debited to Statement of profit and loss, no further adjustment is necessary]		
(d) Provision for wages payable to workers	Nil	
[The provision is based on fair estimate of wages and reasonable certainty of revision, the provision is allowable as deduction, since ICDS X requires 'reasonable certainty for recognition of a provision, which is present in this case. As the provision has been debited to Statement of profit and loss, no adjustment is required while computing business income]		
(e) Provision for doubtful debts [10% of ₹ 200 lakhs]	20,00,000	
[Provision for doubtful debts is allowable as deduction under section 36(1)(viia) only in case of banks, public financial institutions, state financial corporations, state industrial investment corporations		

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	and non-banking financial corporations. Such provision is not allowable as deduction in the case of a manufacturing company. Since the same has been debited to Statement of profit and loss, it has to be added back for computing business income]		
(f)	**Bad debts written off** [Bad debts write off in the books of account is allowable as deduction under section 36(1)(vii). Since the same has already been debited to Statement of profit and loss, no further adjustment is required]	Nil	
(i)	**Provision for gratuity** [Provision of ₹ 500 lakhs for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of ₹ 300 lakhs paid is allowable as deduction. Hence, the difference has to be added back]	2,00,00,000	
(j)	**Commission paid to recovery agent for realization of a debt.** [Commission of ₹ 1 lakh paid to a recovery agent for realisation of a debt is an allowable expense under section 37 as per *DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All)*. Since the same has been debited to Statement of profit and loss, and tax has been deducted at source, no further adjustment is required]	Nil	
(k)	**Purchase of paper at a price higher than the fair market value** [As per section 40A(2), the difference between the purchase price (₹ 30,000 per ton) and the fair market value (₹ 28,000 per ton) multiplied by the quantity purchased (500 tons) has to be added back since the purchase is from a related party, a firm in which majority of the directors are partners, at a price higher than the fair market value]	10,00,000	
AI(vi)	**GST not refunded to customers out of GST refund** [The amount of GST refunded to the company by the Government is a revenue receipt chargeable to tax under section 41(1). Deduction can be claimed of amount refunded to customers *[CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)]*. Hence, the net amount of ₹ 1,00,000 (i.e., ₹ 3,00,000 minus ₹ 2,00,000) would be chargeable to tax]	1,00,000	2,83,00,000
			9,83,00,000

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***Less*:**	**Items credited but to be considered separately/ permissible expenditure and allowances**		
(k)	**Industrial power tariff concession received from State Government** [Any assistance in the form of, *inter alia*, concession received from the Central or State Government would be treated as income as per section 2(24)(xviii). Since the same has been credited to Statement of profit and loss, no adjustment is required].	Nil	
(g)	**Discount given by Sundry Creditors for supply of raw materials** [Discount of 75% given by Sundry Creditors for supply of raw materials is taxable under section 41(1). Since the same has already been credited to Statement of profit and loss, no further adjustment is required]	Nil	
(h)	**Over-valuation of stock [₹ 55 lakhs × 10/110]** [The amount by which stock is over-valued has to be reduced for computing business income. ₹ 50 lakhs, being the difference between closing and opening stock, has to be adjusted to remove the effect of over-valuation]	5,00,000	
AI(i)	**Additional Depreciation** [Additional depreciation@20% is allowable on ₹ 50 lakhs, being actual cost of new plant & machinery acquired on 10.06.2025, as the same was put to use for more than 180 days in the P.Y.2025-26.]	10,00,000	
AI(ii)	**Depreciation as per Income-tax Act, 1961**	80,00,000	
AI(iii)	**Payment to a sub-contractor where tax deducted last year was remitted after the due date of filing of return** [30% of ₹ 10 lakhs, being payment to a sub-contractor, would have been disallowed under section 40(a)(ia) while computing the business income of A.Y.2025-26, since tax deducted was remitted after the due date of filing of return. However, the same is allowable in A.Y.2026-27, since the remittance has been made on 31.12.2025]	3,00,000	98,00,000
Total Income			**8,85,00,000**

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Computation of tax liability of XYZ Ltd. for A.Y.2026-27

Particulars	₹
Tax @30% on the above total income (since the turnover exceeded ₹400 crore in the P.Y. 2023-24)	2,65,50,000
Add: Surcharge @ 7% (since total income exceeds ₹1 crore but less than ₹ 10 crore)	18,58,500
	2,84,08,500
Add: Health and Education cess @ 4%	11,36,340
Total tax liability	**2,95,44,840**

2. Computation of Total Income of Parik Hospitality Ltd. for the A.Y.2026-27

Particulars	Amount (₹)	
Profit as per Statement of profit and loss		1,52,00,000
***Add:* Items debited but to be considered separately or to be disallowed**		
(a) Payment to middleman for purchase of raw corn etc. in an amount exceeding ₹ 10,000 [Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding ₹ 10,000 is made on a day to a person. Payment of ₹ 25,000 to farmer for purchase of corn is covered by exception under Rule 6DD. However, payment of ₹ 30,000 to spice trader is not covered under the exception - *CBDT Circular 27/2017 dated 3/11/2017*].	30,000	
(b) Contribution towards employees' pension scheme [Contribution to the extent of 14% of salary (basic salary + dearness allowance, if it forms part of pay for retirement benefits) is allowable as deduction under section 36(1)(iva). Accordingly, no disallowance is required to be made since contribution made is within the prescribed limit.]	-	
(c) Payment to transport contractor without deduction of tax at source [Since the contractor opts for presumptive taxation under section 44AE and furnished a declaration to this effect, tax is not required to be deducted at source under section 194C in respect of payment to transport contractor].	-	

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(e) Contribution to IIT for scientific research [Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for deduction @100% under section 35(2AA). Since the amount of contribution has already been debited to the statement of profit and loss, there is no further adjustment required].	-	
(f) Expenses on foreign travel of two directors for a collaboration agreement which failed to materialize [Where expenditure is incurred for a project not related to the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature as per *Mc Gaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.).* Brewery project is not related to the existing business of running three - star hotels]	10,00,000	
(g) Fees paid to directors without deducting tax at source [30% of ₹1 lakh] [Disallowance @ 30% would be attracted under section 40(a)(ia) for non-deduction of tax at source from director's remuneration on which tax is deductible under section 194J]	30,000	10,60,000
		1,62,60,000
***Less:* Items credited but to be considered separately/ Expenditure to be allowed**		
(d) Profit on sale of plot of land to 100% subsidiary [Profit on sale of plot of land taxable or otherwise under the head "Capital Gains". Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income].	12,00,000	
(h) & AI(ii) Depreciation [Depreciation allowable under the Income-tax Act, 1961 is ₹ 15 lakhs whereas the depreciation as per books of account debited to the statement of profit and loss is ₹ 10 lakhs. Hence, the additional amount of ₹ 5 lakhs has to be deducted while computing business income]	5,00,000	
(i) Additional compensation received from State Government [Additional compensation is taxable or otherwise under the head "Capital Gains". Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	10,00,000	

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(j) Dividend received from foreign company [Dividend received from foreign company is taxable under the head "Income from other sources". Since the said dividend has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	5,00,000	
AI(i) Interest paid during the year [Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 2 lakhs has been paid in the P.Y.2025-26, the same is allowable as deduction]	2,00,000	
AI(iii) Purchases omitted to be recorded in the books [Since the purchase is made in March, 2026 (i.e., P.Y.2025-26), in respect of which bill of ₹ 2 lakhs received on 31.3.2026 has been omitted to be recorded in the books in that year, it has to be deducted to compute the business income *[Kedarnath Jute Manufacturing Company Ltd. v. CIT (1971) 82 ITR 363 (SC)]*. It is logical to assume that the company is following mercantile system of accounting].	2,00,000	36,00,000
Income under the head "Profits and Gains of Business or Profession"		**1,26,60,000**
Capital Gains		
Profit on sale of plot of land to 100% subsidiary [Short-term capital gains arise on sale of plot of land held for less than 24 months. However, in this case, since the transfer is to a 100% subsidiary company and the subsidiary company is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv).]	-	
Additional compensation received from State Government [Since the additional compensation has been received pursuant to an interim order of the Court, the same would be deemed as income chargeable to tax under the head "Capital Gains" in the year of final order as per section 45(5).]	-	

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Income from Other Sources		
Dividend received from foreign company [Dividend received from a foreign company is chargeable to tax under the head "Income from other sources".]		5,00,000
Gross Total Income		**1,31,60,000**
Less: **Deduction under Chapter VI-A**		
Deduction u/s 80M in respect of inter-corporate dividends [to the extent of dividend distributed by it on or before the due date specified u/s 139(1) of filing return of income]		5,00,000
Total Income		**1,26,60,000**

3. Computation of total income of M/s Hyper Ltd. for the A.Y. 2026-27

Particulars	₹	₹
Profit as per Statement of Profit & Loss		14,25,000
***Add:* Items disallowed/considered separately**		
Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]	85,000	
Provision for income-tax [disallowed under section 40(a)(ii)]	1,05,000	
Interest on deposit credited to buyers on 31.3.2026 and tax deducted in April 2026 which was deposited on 31.7.2026 [30% disallowed under section 40(a)(ia) since tax is deducted only in the next year].	30,000	
Depreciation debited to statement of profit and loss [only depreciation calculated as per the Income-tax Rules, 1962 is allowable as deduction]	3,60,000	5,80,000
		20,05,000
***Less:* Items credited but not includible under business income or are exempt under the provisions of the Act**		
Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.	3,60,000	
Income from units of UTI, since it is not a business income.	75,000	4,35,000
		15,70,000
Less: Depreciation (allowable as per the Income-tax Rules, 1962)		2,80,000
		12,90,000

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Less: Set-off of brought forward business loss and unabsorbed depreciation		
Brought forward business loss under section 72	4,20,000	
Brought forward depreciation under section 32	6,40,000	10,60,000
Income from business		**2,30,000**
Capital Gains		
Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale		3,60,000
Income from Other Sources		
Income from units of UTI		75,000
Total Income		**6,65,000**
Tax on LTCG exceeding ₹ 1.25 lakhs @ 12.5% of ₹ 2,35,000		29,375
Tax on other income of ₹ 3,05,000 @ 30%		91,500
		1,20,875
Add: Health and Education cess @ 4%		4,835
Tax Payable as per the Income-tax Act, 1961		**1,25,710**

Computation of Book Profit under section 115JB

Particulars	₹	₹
Profit as per Statement of Profit & Loss		14,25,000
***Add:* Net Profit to be increased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Provision for loss of subsidiary	85,000	
Provision for income-tax	1,05,000	
Depreciation debited to statement of profit and loss	3,60,000	5,50,000
		19,75,000
***Less:* Net Profit to be reduced by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation debited to statement of profit and loss (excluding depreciation on account of revaluation of fixed assets) (i.e., ₹ 3,60,000 – ₹ 1,50,000)	2,10,000	

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Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less, taken on cumulative basis	6,00,000	8,10,000
Book Profit		**11,65,000**
15% of book profit		1,74,750
Add: Health and Education cess @4%		6,990
Minimum Alternate Tax u/s 115JB		**1,81,740**

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 15% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 15% thereof plus health and education cess @4%.

Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 15% of book profit, the book profit of ₹ 11,65,000 is deemed to be the total income and income-tax is payable @ 15% thereof plus health and education cess @4%. The tax liability, therefore, works out to be ₹1,81,740.

Computation of tax credit

Particulars	₹
Tax on book profit under section 115JB	1,81,740
Less: Tax on total income computed as per the other provisions of the Act	1,25,710
Tax credit to be carried forward under section 115JAA [Can be carried forward for 15 assessment years succeeding A.Y. 2026-27]	**56,030**

4. Computation of book profit of XYZ Ltd. for the year ended 31.3.2026

Particulars	₹	₹
Profit as per Statement of Profit & Loss		1,90,00,000
***Add:* Net profit to be increased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation on assets debited to Statement of P& L	1,00,00,000	
Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, is to be added back	50,00,000	
Provision for tax **(See Note below)**	40,00,000	
Proposed dividend	1,20,00,000	3,10,00,000
		5,00,00,000

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***Less:* Net profit to be decreased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation other than depreciation on revaluation of assets (₹ 100 lakhs - ₹ 40 lakhs)	60,00,000	
Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets (₹ 50 lakhs or ₹ 40 lakhs, whichever is less)	40,00,000	
Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. Unabsorbed depreciation ₹ 10 lakhs and brought forward business loss ₹ 20 lakhs – whichever is less	10,00,000	1,10,00,000
Book profit		**3,90,00,000**

Note – For the purpose of section 115JB, book profit means the profit as per the statement of profit and loss prepared in accordance with Schedule III to the Companies Act, 2013, as adjusted by certain additions/deductions as specified. One of the adjustments is to add back income-tax paid or payable, and the provisions therefor. *Explanation 2* after sub-section (2) of section 115JB clarifies that income-tax includes, *inter alia*, interest on income-tax. Therefore, the entire provision of ₹ 40 lakhs for income-tax is added back for computing book profit for levy of minimum alternate tax.

5. Computation of total income and tax payable by Mr. Harish for the A.Y. 2026-27 under the normal provisions of the Act

Particulars	₹	₹
<u>Income from house property</u>		
Self-occupied portion (50%)		
Annual Value under section 23(2)	Nil	
Less: Deduction under section 24(b)		
Interest on housing loan [₹ 52,000 × 50%]	26,000	(26,000)
Let-out portion (50%)		
Income of let out portion being rent of ₹ 8,500 p.m. received for 12 months[1]		
Gross Annual Value under section 23(1) (₹ 8,500 × 12)	1,02,000	

[1] Rent received has been taken as the GAV in the absence of other information.

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Less: 50% of municipal taxes paid allowable in respect of rented out portion (i.e., 50% of ₹ 2,500)	1,250	
Net Annual Value (NAV)	1,00,750	
Less: **Deduction under section 24**		
30% of NAV under section 24(a)	30,225	
Interest on housing loan under section 24(b)	26,000	44,525
		18,525
Profits and gains of business or profession		
Net profit as per profit and loss account of wholesale business of textiles and fabrics	3,65,500	
Add: Expenses charged in profit and loss account either not allowable or to be considered separately -		
Personal travelling expenses of proprietor	12,750	
Purchase of furniture wrongly debited to shop expenses	25,000	
	4,03,250	
Less: Depreciation on furniture @10% on ₹ 25,000	2,500	4,00,750
Gross Total Income		**4,19,275**
Less: **Deduction under Chapter VI-A**		
Under section 80C - Life insurance premium		
Self	12,500	
Wife	13,500	
Son and daughter	28,000	
- Housing loan repaid	50,000	
	1,04,000	
Under section 80D [Medical insurance premium]		
Mediclaim insurance premium of ₹ 55,000 [maximum deductible is ₹ 50,000 where it covers a resident senior citizen]	50,000	1,54,000
Total Income		**2,65,275**
Total Income (rounded off)		**2,65,280**
Tax on total income of ₹ 2,65,280		Nil
(The basic exemption limit for senior citizen is ₹ 3,00,000 for A.Y.2026-27 under the normal provisions of the Act)		

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6. Computation of total income and tax liability of PQR LLP for A.Y.2026-27 (under the regular provisions of the Income-tax Act, 1961)

Particulars	₹	₹
Profits and gains of business or profession		
Unit in SEZ		40,00,000
Profit from operation of warehousing facility	1,05,00,000	
Less: Deduction under section 35AD **[See Note (1) below]**	65,00,000	
Business income of warehousing facility chargeable to tax		40,00,000
Gross Total Income		**80,00,000**
Less: Deduction under section 10AA **[See Note (2) below]**		16,00,000
Total Income		**64,00,000**
Computation of tax liability (under the normal/regular provisions)		
Tax @ 30% on ₹ 64,00,000		19,20,000
Add: Health and Education cess @ 4%		76,800
Total tax liability		**19,96,800**

Computation of adjusted total income of PQR LLP for levy of Alternate Minimum Tax

Particulars	₹	₹
Total Income (as computed above)		**64,00,000**
Add: Deduction under section 10AA		16,00,000
		80,00,000
Add: Deduction under section 35AD	65,00,000	
Less: Depreciation under section 32		
On building @10% of ₹ 65 lakhs[2]	6,50,000	58,50,000
Adjusted Total Income		**1,38,50,000**
Alternate Minimum Tax @18.5%		25,62,250
Add: Surcharge@12% (since adjusted total income > ₹ 1 crore)		3,07,470
		28,69,720
Add: Health and Education cess@4%		1,14,789
		29,84,509
Tax liability under section 115JC (rounded off)		**29,84,510**

[2]Assuming the capital expenditure of ₹ 65 lakhs is incurred entirely on buildings

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Since the regular income-tax liability is less than the alternate minimum tax liability, the adjusted total income shall be deemed to be the total income and tax is leviable @18.5% thereof *plus* surcharge @ 12% and cess @4%. Therefore, the tax liability is ₹ 29,84,510.

AMT Credit to be carried forward under section 115JD

	₹
Tax liability under section 115JC	29,84,510
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	19,96,800
	9,87,710

Notes:

(1) Deduction @100% of the capital expenditure is available under section 35AD for A.Y.2026-27 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2009.

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction during the previous year in which it commences operations of specified business if the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction under section 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of ₹ 65 lakhs (i.e., ₹ 75 lakhs – ₹ 10 lakhs, being expenditure on acquisition of land) has been incurred in the F.Y. 2024-25 and capitalized in the books of account on 1.4.2025, being the date when the warehouse became operational, ₹ 65,00,000, being 100% of ₹ 65 lakhs would qualify for deduction under section 35AD.

(2) Deduction under section 10AA in respect of Unit in SEZ =

$$\text{Profit of the Unit in SEZ} \times \frac{\text{Export turnover of the Unit in SEZ}}{\text{Total turnover of the Unit in SEZ}} \times 50\%$$

$$₹\ 40,00,000 \times \frac{₹\ 80,00,000}{₹\ 1,00,00,000} \times 50\ \% = \mathbf{₹\ 16,00,000}$$

7. As per section 80AC, while computing the total income of an assessee of a previous year ***(P.Y.2025-26, in this case)*** relevant to any assessment year ***(A.Y.2026-27, in this case)***,

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any deduction is admissible, *inter alia,* under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the 'due date' specified in section 139(1).

Since the turnover of the partnership firm has exceeded the prescribed threshold limit in the previous year 2025-26, it would be subject to audit under section 44AB, in which case the 'due date' of filing its return of income for A.Y.2026-27 would be 31st October, 2026 as per section 139(1).

Computation of total income and tax liability of M/s. Victory Polyfibres for A.Y. 2026-27

I. Where the firm files its return of income on 31st October 2026:

Particulars	₹ in lakhs
Gross Total Income	300.00
Less: Deduction under section 80-IA	200.00
Total Income	**100.00**
Tax liability@ 30%	30.00
Add: Health and Education cess@4%	1.20
Regular income-tax payable	**31.20**

Computation of Alternate Minimum Tax payable [Section 115JC]

Particulars	₹ in lakhs
Total Income	100.00
Add: Deduction under section 80-IA	200.00
Adjusted Total Income	**300.00**
Alternate Minimum Tax (AMT) @ 18.5% on ₹ 300 lakhs	55.50
Add: Surcharge@12% (Since adjusted total income > ₹ 1 crore)	6.66
	62.16
Add: Health and Education cess@4%	2.49
Total tax payable (AMT)	**64.65**

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2025-26 and it shall be liable to pay income-tax on such total income @ 18.5% **[Section 115JC(1)]**. Therefore, the tax payable for the A.Y. 2026-27 would be ₹ 64.65 lakhs.

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Tax credit for Alternate Minimum Tax [Section 115JD]

	₹ in lakhs
Total tax payable for A.Y.2026-27 (Alternate Minimum Tax)	64.65
Less: Regular income-tax payable	31.20
To be carried forward for set-off against regular income-tax payable (upto a maximum of fifteen assessment years).	33.45

II. Where the firm files its return of income on 7th December 2026:

Where the firm files its return on 7-12-2026, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under 80-IA would not be available. In such circumstances, the gross total income of ₹ 300 lakhs would be the total income of the firm.

Particulars	₹ in lakhs
Income-tax @ 30% of ₹ 300 lakhs	90.000
Add: Surcharge @12% (since total income exceeds ₹ 1 crore)	10.800
Income-tax (plus surcharge)	100.800
Add: Health and Education cess @ 4%	4.032
Total tax liability	**104.832**

Practical solution regarding obtaining clarifications:

The practical solution regarding obtaining clarifications would be to file the return of income under section 139(1) on or before the 'due date', i.e., 31.10.2026, and claim deduction under section 80-IA. In such a case, the firm can claim deduction of ₹ 200 lakhs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) by 31.12.2026 which would replace the original return filed under section 139(1). A revised return filed under section 139(5) would replace the original return filed under section 139(1).

If the firm files the return of income under section 139(1) on or before 31.10.2026, its tax liability would stand reduced to ₹ 64.65 lakhs, as against ₹ 104.832 lakhs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of ₹ 33.45 lakhs. Therefore, the firm is advised to file its return of income on or before 31.10.2026.

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8. (i) Computation of total income of the AOP for A.Y.2026-27

Particulars	₹
Profit & gains of business **(See Working Note below)**	3,12,300
Long term capital gain	6,40,000
Income from other sources - Dividend from Indian companies	25,000
Total income	9,77,300

Working Note - Computation of profits and gains of business

Particulars	₹	₹
Net profit as per profit & loss account		5,24,300
Add: Inadmissible payments		
Interest to members T & Q (₹ 48,300 + ₹ 35,700)	84,000	
Advertising [Disallowance under section 40A(3) (100% of ₹ 30,000 being a cash payment)]	30,000	
Remuneration to members T & Q (₹ 1,30,000 + ₹1,70,000)	3,00,000	
GST penalty **(See Note 3 below)**	39,000	4,53,000
		9,77,300
Less: Income not taxable under this head		
Long term capital gain	6,40,000	
Dividend from Indian companies	25,000	6,65,000
Profits and gains of business		**3,12,300**

Notes:

1. Since the employer's contribution to PF has been paid during the previous year itself, it is allowable as deduction.

2. Penalty imposed for delay in filing GST return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – *CIT v. Ratanchand Bholanath (S.S) (1986) 160 ITR 500 (M.P.)*

(ii) Tax implication in the hands of members T & Q for the A.Y. 2026-27

Members of the AOPs have to pay tax on their total income taking into account savings/ investments etc.

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Since one of the members has total income excluding share from AOP more than the basic exemption limit, the AOPs will be chargeable to tax at the maximum marginal rate.

Since the AOPs is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually as per section 86.

9. Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality where the predominant activity of such co-operative society is maintenance of property of the society. It was so held by the Bombay High Court in *Sind Co-op Housing Society v. ITO (2009) 317 ITR 47*.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Therefore, ₹ 6 lakhs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.

10. Computation of total income and tax liability of M/s. Beta & Co., a partnership firm, as per the normal provisions of the Act for A.Y. 2026-27

Particulars		₹ (in lakhs)
Business income (before deduction under section 10AA)		
SEZ Unit		50.00
Add: Amount debited to SEZ Re-investment Reserve		20.00
		70.00
DTA Unit		40.00
Gross Total Income		110.00
Less: Deduction u/s 10AA		
= ₹ 70 lakhs × ₹ 150 lakhs/₹ 210 lakhs = 50 × 50% (being the 13th year)	25.00	
Amount credited to SEZ Re-investment Reserve Account	20.00	
whichever is less is deductible		**20.00**
Total Income		**90.00**
Tax on total income@30%		27.00
Add: Health and Education Cess@4%		1.08
Tax liability (as per normal provisions)		**28.08**

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Computation of Adjusted total income and Alternate Minimum tax of M/s. Beta & Co., a partnership firm, as per the provisions of section 115JC for A.Y.2026-27

Particulars	₹ (in lakh)
Total income as per the normal provisions	90.00
Add: Deduction under section 10AA	20.00
Adjusted total income	110.00
Tax@18.5% of Adjusted Total Income	20.350
Add: Surcharge @12% as the adjusted total income is > ₹ 1 crore	2.442
	22.792
Add: Health and Education cess @4%	0.912
Alternate Minimum Tax as per section 115JC	**23.704**

Since the tax liability as per the normal provisions of the Act is more than the alternate minimum tax payable, the total income as per normal provisions shall be liable to tax and the tax payable for A.Y. 2026-27 shall be ₹ 28.08 lakhs.

11. Computation of Total Income of Lambda Ltd. for the A.Y. 2026-27

	Particulars	Amount (₹)	
I	**Profits and gains of business and profession**		
	Net profit as per the statement of profit and loss		7,50,00,000
	***Add:* Items debited but to be considered separately or items of expenditure to be disallowed**		
	(a) **Depreciation as per Companies Act**	52,00,000	
	(c) **Provision for wages payable to workers**	-	
	[Since the provision is based on a fair estimate of wages payable with reasonable certainty, the provision is allowable as deduction. ICDS X requires a reliable estimate of the amount of obligation and 'reasonable certainty' for recognition of a provision, which is present in this case.		
	As the provision of ₹ 18 lakhs has been debited to statement of profit and loss, no adjustment is required while computing business income]		

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	(e) **Loss due to destruction of machinery by fire** [Loss of ₹ 17 lakhs due to destruction of machinery caused by fire is not deductible since it is capital in nature. Since the loss has been debited to statement of profit and loss, the same is required to added back while computing business income]	17,00,000	
	(f) **Provision for gratuity** [Provision of ₹ 320 lakhs for gratuity based on actuarial valuation is not allowable as deduction. However, actual gratuity of ₹ 160 lakhs paid is allowable as deduction. Hence, the difference has to be added back to income [₹ 320 lakhs (-) ₹ 160 lakhs]	1,60,00,000	
	(g) **Advertisement in souvenir of a political party** [Advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company. Since the expenditure has been debited to statement of profit and loss, the same has to be added back while computing business income]	2,30,000	2,31,30,000
			9,81,30,000
	Add: **Income taxable but not credited to statement of profit and loss**		
	AI(ii) **GST not refunded to customers out of GST refund received from State Govt.** [The amount of GST refunded to the company by the Government is a revenue receipt chargeable to tax. Out of the refunded amount of ₹ 3 lakhs, the amount of ₹ 2 lakh stands refunded to customers would not be chargeable to tax.[3] The balance amount of ₹ 1,00,000 lying with the company would be chargeable to tax]		1,00,000
			9,82,30,000

[3] *CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)*

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	***Less:* Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances**		
	(b) **Industrial power tariff concession received from State Government** [Any assistance in the form of, *inter alia*, concession received from the Central or State Government would be treated as income. Since the same has been credited to statement of profit and loss, no adjustment is required]	-	
	(d) **Dividend received from US company** [Dividend received from foreign company is taxable under "Income from other sources". Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]	12,00,000	
	(e) **Scrap value of machinery** [Scrap value of machinery, being capital in nature, has to be reduced from WDV of machinery. Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]	3,00,000	
	(h) **Long term capital gains on sale of equity shares** [The taxability or otherwise of long-term capital gain on sale of equity shares has to be considered while computing income under the head "Capital Gains". Since such capital gains has been credited to statement of profit and loss, the same has to be reduced to arrive at the business income.]	3,00,000	
	AI(i) **Depreciation as per Income-tax Rules, 1961**	71,00,000	89,00,000
	Profits and gains from business and profession		**8,93,30,000**
II	**Capital Gains**		
	Long term capital gain on sale of equity shares [Long term capital gains in excess of ₹ 1.25 lakhs (i.e., ₹ 1.75 lakhs, being ₹ 3 lakh – ₹ 1.25 lakhs) on sale of equity shares on which STT is paid at the time of acquisition and sale would be taxable@12.5% u/s 112A, without indexation benefit.]		3,00,000

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III	**Income from Other Sources**		
	Dividend received from foreign company		12,00,000
	[Dividend received from a foreign company is chargeable to tax under the head" Income from other sources"]		
	Gross Total Income		**9,08,30,000**
	***Less:* Deduction under Chapter VI-A**		
	Under section 80GGB [Contribution by a company to a registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in souvenir published by such political party tantamount to contribution to such political party.]		2,30,000
	Total Income		**9,06,00,000**

12. Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2026-27

Particulars	₹	₹
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000
Add: Expenses disallowed or considered separately:		
Interest to partners in excess of 12% **(Note 1)**	3,00,000	
Disallowance under section 40A(3) for aggregate cash payment exceeding ₹ 10,000 in a single day **(Note 5)**	52,000	
Provision for gratuity **(Note 7)**	4,50,000	
Partners' Remuneration	30,00,000	
Royalty paid to Partner X **(Note 4)**	5,00,000	43,02,000
		53,02,000
Less: Interest on income-tax refund **(Note 8)**		1,20,000
Book Profit		**51,82,000**
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		
On first ₹ 6,00,000 90%	5,40,000	
On the balance ₹ 45,82,000 60%	27,49,200	
	32,89,200	

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(ii) Remuneration actually paid or payable (₹ 1,00,000 × 10 months × 3 partners) + (Royalty ₹ 5 lakhs)		
(i) or (ii) whichever is less, is deductible	35,00,000	32,89,200
		18,92,800
Income from other sources		
Interest on income-tax refund		1,20,000
Gross Total Income		**21,02,800**
Deductions under Chapter VI-A		Nil
Total Income		**21,02,800**

Notes:

1. As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Excess interest @ 3% paid from 1st June 2025 to 31st March 2026 is to be disallowed. Excess interest of 3% being ₹15,00,000 x 3/15 = ₹ 3,00,000.

2. Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of *Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC).*

3. As per *Explanation 1* to section 40(b), where an individual is a partner in a firm in representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Z represents his HUF in the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, <u>by whatever name called</u>, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of ₹ 5 lakhs paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.

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5. Section 40A(3) provides for disallowance of any expenditure in respect of which the actual payment exceeding ₹ 10,000 is made otherwise than by an account payee cheque, account payee bank draft or use of ECS through bank account or through such other electronic mode as may be prescribed in a single day to a person. Hence, the payments of ₹ 18,000 and ₹ 15,000 in cash on 1.2.2026 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of ₹ 33,000 exceeds the limit of ₹ 10,000.

   The payment of bill of the assistant cameraman of ₹ 19,000 on 1st February is also liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has exceeded ₹ 10,000.

6. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid on or before the due date specified under section 139(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2026 has to be deposited latest by 31st July 2026/ 31st October 2026 (as the case may be). The firm has paid the tax on 3rd June 2026 and hence, the remuneration shall be allowed. Since the same is already debited to profit and loss account, no further adjustment is made.

7. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, gratuity of ₹ 1.50 lakhs paid to retired employees is allowable as deduction. Hence, the balance provision of ₹ 4.50 lakhs (i.e., ₹ 6 lakhs – ₹ 1.50 lakhs) is to be disallowed.

8. Interest on income-tax refund is assessable under the head "Income from other sources".

13. (i) Computation of tax liability of Alpha Ltd. and Beta Ltd. under the special provisions of the Income-tax Act, 1961

Particulars	Alpha Ltd. ₹	Beta Ltd. ₹
Gross Total Income	**5,00,00,000**	**5,00,00,000**
Less: Deduction u/s 80JJAA		
Alpha Ltd - [(₹ 20,000 x 12 x 250) + (₹ 25,000 x 12 x 250)] x 30%	4,05,00,000	

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Beta Ltd – [(₹ 21,000 x 12 x 250) + (₹ 25,000 x 12 x 250)] x 30%		4,14,00,000
Total Income	**95,00,000**	**86,00,000**
Computation of tax liability		
Tax@22% on ₹ 95,00,000 [As per section 115BAA]	20,90,000	
Tax@15% on ₹ 86,00,000 [As per section 115BAB]		12,90,000
Add: Surcharge@10%	2,09,000	1,29,000
	22,99,000	**14,19,000**
Add: Health and Education cess@4%	91,960	56,760
Total tax liability	**23,90,960**	**14,75,760**

Notes -

(1) Alpha Ltd. is eligible to opt for special provisions under section 115BAA, as per which the rate of tax would be 22% plus surcharge@10% and HEC@4%.

(2) Both Alpha Ltd. and Beta Ltd. are eligible to claim deduction u/s 80JJAA, which is a permissible Chapter VI-A deduction while computing total income under section 115BAA and 115BAB.

In case of Alpha Ltd, 30% of the additional employee cost of new employees employed in the P.Y. 2023-24, can be claimed as deduction u/s 80JJAA for P.Y.2025-26. Out of 750 employees, 250 employees whose emoluments are ₹ 20,000 p.m., 250 employees whose emoluments are ₹ 25,000 p.m. qualify as additional employees and 250 employees whose emoluments exceed ₹ 25,000 p.m. do not qualify as additional employees.

Similarly, in case of Beta Ltd, 30% of the additional employee cost of new employees employed in the P.Y. 2023-24, can be claimed as deduction u/s 80JJAA for P.Y.2025-26. Out of 750 employees, 250 employees whose emoluments are ₹ 21,000 p.m., 250 employees whose emoluments are ₹ 25,000 p.m. qualify as additional employees and 250 employees whose emoluments exceed ₹ 25,000 p.m. do not qualify as additional employees.

(ii) Computation of tax liability of Alpha Ltd. as per the regular provisions of the Act

Particulars	Alpha Ltd. ₹
Gross Total Income (computed under the special provisions)	5,00,00,000
Less: Additional Depreciation [10% of ₹ 8 crore, since the plant and machinery has been put to use for less than 180 days in the P.Y.2025-26]	80,00,000

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Gross Total Income (computed under the regular provisions of the Act)	**4,20,00,000**
Less: Deduction u/s 80JJAA	
[(₹ 20,000 x 12 x 250) + (₹ 25,000 x 12 x 250)] x 30%	4,05,00,000
Total Income	**15,00,000**
Computation of tax liability	
Tax@25% on ₹ 15,00,000 [Since turnover of P.Y.2023-24 is less than ₹ 400 crore]	3,75,000
Add: Surcharge (Not applicable, since total income is less than ₹ 1 crore)	Nil
	3,75,000
Add: Health and Education cess@4%	15,000
Total tax liability	**3,90,000**

Since the tax liability under the regular provisions of the Act is ₹ 3,90,000 *vis-à-vis* tax liability of ₹ 23,90,960 computed under section 115BAA, it is not beneficial for Alpha Ltd. to opt for the special provisions under section 115BAA for A.Y.2026-27. Hence, Alpha Ltd. should **not** opt for the special provisions under section 115BAA for A.Y.2026-27.

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CHAPTER 10

ASSESSMENT OF TRUSTS AND INSTITUTIONS, POLITICAL PARTIES AND OTHER SPECIAL ENTITIES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the inclusions in the definition of "charitable purpose", to appreciate whether a trust or institution would qualify for the benefit of exemption under sections 11 and 12;
- **appreciate** the conditions to be fulfilled by a trust or institution to claim benefit of exemption under section 11 or under section 10(23C);
- **appreciate** the procedure to be followed for approval/registration of a trust or institution;
- **analyse** the special provision under section 13, which specifies scenarios when a trust or institution shall not be eligible to claim exemption under section 11 or section 12
- **examine** the special provisions relating to taxability of anonymous donations received by a trust or institution;
- **examine** the special provision relating to taxability of certain specified income of a trust or institution under section 115BBI
- **appreciate** the special provisions for taxability of accreted income of certain trusts and institutions;
- **identify** the income of political parties which are exempt from tax and the conditions to be satisfied to avail the exemption;
- **examine** the conditions to be satisfied by an electoral trust to avail exemption in respect of voluntary contributions received by it;
- **examine** the special provisions relating to taxation of business trusts, securitisation trusts and investment fund and **compute** the tax liability in the hands of such trusts/fund and the unit holders/investors.

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CHAPTER OVERVIEW

10.1 INTRODUCTION

Non-profit organisations in India cater to socio-economic and other needs of common people in the country. Hence, the Government encourages such organisations with philanthropic objective by providing tax exemptions subject to compliance of certain conditions. In this chapter, we will be discussing the income tax exemptions and related aspects of trusts and institutions engaged in charitable activities, political parties, electoral trusts and other special entities such as securitization trusts, business trusts and investment funds.

Chapter III of the Income-tax Act,1961, which covers incomes that are exempt from tax, also contains the provisions pertaining to exemption in respect of charitable trusts and institutions, political parties, electoral trusts and exemptions in respect of income of special entities like securitization trusts, business trusts and investment fund.

A) Charitable or religious trusts/institutions can avail income-tax exemption under two different independent regimes.

- The first regime pertains to the exemption available under section 10(23C), which *inter alia* exempts income received by any person on behalf of university, or other educational institution or any hospital.
- The second regime pertains to the exemption under section 11 that provides for exemption in respect of income derived from property held under trust wholly for charitable or religious purposes.

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Therefore, a trust or institution can choose to opt for an exemption either under the first regime i.e., under section 10(23C) or the second regime i.e., under section 11, as it deems appropriate depending on its objects and activity.

It is noteworthy that the broad features and conditions for availing exemption under both regimes are largely similar. The Finance Act, 2022 made significant amendments to ensure harmonization and consistency in the exemption provisions under both the regimes. Prior to these amendments, there were inconsistencies and gaps in both regimes, wherein certain conditions stipulated for availing exemption under section 11 were absent in section 10(23C). Therefore, the Finance Act 2022 has rationalised the same by ensuring that there is a level playing field between the two alternate regimes.

Exemption provisions in respect of charitable or religious trusts	
University or other educational institution, hospital or other medical institution, other fund or institution for charitable purposes, any trust or institution wholly for public religious purposes or wholly for religious and charitable purposes **[Section 10(23C) – First Regime]**	Trust for charitable or religious purposes **[Sections 11 to 13 – Second Regime]**

Note: *Since both the regimes offer almost similar benefits and the procedural aspects or conditions for availing benefits are largely aligned, amendments have been made by the Finance (No.2) Act, 2024 for discontinuation of approval under the First Regime [i.e. under sub-clauses (iv), (v), (vi) and (via) of section 10(23C)]. Accordingly, application for approval or renewal of approval under First Regime cannot be made on or after 1st October 2024. Consequently, with effect from 1st October 2024, trusts or institutions desirous of availing exemption shall make an application for registration under the Second Regime only.*

It is important to note that, the trust which were approved or made application for approval before 1st October 2024 and got approval, thereafter, are eligible to claim exemption under first regime till the validity of such approval.

B) Political Party and Electoral Trust

Section 13A exempts certain categories of income derived by a political party and section 13B exempts voluntary contributions received by electoral trusts.

C) Securitisation Trust, Business Trust and Investment Fund

The Income-tax Act, 1961 provides pass-through status to certain entities such as Securitisation Trusts, Business Trusts and Investment Fund in respect of certain incomes. Such incomes are taxable in the hands of unitholders/investors. Exemption provisions in respect of certain incomes in the hands of these entities and unitholders are contained in

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Chapter III of the Income-tax Act, 1961. Further, the Income-tax Act, 1961 also contains special provisions relating to Securitization trust, Business Trusts and Investment Fund under Chapter XII-EA, XII-FA and XII-FB, respectively.

General Discussion on Trusts

Non-Profit Organisations intending to carry on charitable or religious activities are normally set up either as a trust or a society or a company registered under section 8.

Trust is the most common and preferred legal form. Therefore, before considering the income-tax exemption provisions governed under section 10(23C) or section 11 to 13, let us see briefly what exactly the term trust signifies, the types of trusts and the manner of their creation. Though this aspect of the topic does not strictly fall within the purview of income-tax, such a general knowledge would be useful in understanding the provisions of tax laws relating to charitable trusts.

Meaning of certain terms

Trust	• is an obligation annexed to the ownership and arising out of a confidence reposed in and accepted by the owner if declared and accepted by him for the benefit of another or of another and the owner.
Author of the trust	• the person who reposes or declares the confidence
Trustee	• the person who accepts the confidence
Beneficiary	• the person for whose benefit the confidence is accepted
Trust property	• the subject matter of the trust
Beneficial interest or interest of the beneficiary	• is his right against the trustees or owner of the trust property
Instrument of trust	• the instrument, if any, by which trust is declared

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Trusts can be broadly classified into two groups - Public and Private.

Distinction between a public and private trust

The distinction between a public and private trust is that, whereas in the former, the beneficiaries are the general public or a class thereof, in the latter they are specific persons. While in the former, the beneficiaries constitute a body which is incapable of ascertainment, in the latter they are persons who are ascertained or capable of being ascertained. Generally private trusts are formed for the convenience of individuals and families. The private trust does not enjoy any tax exemption.

Private trusts are governed by the Indian Trust Act, 1882. This Act does not apply to the following:

(i) The rules of Mohammedan law as to waqf;

(ii) The mutual relations of the members of undivided family as determined by any customary or personal law;

(iii) Public or private religious or charitable endowments; and

(iv) Trust to distribute prizes taken in war among the captors.

On the other hand, Public trusts are constituted mainly for the benefit of the public at large. There are three requirements for creation of a public trust.

There are three requirements for creation of a public trust. They are

(i) a declaration of trust which is binding on the settlor,

(ii) setting apart definite property and depriving himself of the ownership, and

(iii) a statement of objects for which the property is thereafter to be held. In the case of a private trust also, more or less similar requirements exist.

Public trust enjoys tax exemption under the Income-tax Act subject to compliance of certain conditions, that are discussed in detail in this chapter.

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10.2 CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS

1. Exemption in respect of income of universities, hospitals, educational institutions, medical institutions etc. [Section 10(23C)]

Exemption is available under section 10(23C) in respect of any income received by any person on behalf of the certain funds and institutions. In particular, the exemption available under first regime is with regard to income of universities, educational institutions, hospitals and other medical institutions covered under sub-clauses (iiiab), (iiiac), (iiiad), (iiiae), (iv), (v), (vi) and (via) of section 10(23C). The brief summary of the exemptions available is encapsulated in the following table:

Section	Activity Scope	Exemption Conditions
10(23C)(iiiab)	Education	Wholly or substantially financed by the Government.
10(23C)(iiiac)	Medical	Wholly or substantially financed by the Government
10(23C)(iiiad)	Education	Aggregate annual receipts do not exceed **five crore rupees**
10(23C)(iiiae)	Medical	Aggregate annual receipts do not exceed **five crore rupees**
10(23C)(iv)	Charitable purpose, which is important for India & its states	Trust or institution approved on or before 1st October 2024 and application for approval was filed before the said date and got approval thereafter.
10(23C)(v)	Wholly for public religious purposes or wholly for public religious & charitable purposes	
10(23C)(vi)	Education, whose aggregate annual receipts exceed five crore rupees	Trust or institution approved on or before 1st October 2024 and application for approval was filed before the said date and got approval thereafter.
10(23C)(via)	Medical, whose aggregate annual receipts exceed five crore rupees	

Broadly, exemption of any income received by any person on behalf of universities, educational institutions, hospitals and other medical institutions under section 10(23C) is available in the following manner:

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(1) Universities or Educational Institutions or Hospitals or Medical Institutions substantially financed by the Government:

- any university or other educational institution **wholly or substantially financed by the Government** which exists solely for educational purposes and not for profit [Sub-clause (iiiab)].
- any hospital or other institution **wholly or substantially financed by the Government**, which exists solely for philanthropic purposes and not for profit and which exists for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of convalescing persons or persons requiring medical attention or rehabilitation [Sub-clause (iiiac)].

If the government grant to a university or other educational institution, hospital or other institution during the relevant previous year **exceeds 50% of the total receipts** (including any voluntary contributions), of such university or other educational institution, hospital or other institution, as the case may be, then, such university or other educational institution, hospital or other institution shall be considered as being **substantially financed by the Government** for that previous year [Rule 2BBB].

(2) Universities or Educational Institutions or Hospitals or Medical Institutions whose annual receipts not exceed ₹ 5 crore:

- any university or other educational institution existing solely for educational purposes and not for profit and its **aggregate annual receipts do not exceed ₹ 5 crore** [Sub-clause (iiiad)].
- 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 convalescing persons or persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for profit, if its aggregate annual receipts **do not exceed the prescribed limit of ₹ 5 crore** [Sub-clause (iiiae)].
- Where a person has receipts from an institution specified in sub-clause (iiiad) as well as from an institution specified in sub-clause (iiiae), **whose combined receipts exceeds ₹ 5 crores, then, the said person shall not be eligible for exemption** under the respective sub-clauses (iiiad) & (iiiae).

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(3) Universities or Educational Institutions or Hospitals or Medical Institutions or Specified Charitable Institutions exempted subject to certain conditions:

- **any other fund or institution for charitable purposes approved by the Principal Commissioner or Commissioner** having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States [Sub-clause (iv)];
- **any trust (including any other legal obligation) or institution wholly for public religious or wholly for public religious and charitable purposes approved by the Principal Commissioner or Commissioner** having regard to ensure the income applies for the objects of the fund or institution [Sub-clause (v)];
- any other university or educational institution existing solely for educational purposes and not for purposes of profit and which may be approved by the Principal Commissioner or Commissioner other than referred in (1) and (2) above [Sub-clause (vi)];
- any other hospital, or other medical institution other than referred in (1) and (2) above approved by the Principal Commissioner or Commissioner [Sub-clause (via)].

However, no approval would be granted for an application made on or after 1.10.2024.

Note - *The conditions and norms for availing the exemption under section 10(23C)(iv), (v), (vi) & (via) [First regime] are largely similar as those for availing exemption under section 11 to 13 [Second Regime]. Henceforth, in this chapter, reference to First regime would refer to section 10(23)(iv)/(v)/(vi)/(via). The comparative table of the corresponding provisions under the First and Second regime are given under para 10.3, which will help students co-relate the relevant provisions under the First regime with the provisions of sections 11 to 13 under the Second Regime discussed later on in this Chapter.*

ILLUSTRATION 1

An educational institution having annual receipts of ₹3.80 crore during the P.Y. 2025-26, has availed exemption under section 10(23C)(iiiad). The Assessing Officer has denied the exemption on the grounds that the educational institution has not made any application to the prescribed authority for approval under the said section 10(23C)(iiiad). Examine the action of the Assessing Officer in denying the exemption.

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SOLUTION

As per section 10(23C)(iiiad), income of any university or other educational institution existing solely for educational purposes and not for purposes of profit would be exempt if the aggregate annual receipts of such university or educational institution do not exceed ₹ 5 crores. Therefore, the exemption available under this section can be availed without making any application to the prescribed authority.

Therefore, the action of the Assessing Officer in denying the exemption to the educational institution is not correct.

ILLUSTRATION 2

A not for profit trust undertakes philanthropic activities through an educational institution and a hospital. During the P.Y. 2025-26, the trust had annual receipts of ₹ 3 crores from its educational institution and ₹ 4 crore from the hospital. During the P.Y. 2025-26, it desires to avail exemption under section 10(23C)(iiiad) and 10(23C)(iiiae), as the individual threshold under each of the sub-clauses, is less than ₹ 5 crores. Can it do so? Examine.

SOLUTION

As per *Explanation* to section *10(23C)(iiiae),* it has been clarified that the limit of annual receipts of ₹ 5 crore is qua 'taxpayer' and not qua 'activity'. Therefore, if the aggregate annual receipts from educational activity and medical activity exceeds ₹ 5 crores, then, exemption under sub-clause (iiiad) and (iiiae) cannot be availed by the trust.

Since, in the present case, the aggregate annual receipt of ₹ 7 crores (₹ 3 crores of educational institution and ₹ 4 crores from hospital) exceeds the threshold of ₹ 5 crores, exemption under section 10(23C)(iiiad) and (iiiae) cannot be availed, even though the individual receipts from educational institution and hospital have not exceeded ₹ 5 crores.

2. Charitable or Religious Trusts and Institutions [Sections 11 to 13] - Second Regime

The second regime of exemption is available under the Section 11. The second regime is more exhaustive in scope as it is available for any philanthropic organisation involved in charitable or religious purposes. The second regime is more popular and widely adopted by non-profit organisations. It is imperative to note that an assessee can opt to avail exemption only under one of the regime depending upon its objects and purpose. An overview and specifics pertaining to the second exemption regime is provided below.

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Overview

Section 11	• **Exclusion of the following income from total income of the trust:** • Income derived from property held under trust wholly or partly for charitable and religious purposes, applied for such purposes; **and** • Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust
Section 12	• Income derived by a trust from voluntary contributions (other than corpus donations) deemed to be income derived from property held under trust for the purposes of section 11; • Value of medical and educational services made available to specified persons deemed to be income of the trust running a hospital or medical or educational institution notwithstanding the provisions of section 11(1).
Section 12A	• prescribes the conditions for availing the benefits u/s 11 and 12.
Section 12AB	• prescribes the procedure framework for registration with the income-tax authorites to avail the exemption u/s 11 & 12 .
Section 13	• enumerates the circumstances under which the exemption available u/s 11 and 12 will be denied

3. First and Second Regime – A Comparison

In the following table, Column (2) mentions the relevant provisos in section 10(23C) [under the first regime under sections 10(23C)(iv)/(v)/(vi)/(via)] and Column (3) mentions the corresponding provisions under the second regime under sections 11 to 13. Column (4) contains the subject matter of the relevant provision pertaining to both regimes.

(1)		(2)	(3)	(4)
Sl. No.		First Regime [Section 10(23C)(v)/(v)/(vi)/(via)]	Second Regime [Sections 11 to 13]	
		Relevant proviso to section 10(23C) and the Explanations thereto	Corresponding provision in the Second regime [Sections 11 to 13]	Subject matter (in brief)
(1)		1st proviso	12A(1)(ac)	Application to PC or Commissioner for approval before 1st October 2024/ registration of trust/institution and the time limits for making such application *Note – The procedure for approval contained in 1st proviso to section*

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				10(23C) is not discussed in the chapter since no further application for approval can be made on or after 1st October 2024.
(2)		2nd proviso	12AB(1)	Grant of approval on receipt of application before 1st October 2024/ passing an order of registration of trust/ institution or rejection of the application by PC or Commissioner and period of validity of approval/registration *Note – The procedure for approval contained in 2st proviso to section 10(23C) is not discussed in the chapter since no further application for approval can be made on or after 1st October 2024.*
(3)		3rd proviso		
	(i)	Explanation 1	11(1)(d)	Corpus donations not to be included in income subject to investment in forms and modes specified in section 11(5)
	(ii)	Explanation 1A [Applies only in case of section 10(23C)(v)]	Explanation 3A to section 11	Conditions for treatment of voluntary contribution received for renovation or repair of temple/ church/mosque etc. (where they form part of property held under trust) as corpus donation, at the option of the trust
	(iii)	Explanation 1B [Applies only in case of section 10(23C)(v)]	Explanation 3B to section 11	Deemed income in the year of violation of conditions mentioned in Sl. No. (3)(ii) above.
	(iv)	Explanation 2 and its clauses (i), (ii) and (iii)	Explanation 4 to section 11 and its clauses (i), (ii) and (iii)	Amount spent out of – – corpus donations excluded from total income or – loan or borrowing not to be treated as application for charitable purposes [Clause (i) and (ii)] Amount credited or paid out of current year income of the trust to fund/trust/institution by way of donation other than corpus

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				donation would be allowed as application to the extent of 85% of such amount paid or credited.
	(v)	Explanation 3 and its first proviso	11(2) and its first proviso	Conditions stipulated for treating the amount accumulated or set apart beyond 15% as deemed application
	(vi)	Explanation 4	11(3)	Deemed income in case of non-fulfilment of conditions in Sl. No. (3)(v) above and the previous year in which taxable
	(vii)	Explanation 5	11(3A)	Application to A.O. to permit application of accumulated income for other purposes in line with the objects of the trust or institution
		Proviso	Proviso	A.O. cannot allow application of such accumulated income by way of amount credited or paid to another trust or institution
(4)		7th proviso	11(4A)	Maintenance of separate books of accounts in case of carrying on of business incidental to the objects of the trust or institution for claiming exemption of income from such business
(5)		8th proviso	1st proviso to section 12A(2)	Where an application is made under Sl. No. (1) above, the relevant A.Y. from which the exemption provisions would apply *Note – The procedure for approval contained in 8th proviso to section 10(23C) is not discussed in the chapter since no further application for approval can be made on or after 1st October 2024.*
(6)		9th proviso	12AB(3)	Time limit for passing order granting approval/registration under Sl. No. (2) above. *Note – The procedure for approval contained in 9th proviso to section 10(23C) is not discussed in the chapter since no further application*

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				for approval can be made on or after 1st October 2024.
(7)		10th proviso	12A(1)(b)	Requirement to maintain prescribed books of account and get the same audited and furnish audit report on or before the specified date.
(8)		12th proviso	Explanation 2 to section 11(1)	Contribution towards the corpus of another trust or institution out of current year income not to be treated as application of income
(9)		13th proviso	Explanation 3 to section 11(1)	Disallowances under sections 40(a)(ia) and 40A(3) and (3A) to apply in determining the amount of application
(10)		14th proviso	Explanation to section 11(2)	Contribution to any trust or institution out of accumulated income not to be treated as application of income
(11)		15th proviso	12AB(4)	PC/Commissioner to call for documents or information in case he notices specified violations or on receipt of reference from A.O. or selection of case as per risk management strategy of CBDT; and pass an order cancelling or refusing to cancel approval/registration of trust on or before the specified date/time limit.
	(i)	Explanation 1	12AB(5)	Meaning of "specified date"/time limit
	(ii)	Explanation 2	Explanation to section 12AB(4)	Meaning of "specified violation"
(12)		16th proviso	13(7)	Anonymous donation referred to in section 115BBC to be included in total income.
(13)		18th proviso [Relevant only for section 10(23C)(iv) and (v)]	13(8)	Inclusion of income of trust or institution having object of advancement of any object of general public utility in total income, if it carries on activity in the nature of trade commerce or business for consideration and the

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				aggregate receipts from such activity exceeds 20% of total receipts.
(14)		19th proviso	11(7)	Exemptions under section 10 [except section 10(1)] not to apply to trust or institution approved u/s 10(23C) or registered under section 12AA/12AB
		Explanation	First Proviso to section 11(7)	If trust or institution approved u/s 10(23C) or registered u/s 12AA/12AB is notified u/s 10(23EA) or u/s 10(23EC) or 10(23ED) or u/s 10(46) or u/s 10(46A), the approval u/s 10(23C) or registration u/s 12AA/12AB, as the case may be, would become inoperative from the date of notification u/s 10(23EA) or u/s 10(23EC) or 10(23ED) or u/s 10(46) u/s 10(46A) or from 1st April of the P.Y. for which exemption is claimed under section 10(46B).
(15)		20th proviso	12A(1)(ba)	Return of income to be furnished in accordance with section 139(4C)/(4A) within the time allowed u/s 139(1) or 139(4).
(16)		21st proviso	13(1)(c)	Income applied for benefit of person referred to in section 13(3) to be deemed income of the trust or institution in the previous year of application [after taking into account the provisions of sections 13(2)/(4)/(6)].
(17)		22nd proviso	13(10)	In case of non-maintenance of books of account or failure to get them audited or failure to file return of income or inclusion of income in total income due to carrying on of activities in the nature of trade, commerce, business (refer point 13 above), income to be computed as per normal provisions after allowing deduction of revenue expenditure subject to certain conditions stipulated thereunder.

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		Explanation	Explanation	Disallowances under sections 40(a)(ia) and 40A(3) and (3A) to apply in determining the amount of revenue expenditure deductible
(18)		23rd proviso	13(11)	In computing income under regular provisions as per Sl. No. 17 above, no deduction in respect of any expenditure or allowance or set-off of any loss shall be allowed to the assessee under any provision of the Act.
(19)		Explanation 1 to section 10(23C)	11(6)	If acquisition of asset has been claimed as application, then, no deduction for depreciation is allowable.
(20)		Explanation 2 to section 10(23C)	Explanation 5 to section 11(1)	Excess application of an earlier previous year not allowed to be set-off or claimed as deduction or allowance while calculation of income required to be applied or accumulated in the relevant previous year.
(21)		Explanation 3 to section 10(23C)	Explanation to section 11	Sum payable by a trust or institution to be considered as application of income during the P.Y. in which such sum is actually paid by it, irrespective of the method of accounting regularly employed by it.
		Proviso	Proviso	If such sum is already claimed as application in any earlier previous year, it will not be allowed as application again in any subsequent P.Y. on payment basis.

Note –It may be noted that in certain provisions mentioned in the table above, there may be some differences between the corresponding provisions in the first and second regime. The same have been brought out at the relevant places in the course of discussions in the ensuing paragraphs in this chapter relating to the provisions in the second regime [i.e., sections 11 to 13]. The above table will help you co-relate the corresponding provisions in the first regime [Section 10(23C)(iv)/(v)/(vi)/(via)].

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4. Income of Charitable Trusts and Institutions

I. Income from property held under trust

Subject to the provisions of sections 60 to 63, the income of a religious or charitable trust or institution, to the extent specified in the Act, is exempt from tax when certain prescribed conditions are fulfilled. The relevant income does not even form part of the total income of the trust or institution.

Income from property held for charitable or religious purposes in India [Section 11(1)]- The following income shall **not** be included in the total income of the previous year of the person in receipt of the income:

(a) Income derived from property held under trust wholly for charitable or religious purposes to the extent such income is applied in India for such purpose. Further, a minimum 85% of the income derived to be applied for charitable or religious purpose.

(b) Income derived from property held under trust in part only for such purpose, to the extent such income is applied in India for such purposes.

(c) Income derived from property held under trust,

- created on or after 1.4.1952 for charitable purpose which tends to promote international welfare in which India is interested to the extent to which such income is applied to such purpose outside India. This does not cover religious trusts.
- trust for charitable or religious purposes, created before 1.4.1952, to the extent to which such income is applied for such purposes outside India.

In both the cases, the CBDT should have, by general or special order, directed that such income shall not be included in the total income of the person in receipt of such income.

(d) Income in the form of voluntary contributions made with a **specific direction that they shall form part of the corpus** of the trust or institution**.**

Such voluntary contributions received as corpus must be invested or deposited in one or more of the forms or modes specified in section 11(5) maintained specifically for such corpus, for claim of exemption.

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II. **Voluntary Contributions [Section 12]-** Any voluntary contribution received by a trust created wholly for charitable or religious purposes or by an institution established wholly for such purposes shall, for the purposes of section 11, be deemed to be income derived from property held under trust wholly for charitable or religious purposes. However, corpus donations (i.e., contributions made with a specific direction that they shall from part of the corpus of the trust or institution) shall not be treated as income, provided they are invested in the modes specified under section 11(5) [Section 12(1)].

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 under section 13(3), would 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.

III. **Income should be applied for charitable or religious purposes -** One of the primary objectives of providing exemption under section 11 is that the income of the NPO should be applied wholly towards charitable or religious purpose. The income-tax act has not defined the term religious purpose. The shorter Oxford English Dictionary defines the term as follows:

"Devoted to religion; exhibiting the spiritual or practical effects of religion, following the requirements of religion; pious, godly, devout".

However, with regards to the definition of the term 'Charitable Purpose', section 2(15) states that 'charitable purpose' includes-

- relief of the poor,
- education,
- yoga,
- medical relief,
- preservation of environment (including watersheds, forests and wildlife) & preservation of monuments or places or objects of artistic or historic interest and
- the advancement of any other object of general public utility.

Advancement of any other object of general public utility: The definition of "charitable purpose" includes "any other object of general public utility" The question arises as to what is an object of "general public utility". This expression has not been defined anywhere in the Act.

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In *CIT v. Gujarat Maritime Board (2007) 295 ITR 561*, the Supreme Court observed that the Gujarat Maritime Board was established for the predominant purpose of development of minor ports within the State of Gujarat, the management and control of the Board was essentially with the State Government and there was no profit motive. The assessee, Gujarat Maritime Board, was under a legal obligation to apply its income which was directly and substantially from the business held under trust for the development of minor ports in Gujarat. Therefore, the Supreme Court held that the assessee was entitled to be registered as "charitable trust" under section 12A.

A number of entities functioning on commercial basis claim exemption of their income either under section 10(23C) or section 11 on the foundation that they are charitable institutions. This is based on the contention that they are engaged in the "advancement of an object of general public utility" as is included in the fourth part of the present definition of "charitable purpose". There were many decisions rendered in the past supporting the view that if unconnected business is held under a trust for promoting the object of general public utility and if profits are used for promoting such objects, income thereof shall be exempt, for example, the decision of the Supreme Court in *CIT v. Madras Stock Exchange Ltd. (1981) 130 ITR 184*. However, such a claim in respect of an activity carried out on commercial basis, goes against the basic intention of the provision.

"Advancement of any other object of general public utility" would not be a charitable purpose: In order to limit the ambit of the phrase "advancement of any other object of general public utility", section 2(15) provides that "the advancement of any other object of general public utility" would not be a charitable purpose if it involves the carrying on of –

(a) any activity in the nature of trade, commerce or business or,

(b) any activity of rendering of any service in relation to any trade, commerce or business,

for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity.

Thus, the "advancement of any other object of general public utility" shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless,-

(1) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; **and**

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(2) the aggregate receipts from such activity or activities, during the previous year, **does not exceed 20% of the total receipts**, of the trust or institution undertaking such activity or activities, for the previous year.

Therefore, in effect, "advancement of any other object of general public utility" would continue to be a "charitable purpose", if the activity in the nature of trade, commerce or business is undertaken in the course of actual carrying out of such advancement of any other object of general public utility **and** the aggregate receipts from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed 20% of the total receipts of the trust or institution undertaking such activity or activities, for the previous year.

ILLUSTRATION 3

An institution having its main object as "advancement of general public utility" received ₹ 30 lakhs in aggregate during the P.Y. 2025-26 from an activity in the nature of trade. The total receipts of the institution, including donations, was ₹ 140 lakhs. It applied 85% of its total receipts from such activity during the same year for its main object i.e., advancement of object of general public utility.

(i) What would be the tax consequence of such receipt and application thereof by the institution?

(ii) Would your answer be different if the institution's total receipts had been ₹ 150 lakhs (instead of ₹ 140 lakhs) in aggregate during the P.Y. 2025-26?

(iii) What would be your answer if the main object of the institution is "relief of the poor" and the institution receives ₹ 30 lakhs from a trading activity, when its total receipts are ₹ 140 lakhs and applies 85% of the said receipts for its main object?

SOLUTION

(i) As the main object of the institution is "advancement of object of general public utility", the institution will lose its "charitable" status for the P.Y. 2025-26, since it has received ₹ 30 lakhs from an activity in the nature of trade, which exceeds ₹ 28 lakhs, being 20% of the total receipts of the institution undertaking that activity for the previous year. The application of 85% of such receipt for its main object during the year would not help in retaining its "charitable" status for that year. The institution will lose its charitable status and consequently, the benefit of exemption of income for the P.Y. 2025-26, irrespective of the fact that its approval is not withdrawn or its registration is not cancelled.

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(ii) If the total receipt of the institution is ₹ 150 lakhs, and the institution receives ₹ 30 lakhs in aggregate from an activity in the nature of trade during the P.Y.2025-26, then it will not lose its "charitable" status since receipt of upto 20% of the total receipts of the institution in a year from such activity is permissible. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13. Further, such activity should also be undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(iii) The restriction regarding carrying on a trading activity for a cess, fee or other consideration will not apply if the main object of the institution is "relief of the poor". Therefore, receipt of ₹ 30 lakhs from a trading activity by such an institution will not affect its "charitable" status, even if it exceeds 20% of the total receipts of the institution. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13.

ILLUSTRATION 4

"Save Wild Life" *an institution having its main object as 'preservation of wildlife', used the entire income derived from an activity in the nature of trade for its main object during the previous year ended on 31.03.2026. Would such utilization of its income be treated as utilisation for "charitable purpose"? Examine. Would your answer be different, if the main object of the institution is "advancement of object of general public utility"?*

SOLUTION

Section 2(15) defines "charitable purpose" to include relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, the "advancement of any other object of general public utility" shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity.

Therefore, preservation of wildlife is included in the definition of "charitable purpose" under section 2(15). Further, an institution having the preservation of wildlife as its main object would not be subject to the restrictions which are applicable to the "advancement of any other

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object of general public utility". Such institution would continue to retain its "charitable" status, even if it derives income from an activity in the nature of trade.

However, if an institution having its main object as "advancement of any other object of general public utility", derives income from an activity in the nature of trade during a financial year, it would lose its "charitable" status for that year, even if it applies such income for its main objects.

It may be noted that if the receipts from such activity does not exceed 20% of the total receipts in that year, then, the institution would not lose its "charitable" status, even if its main object is "advancement of any other object of general public utility", if such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

Circular No.11/2008 dated 19.12.2008

Exemption under section 11 in case of an assessee claiming both to be a charitable institution as well as a mutual organisation

The proviso to section 2(15) will apply only to entities whose purpose is advancement of any other object of general public utility i.e., the last limb of the definition of charitable purpose contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C), if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

There are industry and trade associations who claim exemption from tax under section 11 on the ground that their objects are for charitable purpose as these are covered under any other object of general public utility. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants.

Therefore, where industry or trade associations claim to be both charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall within the purview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealings

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with non-members, their claim to be charitable organizations would be governed by the additional conditions stipulated in the proviso to section 2(15).

In the final analysis, however, whether the assessee has, for its object, the advancement of any other object of general public utility is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of general public utility will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible.

Circular No.395, dated 24.9.1984– Promotion of sports and games is considered to be a charitable purpose within the meaning of section 2(15). Therefore, an association or institution engaged in the promotion of games and sports can claim exemption under section 11.

A trust will be treated as a charitable trust under section 2(15) even if its object involves the carrying on of an activity for profit. Such a trust will not be denied exemption under section 11 on the ground that its objects are non-charitable.

IV. Charitable trust engaged in business activity- Section 11(4A) provides that the exemption under the respective regime, would be available in respect of income, being profits and gains from business activity if —

(a) such business is incidental to the attainment of the objects of the trust/institution; and

(b) separate books of account are maintained by such trust/institution in respect of such business.

Cases where trust property consists of a business undertaking -Section 11(4) clarifies that for the purposes of section 11, property held under trust may consist of a business undertaking so held. If that be so, the trustees may claim that the income of such undertaking enjoys exemption under section 11. Section 11(4) provides that -

(a) The Assessing Officer shall have the power to determine the income of the undertaking in accordance with the provisions of the Act relating to assessment, and

(b) Where the income determined by the Assessing Officer is in excess of that shown in the books of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes.

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ILLUSTRATION 5

NSN, a charitable educational trust approved under section 10(23C)(vi), is running a school. It operates a stationery shop outside the school campus. A sum of ₹ 75 lakhs has been derived as net income from such business activity, which has been applied towards the objectives of the trust in providing education. The trust maintains separate books of accounts for the business activity. Examine the taxability of application of the income, if the income so derived relates to the previous year 2025-26.

SOLUTION

The trust objective of providing education is a charitable purpose as per section 2(15). The trust in the given case runs a stationery shop business, whose income is applied towards the objectives of the trust. In this case, the business income from the stationery shop will be eligible to avail exemption in respect of profits and gains of business, if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business.

Therefore, in the given case, the profit from the business shall be eligible for exemption under section 11, assuming that the said business is incidental to the attainment of the objects of the trust (i.e., education) and books of account for such business activity is maintained separately.

5. Conditions for availing exemption under First Regime and Second Regime

Conditions for availing exemption under both the regimes i.e., section 10(23C)(iv)/(v)/(vi)/(via) are largely similar. It is essential to satisfy the following conditions for availing exemption under these regimes:

(I) Registration for claiming exemption

The primary condition for a trust or institution or fund to avail exemption in both the regimes, is that the trust or institution must be approved under section 10(23C) or registered under section 12AB, as the case may be. Failure to register will deprive tax exemption for such trust or institution.

The procedure for obtaining registration for exemption to a trust or fund or institution had undergone a significant change from April 1st, 2021. Prior to the change in the registration procedure, a taxpayer desirous of availing exemption under this section must submit an application to the Commissioner of Income-tax, within a specified time limit. The Commissioner, on detailed verification and enquiry, will grant registration or refusal of the

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exemption application. This process was time consuming and also paved way for prolonged litigation.

Some of the key aspects of change in the registration procedure is that the registration process is made online and the approvals are valid only for a certain time period. Closure to the expiry of the validity period, the taxpayer must apply for renewing the registration. Failure to renew the exemption approval will not entitle the taxpayer to avail the exemption any further. The procedure for registration under the second regime i.e. under section 12AB in below Table:

Table : Procedure & Timelines for availing exemption under section 12AB read with section 12A(1)(ac)[1]

Section 12A(1)(ac) (1)	Case (2)	Time limit for making the application (3)	Time limit for passing order by the PC/C [Section 12AB(3)] (4)	Validity Period (5)	Registration granted is applicable from (6)
Clause (i)	Re-registration of the institutions or funds which were already registered under section 12A/section 12AA. prior to 1.4.2021	Within three months from April 1, 2021[2] in Form No. 10A	Order to be passed within 3 months from end of the month when application was made.	Five years [Section 12AB(1)(a)/(b)] ***Where the total income of a trust or institution without giving effect to the provisions of section 11 and 12 does not exceed ₹ 5 crores during each of the two P.Y's, preceding the P.Y. in which application is***	A.Y. from which registration was earlier granted [Proviso to section 12A(2)]
Clause (ii)	Renewal of registration/ approval for trust/ institution already registered under section 12AB or	at least six months prior to the expiry of the five-year validity in Form No. 10AB.	within 6 months from the end of the quarter in which application was received after satisfying himself about the		A.Y. immediately following the F.Y. in which application is made [Section 12A(2)]

[1] *For detailed study of procedure, manner and form applicable for making application for registration or provisional registration, students are advised to refer Rule 17A of the Income-tax Rules, 1962 available at https://incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx*

[2] *As per the provision, the effective date for making application is 30.06.2021. However, this date is extended upto 30.06.2024 vide Circular No. 7/2024, dated 25.04.2024.*

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	approved u/s 10(23C)(iv)/(v)/(vi)/(via) and whose period of 5 years is due to expire.		genuineness of activities and compliance of other laws, as are material for the purpose of achieving its objects. For this purpose, the PC or C shall call for such documents or information and make inquiries as he thinks necessary. If not satisfied, pass an order in writing rejecting such application and also cancelling its registration after giving opportunity of being heard.	***made, the registration would be valid for 10 Years.***	
Clause (iii)	Final registration where a trust/ institution is provisionally registered u/s 12AB or provisionally approved u/s10(23C)(iv)/(v)/(vi)/(via) as the case may be	At least six months prior to the expiry of the provisional registration or approval **or** within six months of commence-ment of activities, whichever is earlier, in Form No. 10AB.			First of the A.Y. for which it was provisionally registered [Proviso to section 12A(2)]
Clause (iv)	To revive inoperative registration of trust/ institution on account of grant of approval as provided in first proviso to section 11(7)	At least six months prior to the commence-ment of the AY from which the said registration is sought to be made operative in Form No. 10AB.			A.Y. immediately following the F.Y. in which application is made [Section 12A(2)]
Clause (v)	The trust or institution has adopted or undertaken modifications of the objects which do not conform to the conditions of registration.	Within a period of thirty days from the date of the said adoption or modification, in Form No. 10AB			A.Y. immediately following the F.Y. in which application is made [Section 12A(2)]

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Clause (vi)	In any other case (for e.g., first time applications) ***[See Note below]***	At least one month prior to the commence-ment of the previous year relevant to the assessment year in which the registration is sought in Form No. 10A.	Within one month from the end of the month in which the application is made order to be passed for provisional registration without detailed enquiry.	Three years [Section 12AB(1)(c)]	the A.Y. for which registration is sought in Form 10A, where the application is filed within the stipulated time limit[3]

Note – A trust which has already commenced its activities and has not availed exemption under first regime or second regime for any P.Y. ending on or before the date of such application, need not first apply for provisional registration in Form 10A. It can at any time after the commencement of such activities directly apply for final registration in Form 10AB. The PC or C after following the compliances stipulated in Column (4) [corresponding to clause (iii) of Section 12A(1)(ac)], can grant approval within 6 months from the end of the month in which application is received. If not satisfied, he can pass an order in writing rejecting such application after affording it a reasonable opportunity of being heard. For such trust/fund/institution, registration would be valid for 5 years ***or 10 years, as the case may be*** [Section 12AB(1)(b)]. Exemption under section 11 and 12 is applicable from the A.Y. immediately following the F.Y. in which such application is made.

Thus, only the trusts/funds/institutions which have not commenced activities are required to get provisional registration and will fall within the scope of section 12AB(1)(c).

Condonation of delay in making application for registration / renewal of registration u/s 12A

A trust or an institution is entitled to claim exemption under second regime if it makes an application for registration/renewal, as the case may be, to the PC or C within prescribed time. Non filing of application within the time specified in section 12A(1)(ac) renders the applicant ineligible to claim the exemption.

In such cases, in order to avoid difficulty and potential adverse consequences, with effect from 1st October 2024, where an application is filed beyond the time limit specified in section

[3] *The CBDT Circular 6/2023 dated 24.5.2023 clarifies that the provisional registration shall be effective from the assessment year relevant to the previous year in which the application is made. However, it appears that the intent is to make the same applicable from the assessment year for which the registration is sought, provided the application is filed within the time limit mentioned in Column (3).*

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12A(1)(ac), the PC or C, may, if he considers that there is a reasonable cause for delay in filing the application, condone such delay and such application shall be deemed to have been filed within time.

ILLUSTRATION 6

A public trust has commenced its activities of providing "relief to poor" in the year 2023-24. The trust intends to claim benefits of sections 11 and 12 from A.Y. 2026-27. It approaches you in October, 2025. Total income of the trust for P.Y. 2023-24 and P.Y. 2024-25 was ₹ 20 lakhs and ₹ 45 lakhs, respectively. Advise the trust as to the time limit for making an application for registration, time limit for granting approval by the Principal Commissioner or Commissioner and the period for which the approval is valid.

SOLUTION

In order to avail the exemption under section 11, the trust has to obtain registration under section 12AB read with section 12A(1)(ac). A trust which has already commenced its activities can directly apply for final registration. In the present case, the trust has to apply for registration after commencing its activities but on or before 31.3.2026 to avail the exemption for A.Y. 2026-27. Accordingly, the time limit for making application, time limit for granting registration and period of validity would be as follows:

S. No	Particulars	Time Limit
1	Registration application to be filed online as prescribed under Rule 17A	Application for final registration to be made in Form 10AB at any time after the commencement of such activities.
2	Grant of registration by the Principal Commissioner or Commissioner	Grant registration within 6 months from the end of the quarter in which application was received after satisfying himself about the genuineness of activities and compliance of other laws, as are material for the purpose of achieving its objects. For this purpose, the PC or C shall call for such documents or information and make inquiries as he thinks necessary. If not satisfied, pass an order in writing rejecting such application after giving opportunity of being heard.
3	Validity period of the approval	Registration is valid for ten years effective from the A.Y. immediately following the F.Y. in which application is made.

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ILLUSTRATION 7

Help All, a trust created on 1st April 2024 for providing relief to the poor, applied for registration under section 12AB on 28th February 2025. The Commissioner denied registration on the ground that the trust had not commenced any charitable activity, due to which he could not satisfy himself about the genuineness of the trust. Is the ground for denial of registration by the Commissioner justified in this case? Discuss.

SOLUTION

Section 12AB read with section 12A(1)(ac)(vi) provides that in case of a trust seeking registration for first time, provisional registration will be provided for a period of three years without detailed enquiry by the prescribed income-tax authority even in cases where activities of the entity are yet to begin.

Hence, the Commissioner cannot deny registration on the ground that activities have not commenced. The Commissioner can make detailed enquires and call for information when the trust applies to convert its provisional registration into a final registration as stipulated under section 12A(1)(ac)(iii) read with section 12AB.

(II) Cancellation of Registration/approval [Section 12AB(4) & (5)]

The Principal Commissioner of Income-tax (PCIT) or Commissioner Income-tax (CIT) can cancel registration or provisional registration or approval or provisional approval of a trust or an institution granted under either the first regime i.e., section 10(23C) or under the second regime i.e., section 11 read with section 12AB.

Situations in which registration/approval can be cancelled

The registration can be cancelled in the following situations:

- The PCIT or CIT has **noticed the occurrence of one or more specified violations** during any previous year; or
- The PCIT or CIT **has received a reference from an Assessing Officer** under the second proviso to section 143(3) for any previous year **to withdraw the approval or registration due to occurrence of a specific violation**; or
- The case of the institution has been selected in accordance **with risk management strategy,** formulated by the CBDT from time to time for any previous year.

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Procedure for cancellation

The PCIT or CIT in this regard shall

- **call for such documents or information from the trust or institution**, or make such inquiry as he thinks necessary in order to satisfy himself about the occurrence or otherwise of any specified violation;
- **pass an order in writing, cancelling the registration or approval of such trust or institution**, after affording a reasonable opportunity of being heard, for such previous year and all subsequent previous years, if he is satisfied that one or more specified violations have taken place;
- **pass an order in writing, refusing to cancel the registration** or approval of such trust or institution, if he is not satisfied with the occurrence of one or more specified violations;
- **forward a copy of the order** cancelling the registration or refusing to cancel the registration **to the Assessing Officer and to such trust or institution**.

Time limit for passing the order

The order cancelling or refusing to cancel registration has to be passed **before the expiry of a period of six months, from the end of the quarter in which the first notice is issued by the PCIT or CIT**, calling for any document or information, or for making any inquiry.

Meaning of Specified Violation: Specified violation

(a) where any income derived from property held under trust, wholly or in part for charitable or religious purposes, **has been applied, other than for the objects of the trust or institution**; or

(b) the trust or institution has **income from profits and gains of business which is not incidental** to the attainment of its objectives **or separate books of account are not maintained** by such trust or institution in respect of the business which is incidental to the attainment of its objectives; or

(c) the trust or institution has **applied** any part of its income from the property held under a trust for **private religious purposes**, which does not enure for the benefit of the public; or

(d) the trust or institution established for charitable purpose created or established after the commencement of this Act, has **applied** any part of its income for the benefit of any **particular religious community or caste**; or

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(e) any activity being carried out by the trust or institution—

(i) is not genuine; or

(ii) is not being carried out in accordance with all or any of the conditions subject to which it was registered; or

(f) the trust or institution **has not complied with the requirement of any other law**, and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality.

(g) the application for approval under first regime or registration under second regime contains false or incorrect information.

Note – *Cancellation procedure for approval granted under first regime is similar as prescribed above for second regime. However, the situations mentioned in (c) and (d) are mentioned only in the case of a trust or institution registered under section 11.*

(III) Mandatory filing of return [Section 12A(1)(ba)]:

In order to avail of exemption under any of these regimes, the entities approved under first regime and entities registered under second regime are required to file the return of income under section 139(4C) or under 139(4A), respectively within the time allowed under section 139(1) [i.e., on or before the due date of filing return of income] or section 139(4) [upto 31st December of the relevant assessment year], if the total income without giving effect to the provisions of

– section 10, in case of first regime approved entities or

– section 11 and 12 in case of second regime approved entities,

exceeds the maximum amount which is not chargeable to income-tax.

(IV) Maintenance of Books of account & Other Documents and Audit of accounts [Section 12A(1)(b)]:

With effect from A.Y. 2023-24, where the total income of the trust or institution or fund referred under these two regimes without giving effect to the provisions of section 10(23C)(iv)/(v)(vi)(via) or section 11 and 12, as the case may be exceeds the maximum amount which is not chargeable to income-tax in any previous year, such entities shall

– keep and maintain books of account and other documents in such form and manner and at such place,

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– get the accounts audited by a chartered accountant and the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such prescribed particulars, should be furnished on or before the specified date i.e., one month prior to the due date for filing return of income.

Rule 16CC and Rule 17B prescribe that the report of audit of the accounts of a trust or institution is required to be furnished in

(a) Form No. 10B where -

(I) the total income of such trust or institution, without giving effect to the provisions of 10(23C)(iv)/(v)(vi)(via) or sections 11 and 12, exceeds ₹ 5 crores during the previous year; or

(II) such trust or institution has received any foreign contribution during the previous year; or

(III) such trust or institution has applied any part of its income outside India during the previous year;

(b) Form No. 10BB in other cases.

The term "books or books of account" as defined under section 2(12A) includes ledgers, day-books, cash books, account-books and other books, **whether kept in the written form or in electronic form or in digital form or as print-outs of data stored in such electronic form or in digital form** or in a floppy, disc, tape or any other form of electro-magnetic data storage device.

Prescribed books of account and documents

Rule 17AA prescribes the following books of account and other documents to be maintained by the entities under both the regimes:

(a) books of account, including the following, namely: -

(i) cash book;

(ii) ledger;

(iii) journal;

(iv) copies of bills, whether machine numbered or otherwise serially numbered, wherever such bills are issued by the assessee, and copies or counterfoils of machine numbered or otherwise serially numbered receipts issued by the assessee;

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(v) original bills wherever issued to the person and receipts in respect of payments made by the person;

(vi) any other book that may be required to be maintained in order to give a true and fair view of the state of the affairs of the person and explain the transactions effected;

(b) books of account, as referred in clause (a), for business undertaking referred in section 11(4);

(c) books of account, as referred in clause (a), for business carried on by the assessee other than the business undertaking referred in section 11(4);

(d) other documents for maintaining,

(i) record of all the projects and institutions run by the person

(ii) record of income of the person during the previous year, in respect of-

(I) voluntary contribution containing details of name of the donor, address, permanent account number (if available) and Aadhaar number (if available);

(II) income from property held under trust referred to under section 11 along with list of such properties;

(III) income of fund or institution or trust or any university or other educational institution or any hospital or other medical institution other than the contribution referred in items (I) and (II);

(iii) record of the following, out of the income of the person during the previous year, namely:-

(I) application of income, in India,

(II) amount credited or paid to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in first and second regime;

(III) application of income outside India;

(IV) deemed application of income;

(V) income accumulated or set apart which has not been applied or deemed to be applied containing details of the purpose for which such income has been accumulated;

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(VI) money invested or deposited in the forms and modes specified in section 11(5);

(VII) money invested or deposited in the forms and modes other than those specified in section 11(5);

(iv) record of the following, out of the income of the person of any previous year preceding the current previous year, namely -

(I) application out of the income accumulated or set apart containing details of year of accumulation, amount of application during the previous year out of such accumulation, name and address of the person to whom any credit or payment is made and the object for which such application is made;

(II) application out of the deemed application of income;

(III) application, other than the application referred in item (I) and item (II), out of income accumulated during any preceding previous year containing details of year of accumulation, amount of application during the previous year out of such accumulation, name and address of the person to whom any credit or payment is made and the object for which such application is made;

(IV) money invested or deposited in the forms and modes specified in section 11(5);

(V) money invested or deposited in the forms and modes other than those specified in section 11(5);

(v) record of voluntary contribution made with a specific direction that they shall form part of the corpus.

(vi) record of contribution received for the purpose of renovation or repair of temple, mosque, gurdwara, church or other place notified under section 80G(2)(b) which is being treated as corpus as referred section 10(23C) or in section 11(1).

(vii) record of loan or borrowings

(viii) record of properties held by the assessee

(ix) record of specified persons, as referred to in section 13(3) and transactions undertaken by the fund or institution or trust with such specified persons.

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Place of maintenance of books of account and other documents

The books of account and other documents shall be kept and maintained by the trust/ institution at its registered office.

Such books of accounts may be kept at such other place in India as the management may decide by way of a resolution and where such a resolution is passed, these entities should, within seven days thereof, intimate the jurisdictional Assessing Officer in writing giving the full address of that other place and such intimation shall be duly signed and verified by the person who is authorized to verify the return of income under section 140.

Time period

These books of account and other documents shall be kept and maintained for a period of ten years from the end of the relevant assessment year.

However, where the assessment in relation to any assessment year has been reopened under section 147, the books of account and other documents which were kept and maintained at the time of reopening of the assessment shall continue to be so kept and maintained till the assessment so reopened has become final.

V. **Application of Income – Key Considerations under both regime:** We have seen that the exemption is limited to the extent to which such income is applied. Is it necessary that the entire income should be so applied? The Act gives a concession here. It is possible to claim the exemption even if the trust or institution applies only 85% of the income derived from the trust property for the purpose of the trust, during the relevant previous year.

An accumulation not exceeding 15% of the income from such property is permissible. For computing this 15%, voluntary contributions referred to in section 12 shall be deemed to be part of the income. The exemption under both regime will be available only if at least 85% of the income is applied for charitable or religious purposes in India during the year and the remaining amount i.e., 15% is invested in the forms or modes specified under section 11(5)[4]. Some relevant considerations for determining application of income are discussed below:

(A) **Inability to apply in full 85% of the income -** It is clear from the above discussion that free accumulation not exceeding 15% of income[5] from property is permissible. Hence, the balance 85% must be applied during the previous year for the purposes for which the trust has been created.

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[4] *Circular No. 335 [F. No. 180/9/81-IT(A-I)], dated 13-4-1982.*

[5] *As per the Supreme Court ruling in CIT v. Programme for Community Organisation (2001) 116 Taxman 608, 15% of gross receipts would be eligible for accumulation under section 11(1)(a).*

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However, it is possible that the trust is unable to apply the minimum of 85% of its income during the previous year due to either of the following reasons.

(1) The whole or any part of the income has not been received during that year. (For e.g., if the assessee follows accrual basis of accounting wherein the income has been recognised but not received)

(2) Any other reason (For e.g., late receipt of the income making it impossible to spend it before the end of the year)

- In the first situation, wherein the whole or any part of the income has not been received during that year, the period of application is extended to cover the previous year in which the income is actually received and the previous year immediately following the year. However, the amount which may be so claimed to have been so applied during the subsequent previous year cannot exceed the amount of the income which had not been received earlier but received during a subsequent previous year.

- In the second case, the period of application is extended to the previous year immediately following the previous year in which the income was derived.

Example 1

During the previous year ending 31st March, 2026, a charitable trust earned an income of ₹ 1,00,000 but it received only ₹ 60,000 in that year. The balance of ₹ 40,000 is received during the previous year 2026-27.

	₹
Total income earned during the P.Y.2025-26	*1,00,000*
Less: Permissible accumulation @15% of ₹ 1,00,000	*15,000*
Balance 85% of income to be applied during the P.Y.2025-26	*85,000*
Less: Amount deemed to be applied would be the amount not received during the P.Y. 2025-26	*40,000*
Amount to be applied in the P.Y. 2025-26	*45,000*
Balance amount received in P.Y.2026-27 to be applied in the P.Y.2026-27 or P.Y.2027-28.	*40,000*
***Note -** Since this amount of ₹ 40,000 is received during the P.Y. 2026-27, this can be applied in the P.Y.2026-27 or in the P.Y.2027-28.*	

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Example 2

A trust receives a sum of ₹ 50,000 on 30th March, 2026. Its previous year ends on 31-3-2026.

It is obvious that it is impossible to apply the requisite sum within one day. Therefore, it has been provided that such sum can be applied at any time during the immediately following previous year i.e., up to 31-3-2027.

(B) **Procedural Formalities:** For exercising an option for availing the extended period for application in the above two situations [Clause (2) of *Explanation 1* to section 11(1)], the trust has to exercise an option in writing that the income applied later as **prescribed <u>may be deemed to be income applied to the relevant charitable purposes during the previous year in which the income was derived</u>.** Such option has to be exercised at least 2 months before the due date for filing return of income specified under section 139(1).

The income so deemed to have been applied shall, however, not be taken into account in calculating the amount of income applied to such purposes, during the previous year in which the income is actually received or during the immediately following previous year, as the case may be.

Thus, in ***Example 1*** given above, the amount of ₹ 40,000 received subsequently in the previous year 2026-27 and applied to charitable purposes in the previous year 2026-27, will, by virtue of the option exercised by the trust, be deemed to be applied for charitable purposes in the previous year 2025-26 itself. **Therefore, such an amount will not be taken into consideration in determining the amount of income applied for charitable purposes in the previous year 2026-27.**

Section 11(1B) also provides that where the income for which an option has been exercised as discussed above, is not actually applied, it is to be treated as the income of-

- the previous year immediately following the previous year in which the income was received in case of first situation or
- the previous year immediately following the previous year in which it was derived, in case of second situation.

Note: The option for availing the benefit for extended period for application of income in the two situations mentioned above is not available to trust or institution availing exemption under the first regime i.e., section 10(23C).

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(C) Amounts not treated as application of income or not allowable as deduction

(i) Amount credited or paid out of income of any trust by way of corpus donation not to be considered as application [*Explanation 2* to section 11(1)]- Any amount credited or paid, out of income derived from property held under trust, to any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C)(iv)/(v)/(vi)/(via) or other trust or institution registered under section 12AA or 12AB, as the case may be, being contribution with a specific direction that it shall form part of the corpus, shall not be treated as application of income for charitable or religious purpose [*Explanation 2* to section 11(1)].

(ii) Only 85% of the amount credited or paid by way of donation (other than corpus donations) to another trust or institution out of current year income would be considered as application [*Explanation* 4(iii) to section 11(1)]: Any amount credited or paid by way of donation, other than corpus donations, to any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in 10(23C)(iv)/(v)/(vi)/(via) or other trust or institution registered under section 12AB, as the case may be, out of current year income shall be treated as application for charitable or religious purposes only to the extent of **85% of such amount credited or paid.**

Accordingly, CBDT has, *vide* Circular No. 3/2024 dated 06.03.2024, reiterated that eligible donations made by a trust/institution to another trust/institution under any of the two regimes shall be treated as application for charitable or religious purposes only to the extent of 85% of such donations. It means that when a trust/institution in either regime donates ₹ 100 to another trust/institution in either regime, it will be considered to have applied 85% (₹ 85) for the purpose of charitable or religious activity.

It is clarified that 15% (₹ 15) of such donations by the donor trust/institution shall not be required to be invested in specified modes under section 11(5) as the entire amount of ₹ 100 has been donated to the other trust/institution and is accordingly eligible for exemption under the first or second regime.

This is illustrated by the following example where Trust 1, Trust 2 and Trust 3 are trusts or institutions under any of the two regimes. Further, Trust 1 is making eligible donation to Trust 2 and Trust 2 is further making eligible donation to Trust 3.

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S. No	Particulars	Trust 1		Trust 2		Trust 3	
1.	Income (A)	300		100		100	
2.	Income which is required to be applied (B = 85% of A)		255		85		85
3.	**Application of income**						
4.	Donation to other trusts under the first or second regime (C)	100		100			Nil
5.	Amount to be considered as application of income against the donations at row no. 3 [as per clause (iii) of the *Explanation 2* to third proviso to section I0(23C) or clause (iii) of the *Explanation 4* to section 11(1) (D = 85% of C)		85		85		
6.	Balance income for application (E = A - C)	200		Nil		100	
7.	Application other than SI. No. 4 (F = 85% of E)		170		Nil		85
8.	Remaining income which may be accumulated without Form No. I0/ 9A (G = 15% of E)		30		Nil		15
9.	Funds required to be invested in section 11(5) modes (H = G)		30		Nil		15
10.	Exemption of income (I = C + F + G)	300		100		100	

(iii) Amount credited or paid, out of accumulated income of any trust, to any trust or institution registered under section 12AA/12AB or referred to in section 10(23C)(iv)/(v)/(vi)/ (via), not considered as application of income *[Explanation* to section 11(2)]

Any amount credited or paid, out of income derived from property held under trust, which is not applied, but is accumulated or set apart, to any trust or institution registered under section 12AA/12AB, or to any fund or institution or trust or any university or other educational institution or any hospital or other

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medical institution referred to in sub-clause (iv)/(v)/(vi)/(via) of section 10(23C), shall **not** be treated as application of income for charitable or religious purpose, either during the period of accumulation or thereafter.

Note – Any contribution to another trust or institution out of accumulated income will not be treated as application. Contribution to another trust or institution towards corpus will not be deemed as application even if it is out of current year income.

(iv) Provisions of sections 40(a)(ia), 40A(3) and 40A(3A) apply in case of application of income by trust [*Explanation 3* to section 11(1)] – In case where an expenditure is incurred on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or after deduction, has not been paid on or before the due date under section 139(1), 30% of sum paid would not be treated as application of income in that year. The same would be, however, be treated as application in the year in which tax is deducted and paid.

Likewise, where the trust 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/ bank draft/ ECS or through such other prescribed electronic mode [Credit card, debit card, net banking, IMPS (Immediate Payment Services), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Fund Transfer), BHIM (Bharat Interface for Money) Aadhar Pay], exceeds ₹ 10,000, the same would not be considered as application of income.

(v) Income received for repairs and renovation of temples, mosques etc. [*Explanation 3A* to section 11(1) - This provision would apply where the property held under a trust or institution includes any temple, mosque, gurdwara, church or other place notified under section 80G(2)(b).

In such a case, any sum received as a voluntary contribution by such trust or institution for the purpose of renovation or repair of such temple, mosque, gurdwara, church or other place, may, at its option, be treated as forming part of the corpus of the trust or the institution, provided such corpus is:

(a) applied by the trust or institution only for the purpose for which contribution was made;

(b) not utilised for making contribution or donation to any person;

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(c) separately identifiable; and

(d) invested or deposited in the forms and modes specified in section 11(5).

However, in case such trust or institution has violated any of the above conditions, such sum treated as corpus will be deemed as income of the previous year during which violation takes place.

(vi) Corpus donations utilised by fund/trust/institution towards its objects shall not be treated as application of income – Under both the exemption regimes, corpus donations received by a fund/trust/institution etc. are exempt from income, if the corpus donations are received with a specific direction that they shall form part of the corpus and the said corpus contribution is invested in any of the modes specified under section 11(5) [Section 11(1)(d].

Therefore, corpus donations being exempt income, any application made from corpus donation shall **not** be treated as application of income [*Explanation 4(i) to section 11(1)].*

However, the amount not so treated as application thereof, shall be treated as application for charitable or religious purposes in the previous year in which the amount is invested or deposited back, into one or more of the forms or modes specified in section 11(5) maintained specifically for such corpus, from the income of that year and to the extent of such investment or deposit, subject to the satisfaction of conditions which are required to be satisfied in case of application for charitable or religious purposes. These conditions are as follows:

(1) Application should be in India except with the approval of the Board in accordance with the provisions of section 11(1)(c).

(2) Application should not be by way of donation to the corpus of another trust or institution.

(3) TDS, if applicable, should be deducted on such application.

(4) Application whereby payment or aggregate of payments made to a person in a day does not exceed ₹ 10,000 otherwise than by way otherwise than by an account payee cheque/ bank draft/ ECS or through such other prescribed electronic mode [Credit card, debit card, net banking, IMPS (Immediate Payment Services), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Fund Transfer), BHIM (Bharat Interface for Money) Aadhar Pay].

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(5) Carry forward and set off of excess application is not allowed.

(6) Application is allowed in the year in which it is actually paid.

(7) Application should not directly or indirectly benefit any person referred to in section 13(3) and the income of the trust or institution should not enure any benefit to such person.

(8) If the trust or institution invests or deposits back the amount into corpus within 5 years of application from the corpus, only then such investment/ depositing back into corpus will be allowed as application for charitable or religious purposes.

Note - *No application would be allowed for amount invested or deposited back in modes specified under section 11(5), where application was made out of corpus on or before 31.3.2021.*

ILLUSTRATION 8

XYZ Charitable Trust is an educational institution registered under section 12AB of the Income-tax Act. During the Financial Year 2025-26, the trust receives a corpus donation of ₹25 lakhs with a specific direction that the corpus fund should be utilised for setting up a science laboratory. The trust intends to set up the lab only during P.Y. 2027-28 and will utilize the funds only during that financial year. In this regard, the trust wants to understand whether the corpus donations are exempt u/s 11(1)(d) of the Income-tax Act, 1961.

SOLUTION

As per section 11(1)(d), voluntary contributions made with a specific direction that they shall form part of the corpus of the trust is an exempted income. However, in order to avail the exemption by the trust, such corpus donations must be invested or deposited in one or more of the forms or modes specified in section 11(5). Failure to deposit the same in the prescribed modes, will result in inclusion of corpus donation as an income of the XYZ Charitable trust.

(vii) Application out of loan/borrowings not to be treated as application of income - Application for charitable or religious purposes, from any loan or borrowing, shall not be treated as application of income for charitable or religious purposes [*Explanation 4(ii)* to section 11(1)].

However, the amount not so treated as application or part thereof, shall be treated as application in the previous year in which the loan or borrowing or

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part thereof is repaid from the income of that year to the extent of such repayment subject to satisfaction of conditions which are required to be satisfied in case of application for charitable or religious purposes. These conditions are as follows:

1. Application should be in India except with the approval of the Board in accordance with the provisions of section 11(1)(c).
2. Such application should not be in the form of corpus donation to another trust.
3. TDS, if applicable, should be deducted on such application.
4. Application whereby payment or aggregate of payments made to a person in a day does not exceed ₹ 10,000 otherwise than by way of an account payee cheque/ bank draft/ ECS or through such other prescribed electronic mode [Credit card, debit card, net banking, IMPS (Immediate Payment Services), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Fund Transfer), BHIM (Bharat Interface for Money) Aadhar Pay].
5. Carry forward and set off of excess application is not allowed.
6. Application is allowed in the year in which it is actually paid.
7. Application should not directly or indirectly for the benefit of any person referred to in section 13(3) and the income of the trust or institution should not enure any benefit to such person.
8. Repayment of loan is made within a period of 5 years from the end of the previous year in which such application was made from loan or borrowing.

Note *- Application from any loan or borrowing made on or before 31.3.2021 will not be treated as application. This is because upto 31.3.2021, the amount applied out of loan or borrowing was allowed as application. Hence, at the time of repayment, it cannot be claimed as application once again.*

(viii) No set off or deduction allowable of any excess application of earlier previous year [*Explanation 5* to section 11(1)] – No set off or deduction or allowance of any excess application of any of the year preceding the previous year shall be made for computation of income required to be applied or accumulated during the previous year. For example, excess application in

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A.Y. 2025-26 cannot be reduced to determine the income to be applied or accumulated during the P.Y. 2025-26 (A.Y. 2026-27).

(ix) **No deduction for depreciation where cost of asset has been claimed as application of income –** Income for the purposes of application under section 11 shall be determined without allowing any deduction or allowance for depreciation or otherwise, in respect of any asset, the cost of acquisition of which has been claimed as an application of income under this section in the same or any other previous year [Section 11(6)].

ILLUSTRATION 9

MSO Foundation, a registered charitable institution set up on 1st April, 2024 is engaged in providing education in hotel management. The organization acquires a building in July 2025 for using the same for holding classes and office activities. It has approached you for your opinion on its eligibility to claim the cost of the building and also depreciation thereon in the current year and the subsequent year. Advise the institution indicating the reasons.

Would your advise change, if building has been acquired out of loan taken in July 2025 from bank, to be repaid in installments over a period of 7 years?

SOLUTION

15% of income from property held for charitable purposes is exempt from tax under section 11. The remaining 85% of such "income" would be exempt if it is "applied" for charitable purposes in India.

Application of the amount can be for revenue or capital purposes. As long as the expenditure is incurred out of income earned by the trust and for the purposes of carrying on the objects of the trust, it would be treated as application of income even if such expenditure is for capital purposes. Therefore, since the building is acquired by the organization for holding classes and office activities, which is for the purposes of carrying on the objects of the charitable institution i.e., for providing education in hotel management, the cost of the building would be treated as application of income.

However, section 11(6) provides that where the cost of building is claimed as application, no other deduction for depreciation or otherwise would be allowed as an application of income in respect of such asset for the same or any other previous year.

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If building has been acquired out of loan taken from bank, then, cost of building cannot be claimed as application. Repayment of loan would be treated as application in the year of repayment to the extent of amount repaid for a period of 5 years from the end of the previous year in which building was acquired. The repayment made upto 31.3.2031 would be eligible to be treated as application in the respective year of repayment. Repayment made thereafter i.e. from 1.4.2031 cannot be treated as application.

Alternatively, since cost of building is not claimed as application, depreciation on such building can be claimed as deduction. However, if deduction in respect of depreciation is claimed, then, it is possible to take a view that repayment of loan may not be eligible to be treated as application.

(x) **Expenditure allowed only on actual payment basis –** Previously, the term "application" included expenses that accrued during the year, even if they are not actually paid. However, with effect from A.Y. 2022-23, any sum payable by any trust or institution shall be treated as application of income only in the previous year when such sum is actually paid by it. This is irrespective of the previous year in which the liability to pay such sum was incurred or method of accounting regularly employed by it. Thus, expenditure is allowed as application only when the payment is actually made and not when the liability is incurred [Explanation to section 11].

However, where during any previous year, any sum has already been claimed to have been applied by the trust or institution, such sum would not be allowed as application in any subsequent previous year based on actual payment.

For example, if a trust has incurred ₹ 2,00,000 in the P.Y. 2020-21 and claimed the same as application of income in that year and subsequently, the actual payment is made in the P.Y. 2025-26. Since such sum was already claimed as application in the P.Y. 2020-21, the same would not be allowed as application in the P.Y. 2025-26, on the basis of actual payment.

ILLUSTRATION 10

VPS Foundation, a charitable institution registered under section 12AB set up on 1st August 2023 is engaged in providing education in sports management. The Foundation follows accrual basis of accounting and during the previous year 2025-26, has accrued staff's salary expenses pertaining to the month of March 2026 amounting to ₹ 5 lakhs. The salary was paid during the first week of April 2026. KS, the tax advisor of the foundation has advised them that the

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salary expenses provided for in the accounts will not be treated as an application of income for the previous year 2025-26. Examine.

SOLUTION

Upto Assessment Year 2021-22, an expenditure could be regarded as an application of income even if it was not actually paid. However, effective from assessment year 2022-23, *Explanation* to section 11 provides that any sum payable by an institution shall be considered as an application of income only in the previous year in which such sum is actually paid by it. This is irrespective of the previous year in which the liability to pay such sum is incurred by the institution according to the method of accounting regularly employed by it. Therefore, the tax advisor's statement is correct.

(D) Instances where capital gains would be deemed to have been applied for charitable purposes [Section 11(1A)]

(a) Transfer of a capital asset held under trust wholly for charitable or religious purposes [Section 11(1A)(a)]- Where the whole of the net consideration from the transfer of the capital asset is utilised for acquiring a new capital asset which is held under trust wholly for charitable or religious purposes, the entire amount of capital gains arising from the transfer would be deemed to have been applied for charitable or religious purposes. If, however, only a part of the net consideration is utilised in acquiring the new capital asset, the amount of capital gains deemed to have been utilised for charitable or religious purposes shall be equal to the excess of the proceeds utilised over the cost of the asset transferred.

Example 3

Original cost of capital asset transferred	*₹ 1,00,000*
Consideration for which it is transferred	*₹ 1,50,000*
Situation 1 Cost of new capital asset acquired	*₹ 1,50,000*
Situation 2 Cost of new capital asset acquired	*₹ 1,20,000*

Amount that will be deemed to have been applied for charitable purposes.

Situation 1 ₹ 50,000

Situation 2 ₹ 20,000

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(b) **Transfer of a capital asset held under trust in part only for charitable and religious purposes [Section 11(1A)(b)] -** Where only a part of a capital asset has been transferred, only the "appropriate fraction" of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes. Where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain will be deemed to have been so applied. In any other case, the exemption will be limited to so much of the appropriate fraction of the amount utilised for acquiring the new asset as exceeds the appropriate fraction of the cost of the transferred asset.

"Appropriate fraction" means the fraction which represents the extent to which the income derived from the capital asset transferred was applicable to charitable or religious purposes before such transfer.

Example 4

A capital asset is being held under trust. Two-thirds of the income derived from such capital asset are being utilised for the charitable purposes of the trust. The asset is being transferred.

Cost of transferred asset	*₹ 1,20,000*
Net consideration	*₹ 1,80,000*
Cost of new asset acquired	*₹ 1,50,000*
Capital gains	*₹ 60,000 [₹ 1,80,000 – ₹ 1,20,000]*

Appropriate fraction 2/3rd

Income represented by 'appropriate fraction' = 2/3rd of ₹ 60,000 = ₹ 40,000

Since the entire net consideration has not been utilised in acquiring the new asset, the amount deemed to have been utilised for charitable purpose will be (2/3rd of ₹ 30,000, being the difference between cost of new asset and cost of transferred asset) = ₹ 20,000.

Note – There is no provision akin to section 11(1A) in the first regime under section 10(23C).

VI. Accumulation of Income:

Conditional accumulation - Under both regimes, application of income derived from property held under trust for charitable purposes in India is the main condition for grant of exemption to trust or institution in respect of income derived from property held under such trust. In case such

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income cannot be applied during the previous year, the same can be accumulated and applied for such purposes, subject to satisfaction of the conditions provided therein.

Both regimes permit accumulation of 15% of the income indefinitely by the trust or institution. However, 85% of income can only be accumulated for a period not exceeding 5 years subject to the conditions that such person submits the prescribed form i.e., Form 10 to the Assessing Officer and the money so accumulated or set apart is invested or deposited in the specified forms or modes.

As per section 11(2), the conditions for accumulation are as follows:

(1) such person should furnish a statement in the prescribed form (Form 10) and in the prescribed manner to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for which the income is being accumulated or set apart, which shall, in no case, exceed five years.

In computing the period of five years, the period during which the income could not be applied for the purpose for which it is so accumulated or set apart, due to an order or injunction of any court, shall be excluded.

(2) the money so accumulated or set apart should be invested or deposited in the modes specified in section 11(5).

(3) the statement in Form 10 should be filed at least 2 months prior to the due date of filing return of income specified under section 139(1).

As per section 13(9), in case the statement in Form 10 is not submitted on or before the due date under section 139(1), then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing return of income specified in section 139(1).

Note – *Section 11(2) stipulates the conditions for accumulation, on fulfillment of which the income so accumulated or set apart would not be included in the total income of the previous year of the trust. The condition stipulated in clause (c) of Section 11(2) is that the statement in Form 10 has to be furnished at least 2 months prior to the due date of filing of return of income u/s 139(1). However, as per section 13(9), the income accumulated would not be excluded from total income if Form 10 is not submitted on or before the due date under section 139(1). Section 13(9) permits exclusion of accumulated income from total income of the previous year, if Form 10 is filed on or before the due date under section 139(1). CBDT Circular No.6/2023 dated 24.5.2023 clarifies that the statement of accumulation in Form No.*

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10 is required to be furnished at least two months prior to the due date of furnishing return of income so that it may be taken into account while auditing the books of account. However, the accumulation/deemed application shall not be denied to a trust as long as the statement of accumulation/deemed application is furnished on or before the due date of furnishing the return as provided in section 139(1).

Consequences on failure to satisfy the conditions of accumulation [Section 11(3)]

Where the accumulated income of the trust -

(a) is applied to purposes other than charitable or religious purposes or to the objects for which first regime entities are established; then such income shall be deemed to be the income of such person in the concerned previous year in which it is so applied.

(b) ceases to be accumulated or set apart for application; then such income shall be deemed to be the income of such person in the previous year in which the income ceases to be so accumulated or set apart.

(c) ceases to remain invested or deposited in any of the forms or modes specified in section 11(5); then such income shall be deemed to be the income of such person in the previous year, in which the income ceases to remain invested or deposited as per modes in section 11(5).

(d) is not utilised for the purpose for which it is accumulated or set apart during the period specified under the statement for accumulation; such income shall be deemed to be income of such person of the previous year being the last previous year of the period for which the income is so accumulated or set apart.

(e) is credited/paid to any trust or fund or institution registered under section 12AA/12AB/section 10(23C)(iv)/(v)/(vi)/(via); such income shall be deemed to be income in the previous year when it is so credited or paid.

As per section 11(3A), where due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited 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 purpose in India as is specified in the application by such person and as is in conformity with the objects of the trust.

However, the Assessing Officer shall not allow application of such income by way of payment or credit to any trust or fund or institution registered under section 12AA/12AB/section 10(23C)(iv)/(v)/(vi)/(via).

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In case of a trust or institution which has deposited its income in forms or modes specified under section 11(5) is dissolved, the Assessing Officer may allow application of such income by way of payment or credit to a trust or institution registered under section 12AA/12AB or fund or trust or institution referred to section 10(23C)(iv)/(v)/(vi)/(via) [This provision is mentioned only with reference to the second regime].

ILLUSTRATION 11

A charitable institution registered under section 12AB of the Income-tax Act, 1961 filled in Form No.10 for seeking permission to accumulate unapplied income under section 11(2) of the Act for the objects of the institution and submitted it to the Assessing Officer along with the resolution for accumulation. The Assessing Officer found that the objects for which accumulation was sought were not particularised in as much as they covered the entire range of objects of the institution. Can the Assessing Officer deny the benefit of accumulation in such a case?

SOLUTION

Section 11(2) permits a charitable trust or institution to accumulate its unspent income where 85% of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year. The institution or trust has to specify, in the statement furnished to the Assessing Officer, the purpose for which the income is being accumulated or set apart and the period for which such income is to be accumulated or set apart.

In the given case, the assessee institution sought the permission of the Assessing Officer to accumulate unapplied income for the objects of the institution. The institution had not stated any objects in particular for which the unspent income was sought to be accumulated or set apart. In *Bharat Krishak Samaj vs. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del.)*, it was held that it is not necessary for a charitable trust to particularize each and every object for which accumulation is sought. It is enough if the assessee seeks permission for accumulation for the objects of the trust. Therefore, the Assessing Officer cannot deny the benefit of accumulation in such a case.

ILLUSTRATION 12

A charitable institution registered under section 12AB of the Income-tax Act, 1961 for the previous year ended 31 March 2026, filled in Form No.10 for seeking permission to accumulate unapplied income for a period of five years under section 11(2) of the Act for the objects of the institution and submitted it to the Assessing Officer along with the resolution

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for accumulation. The charitable institution could not utilise the accumulated income within the period of five years. Examine the consequences of the same for the charitable institution with regards to the accumulated income.

SOLUTION

Section 11(3) provides for consequences when an assessee registered under section 12AB fails to satisfy the conditions of 11(2) accumulation. In this regard, the charitable institution has not utilised the accumulated income of P.Y. 2025-26 within a period of five years as specified in Form 10. Hence, by virtue of section 11(3), the said income will be deemed to be the income of the charitable institution of the previous year, being the last previous year of the period for which the income accumulated is not utilised. Hence, the said income will be taxable in the 5th year as it is the last previous year of the period of accumulation.

Modes specified in section 11(5):

(1) Investment in Government Saving Certificates.

(2) Deposits with Post Office Savings Banks.

(3) Deposit with Scheduled banks or Co-operative Banks.

(4) Investment in units of the Unit Trust of India.

(5) Investment in Central or State Government Securities.

(6) Investments in debentures issued by or on behalf of any company or corporation. However, both the principal and interest thereon must have been guaranteed by the Central or the State Government.

(7) Investment or deposits in any public sector company.

Where an investment is made in the shares of any public sector company and such public sector company ceases to be a public sector company, the investment so made shall be deemed to be an investment made for a period of three years from the date of such cessation and in the case of any other investment or deposit, till the date of its maturity.

(8) Investment in bonds of approved financial corporation providing long term finance for industrial development in India and eligible for deduction under section 36(1)(viii).

(9) Investment in bonds of approved public companies whose principal object is to provide long-term finance for construction or purchase of houses in India for residential purposes and eligible for deduction under section 36(1)(viii).

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(10) Deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

"Long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years.

"Urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, road, bridges and flyovers or urban transport.

(11) Investment in immovable property excluding plant and machinery, not being plant and machinery installed in a building for the convenient occupation thereof.

(12) Deposits with Industrial Development Bank of India.

(13) **Any other mode of investment or deposit as may be prescribed. Rule 17C specifies the following other modes:**

(i) Investments in units issued under any scheme of mutual fund referred to in section 10(23D);

(ii) Any transfer of deposits to Public Account of India;

(iii) Deposits made with an authority constituted in India or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both;

(iv) investment by way of acquiring equity shares of a 'depository';

(v) investment by a recognized Stock Exchange, in the equity shares of a company promoted by it to acquire the membership rights of other stock exchanges, where at least 51% of the paid-up share capital is held by the Stock Exchange and the balance is held by its members;

(vi) investment made by a person, authorised under section 4 of the Payment and Settlement Systems Act, 2007, in the equity share capital or bonds or debentures of a company —

(A) which is engaged in operations of retail payments system or digital payments settlement or similar activities in India and abroad and is approved by the Reserve Bank of India for this purpose; and

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(B) in which at least 51% of equity shares are held by National Payments Corporation of India.

(vii) investment made by a person, authorised under section 4 of the Payment and Settlement Systems Act, 2007, in the equity share capital or bonds or debentures of Open Network for Digital Commerce Ltd, being a company incorporated under section 7(2) read with section 8(1) of the Companies Act, 2013, for participating in network based open protocol models which enable digital commerce and interoperable digital payments in India;

(viii) investment by way of acquiring equity shares of an incubatee by an incubator;

(ix) investment by way of acquiring shares of National Skill Development Corporation;

(x) investment in debt instruments issued by any infrastructure finance company registered with RBI;

(xi) investment in Stock Certificate as defined in of Sovereign Gold Bonds Scheme, 2015.

(xii) investment by way of acquiring units of POWERGRID Infrastructure Investment Trust.

ILLUSTRATION 13

A charitable trust derives its income from the business of providing mineral water to various companies situated in Software Technology Park in Hyderabad. A sum of ₹ 30 lakhs has been derived as net income from such business activity, which has been applied for the object of general public utility. The total receipts of the trust during the P.Y. 2025-26 was ₹ 140 lakhs.

Examine the taxability of application of the income, if the income so derived relates to the previous year 2025-26. Would your answer be different, if the trust runs a school in a backward district and applies the profits from the business for such school's activity?

SOLUTION

In the first case, net income from the business of supplying mineral water to various companies i.e., ₹ 30 lakhs is not eligible for exemption under section 11, since the receipt from such activity exceeds 20% of total receipts (i.e., 20% of ₹ 140 lakhs) during the year. This is because "advancement of any object of general public utility" would not be a charitable purpose if it involves carrying on of any activity in the nature of trade, commerce or business,

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for example, supply of mineral water for a consideration, as in this case. It is immaterial that the net income from such business is applied for the object of general public utility. On the other hand, where the trust runs a school in a backward district, this restriction is not applicable. The reason is that the restriction contained in section 2(15) is applicable only to the last limb of the definition of "charitable purpose" i.e. advancement of object of general public utility. It does not affect the other limbs of the definition viz. "relief of the poor", "education", "medical relief" etc.

Section 11(4) clarifies that "property held under trust" includes a business undertaking so held. As per section 11(4A), exemption can be availed in respect of profits and gains of business, if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business. Therefore, in the second case, the profit from the business shall be eligible for exemption under section 11, assuming that the said business is incidental to the attainment of the objects of the trust (i.e., education) and books of account for such business activity is maintained separately.

VII. No claim for exemption under section 10 permissible where trust has been granted registration/approval for availing exemption under section 11 or under section 10(23C)

Where a trust or an institution or fund has been granted registration/approval for purposes of availing exemption under second regime, and the registration is in force for a previous year, then, such trust or institution cannot claim any exemption under any provision of section 10 [other than exemption of agricultural income under section 10(1)].

Prior to 1st June 2020, the organisation registered u/s 12AA could also avail approval u/s 10(23C) or 10(46) and thus, could avail tax exemption under either of the two sections. However, with effect from 1 June 2020, the registration granted for availing exemption under section 11 would become inoperative from the date on which the trust or institution is approved under section 10(23C) or is notified under section 10(23EC) or under section 10(46) or under section 10(46A).

Accordingly, the registration granted for availing exemption under section 11 would become inoperative from the date on which the trust or institution is approved under section 10(23C) or is notified under section 10(23EA) or section 10(23EC) or section 10(23ED) or section 10(46) or section 10(46A) or from 1st April of the P.Y. for which exemption is claimed under section 10(46B) [First proviso to section 11(7)].

The trust or institution, whose registration/approval has become inoperative, may apply to get its registration operative under section 12AB/ 10(23C)(iv)/(v)/(vi)/(via) subject to the condition that on doing so, the approval under section 10(23C) or notification under section 10(23EA)/(23EC)/ (23ED)/10(46) or 10(46A), as the case may be, to such trust or institution

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shall cease to have any effect from the date on which the said registration/approval becomes operative and thereafter, it shall not be entitled to exemption under section 10(23C) or under section 10(23EA)(23EC)/(23ED) or section 10(46) or section 10(46A), as the case may be [Second proviso to section 11(7)].

6. Denial of Exemption [Section 13]

(A) Income not eligible for exemption under sections 11 and 12

In the following situations, income of a trust, fund or institution will not be eligible for availing exemption under section 10(23C)(iv)/(v/(vi)/(via) or Section 11 as the case may be.

(a) **Income from property held under a trust for private religious purposes** - Where the property is held under a trust for private religious purposes, no part of the income will be exempt under section 11, if it does not ensure for the benefit of the public [Section 13(1)(a)].

(b) **Income from trust established for benefit of any particular religious community or caste** -Where a trust set up for charitable purposes or a charitable institution has been established for the benefit of any particular religious community or caste, the income thereof will not be eligible for exemption under section 11. However, a trust or institution created or established for the benefit of scheduled caste, backward classes, scheduled tribes or women and children shall not be treated as a trust or institution created or established for the benefit of a religious community or caste within the meaning of section 13(1)(b).

Note: The situations referred to in (a) & (b) on non-availability of exemption are with reference to only income under the second regime.

(c) **Income of trust enuring for the benefit of any person referred to in section 13(3) [Section 13(1)(c)]:** Where any part of the income or property of trust or the institution enures directly or indirectly for the benefit of any person referred to in section 13(3), then such part of the income shall not be eligible for exemption and the said income will taxed at 30% under Section 115BBI.

Such part of income or property would not be eligible for exemption and would be taxed under section 115BBI at 30%. Further, to avoid income of the trusts or institutions to be used for the benefit of specified persons under section 13(3), penalty is leviable under 271AAE on the amount of income provided as a benefit.

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Penalty for providing benefit to person referred in section 13(3) [Section 271AAE]

If during any proceeding under this Act, it is found that any person, being any fund or institution or trust referred under section 10(23C)(iv)/(v)/(vi)/(via) or any trust or institution referred to in section 11 applied income of the trust or institution, directly or indirectly, for the benefit of any person referred to in section 13(3), the Assessing Officer may direct such fund or trust or institution to pay penalty equal to -

(i) 100% of the aggregate amount of income so applied, where the violation is noticed for the first time during any previous year; and

(ii) 200% of the aggregate amount of income so applied, where violation is noticed again in any subsequent previous year.

Non-applicability of relaxation u/s 56(2)(x)

The provisions of section 56(2)(x) are not attracted in the hands of the recipient who receives any sum of money or property from a trust or institution approved u/s 10(23C) or registered u/s 12AA or 12AB.

However, this relaxation is not available where sum of money or property has been received by specified persons under section 13(3).

(d) Deposit or investment of funds in impermissible modes [Section 13(1)(d)] -Any income of a trust or institution, if –

(1) its funds are invested or deposited otherwise than in the forms or modes specified in section 11(5);

(2) it holds shares in a company other than -

(i) a public sector company; or

(ii) shares prescribed as a form or mode of investment under section 11(5)(xii).

However, these restrictions do not apply in respect of :

(a) any assets forming part of corpus of the trust as on 1-6-1973.

(b) any accretion to the corpus shares mentioned in (a) above by way of bonus shares allotted to the trust.

(c) debentures issued by or on behalf of any company or corporation and acquired by the trust before March 1, 1983.

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(d) any asset not covered under section 11(5), where such asset is held for not more than one year from the end of the previous year in which such asset is acquired.

(e) any funds representing the profits and gains of business. However, where a trust has any other income in addition to profits and gains of business, such relaxation of the restriction will be denied unless the trust keeps separate accounts for the business. [This is applicable only for the second regime].

Note – Under the first regime, the 3rd proviso to section 10(23C), requiring investment or deposit of funds in forms or modes specified under section 11(5), contains similar exclusions [mentioned in (a), (b), (c) and (d) above]. In addition, voluntary contributions received and maintained in the form of jewellery, furniture or any other article as the Board may specify, are also excluded from the applicability of this requirement under the first regime.

W.e.f. 1st October 2024, no application for approval can be made under the first regime, resultantly, certain trusts or institutions need to shift from first regime to second regime. In order to provide protection to these trusts or institutions the assets permissible for investment in first regime i.e., mentioned in (a), (b), (c) and (d) above and voluntary contributions received and maintained in the form of jewellery, furniture or any other article as the Board may specify are also included under section 13(1)d).

(B) Prohibited use or application -We have noted above that when any part of the income or any property of the trust whenever created, is, during the previous year, used or applied directly, for the benefit of any person referred to in section 13(3), the denial of exemption operates. Section 13(2) specifies a few particular instances where the income or the property is to be deemed to have been used for the benefit of a person referred to in section 13(3). It should be noted that those particular instances do not in any way restrict the general meaning of the expression "used or applied for the benefit of a person". The provisions of section 13(2) are as follows:

The income or the property of the trust or institution or any part of such income or property is to be deemed to have been used or applied for the benefit of a person referred to in section 13(3) in the following cases:

(a) **Loan without adequate interest or adequate security -** If any part of the income or the property of the trust or institution is or continues to be lent to any person referred to in section 13(3) for any period during the previous year without either adequate security or adequate interest or both.

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(b) **Allowing use of property without adequate rent -**If any land, building or other property of the trust or institution is or continues to be, made available, for the use of any person referred to in section 13(3) for any period during the previous year without charging adequate rent or other compensation.

(c) **Excess payment for services -** If any amount is paid out of the resources of the trust or institution to any of the persons referred to in section 13(3) for services rendered to the trust or institution but such amount is in excess of a reasonable sum payable for such services.

(d) **Inadequate remuneration for services rendered -** If the services of the trust or institution are made available to any person referred to section 13(3) without adequate remuneration or other compensation.

(e) **Excess payment for purchase of property -** If any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in section 13(3) during the previous year for a consideration which is more than adequate.

(f) **Inadequate consideration for property sold -** If any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in section 13(3) during the previous year for a consideration which is less than adequate.

(g) **Diversion of income or property exceeding ₹ 1,000 -** If any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in section 13(3) provided the aggregate value of such income and property diverted exceeds ₹ 1,000.

(h) **Investment in substantial interest concerns** - If any funds of the trust or institution are, or continue to remain, invested for any period during the previous year in any concern in which any person referred to in section 13(3) has a substantial interest.

Section 13(4) provides some respite where the aggregate of the funds invested in the said concern does not exceed five per cent of the capital of that concern. In such a case, the exemption under section 11 or 12 will be denied only in relation to such income as arises out of the said investment. Exemption will not be denied to the remaining income only due to this reason.

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(C) Prohibited category of persons - Section 13(3) gives the list of persons, use or application of the income or property of a trust for whose direct or indirect benefit results in a denial of the exemption contemplated in section 11 for a charitable or religious trust or institution. The said persons are:

(1) The author of the trust or the founder of the institution.

(2) ***Any person whose total contribution to the trust or institution, during the relevant previous year exceeds ₹ 1 lakh, or, in aggregate up to the end of the relevant previous year exceeds ₹ 10 lakh rupees, as the case may be.***

(3) Where the author, founder or the person is a HUF, any member of the family.

(4) Any trustee of the trust or manager (by whatever name called) of the institution.

(5) Any relative of any such author, founder, member, trustee or manager as referred to above.

(6) Any concern in which any of the persons referred to in clauses (1) to (5) ***except (2)*** above has a substantial interest.

Relative - The expression "relative", in relation to an individual, means -

(a) spouse of the individual;

(b) brother or sister of the individual;

(c) brother or sister of the spouse of the individual;

(d) any lineal ascendant or descendant of the individual;

(e) any lineal ascendant or descendant of the spouse of the individual;

(f) spouse of a person referred to in (b), (c), (d) or (e) above;

(g) any lineal descendant of a brother or sister of either the individual or the spouse of the individual;

Substantial interest in a concern - Section 13(2)(h), section 13(3) and section 13(4) refers to cases where a person has a substantial interest in a concern. These references occur where the "Prohibited use or application" and "Prohibited category of persons" have been described. The circumstances in which a person shall be deemed to have a substantial interest in a concern, have been laid down in *Explanation 3* to section 13.

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(D) Exemption not to be denied to charitable trusts providing educational or medical facilities to specified persons [Section 13(6)]- A charitable or religious trust running an educational institution or a medical institution or a hospital shall not be denied the benefit of exemption under section 11 merely due to the reason that the benefit of educational or medical facilities have been provided to the specified persons referred to in section 13(3). However, the value of such facilities provided to such specified persons either free of cost or at a concessional rate would be deemed to be the income of the trust. Such income would not be eligible for exemption under section 11.

(E) Anonymous donations [Section 13(7)]-The exemption provisions contained in both regimes shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section. For example, section 11(1)(d) provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of such trust/institution for the relevant previous year.

However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

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(F) Exemption to be denied to a charitable trust having its main object as "advancement of any other object of general public utility" if its trading receipts exceed the specified threshold irrespective of withdrawal of approval or cancellation of registration or rescindment of notification [Section 13(8)]

(a) Under both regimes, income of any charitable trust or institution is exempt if such income is applied for charitable purposes in India and such institution is registered under second regime or approved under first regime.

(b) The definition of "charitable purpose" under section 2(15) provides that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless,-

(1) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and

(2) the aggregate receipts from such activity or activities, during the previous year, does not exceed 20% of the total receipts, of the trust or institution undertaking such activity or activities, for the previous year .

(c) Thus, a charitable trust or institution pursuing "advancement of object of general public utility" may be a charitable trust in one year and not a charitable trust in another year depending on the percentage of receipts from commercial activities *vis-à-vis* its total receipts.

(d) Therefore, no exemption would be available to a trust or institution for the previous year in which the receipts from commercial activities exceed 20% of the total receipts of that year. However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution.

(e) Therefore, there is need to ensure that if the purpose of a trust or institution does not remain charitable in a previous year on account of the commercial receipts exceeding the specified percentage of total receipts, then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year in which the commercial receipts exceed the specified percentage of total receipts. The denial of exemption would be compulsory by operation of law and would not be

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dependent on any approval being withdrawn or registration being cancelled or a notification being rescinded.

(f) Accordingly, section 13(8) ensures that such trust and institution does not get benefit of tax exemption under section 11 or 12 in the year in which its receipts from commercial activities exceed the specified percentage of total receipts, whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded in respect of such trust or institution.

(G) Non-submission of statement in prescribed form and non furnishing of return of income on or before the due date of filing return of income under section 139(1) [Section 13(9)]- In case the statement in Form 10 is not submitted and return of income is not filed on or before the due date of filing return of income under section 139(1), then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing return of income specified in section 139(1).

Note – *Section 11(2) stipulates the conditions for accumulation, on fulfillment of which the income so accumulated or set apart would not be included in the total income of the previous year of the trust. The condition stipulated in clause (c) of Section 11(2) is that the statement in Form 10 has to be furnished at least 2 months prior to the due date of filing of return of income u/s 139(1). However, as per section 13(9), the income accumulated would not be excluded from total income if Form 10 is not submitted on or before the due date under section 139(1). Section 13(9) permits exclusion of accumulated income from total income of the previous year, if Form 10 is filed on or before the due date under section 139(1). CBDT Circular No.6/2023 dated 24.5.2023 clarifies that the statement of accumulation in Form No. 10 is required to be furnished at least two months prior to the due date of furnishing return of income so that it may be taken into account while auditing the books of account. However, the accumulation/deemed application shall not be denied to a trust as long as the statement of accumulation/deemed application is furnished on or before the due date of furnishing the return as provided in section 139(1).*

7. Manner of computation of income of a trust violating certain conditions [Sections 13(10) & (11)]

(i) Consequences of failure to comply with stipulated conditions: If a trust or an institution violates certain stipulated conditions, the income shall be chargeable to tax after allowing

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deduction for expenditure (other than capital expenditure) incurred in India for the objects of the trust/ institution.

The following are the violations:

- It has receipts from trade, commerce etc. while advancing the object of general public utility, in excess of 20% of total receipt;
- It fails to maintain prescribed books of account;
- It fails to get its books of account audited and furnish audit report on or before the specified date;
- It fails to file return of income under section 139(4A) (or 139(4C), as the case may be, for the first regime trust) within the time stipulated under section 139(1) or 139(4).

(ii) Conditions to be fulfilled for claim of deduction of revenue expenditure: The deduction for revenue expenditure incurred is subject to fulfilment of the following conditions:

(a) such expenditure is not from the corpus standing to the credit of the trust or institution as on the end of the financial year immediately preceding the previous year relevant to the assessment year for which income is being computed;

(b) such expenditure is not from any loan or borrowing;

(c) there is no claim of depreciation on those assets, whose acquisition cost has been claimed as application of income in any previous year; and

(d) such expenditure is not in form of any contribution or donation to any person.

(iii) Disallowances: While determining the amount of expenditure allowable as deduction, the following points need to be considered:

(a) Capital expenditure is not allowed as a deduction.

(b) Disallowance under sections 40(a)(ia), on account of non-deduction of tax or non-payment of tax deducted at source on or before the due date of filing of return, would be attracted

(c) Disallowance of expenditure in respect of cash payment in excess of ₹ 10,000 under section 40A(3) and 40A(3A) would be attracted .

(d) no deduction in respect of any expenditure or allowance or set-off of any loss shall be allowed to the assessee under any other provision of this Act.

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8. Anonymous donations received by Charitable Trusts/Institutions to be subject to tax [Section 115BBC]

(i) As per the provisions of the Income-tax Act, 1961, tax exemption under section 10(23C) and section 11 are available to certain entities, as briefed in the table below, on fulfillment of the conditions prescribed under the relevant sections –

Entity	Applicable section
Charitable or religious trusts/institutions	11
Universities and other educational institutions	10(23C)(iiiad) and (vi)
Hospitals and other medical institutions	10(23C) (iiiae) and (via)
Notified funds or institutions established for charitable purposes	10(23C)(iv)
Notified trusts or institutions established wholly for public religious purposes or wholly for public religious and charitable purposes	10(23C)(v)

(ii) As per section 115BBC anonymous donations received by the above entities are taxed at 30%.

(iii) In order to provide relief to these trusts and institutions and to reduce their compliance burden, an exemption limit has been introduced, and only the anonymous donations in excess of this limit would be subject to tax@30% under section 115BBC.

(iv) The exemption limit is the higher of the following –

(1) 5% of the total donations received by the assessee; or

(2) ₹ 1 lakh.

(v) The total tax payable by such institutions would be –

(1) tax@30% on anonymous donations exceeding the exemption limit as calculated above; and

(2) tax on the balance income i.e., total income as reduced by the anonymous donations which have been subject to tax@30% under section 115BBC.

(vi) The following table illustrates the calculation of anonymous donations liable to tax @30% under section 115BBC –

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I	II	III	IV	V	VI
Situation	**Total donations during the year (₹)**	**Anonymous donations received during the year (₹)**	**Exemption [5% of total donations or ₹ 1,00,000, whichever is higher] (₹)**	**Anonymous donations taxable@30% (₹)**	**Donations subject to tax at normal rates# (₹)**
A	15,00,000	4,00,000	1,00,000	3,00,000	12,00,000
B	30,00,000	7,00,000	1,50,000	5,50,000	24,50,000
C	40,00,000	10,00,000	2,00,000	8,00,000	32,00,000

It is possible to take a view that the remaining donations reflected in Column VI which are taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 can be claimed in respect of such donations.

(vii) For this purpose, **"anonymous donation"** means any voluntary contribution referred to in section 2(24)(iia), where the person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed.

Section 115BBC does not apply to trust or institution wholly for religious purposes.

(viii) However, the above provision does not apply to a trust or institution created or established wholly for religious purposes.

(ix) Further, anonymous donations to trusts/institutions created or established wholly for religious and charitable purposes (i.e., partly charitable and partly religious institutions/trusts) would be taxed only if such anonymous donation is made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution. Other anonymous donations received by such trusts/institutions are not taxable.

(x) Section 13(7) provides that the exemption provisions contained in section 11 or section 12 shall not be applicable in respect of any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section.

(xi) For example, section 11(1)(d) provides that any income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution and deposited or invested in modes specified u/s 11(5), shall not be included in the total income of such trust/institution for the relevant previous year. However, if a trust or institution established wholly for charitable purposes receives an anonymous donation with a specific

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direction that the donation shall form part of the corpus of the trust or institution, such anonymous donation would not be exempt by virtue of section 11(1)(d). It would be taxable at 30% as provided in section 115BBC.

(xii) Similarly, section 10(23C) provides that any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income. Consequently, sections 10(23C) and 13 provide that any income by way of any anonymous donation which is taxable under the provisions of section 115BBC shall not be excluded from the total income of the trust or institution.

ILLUSTRATION 14

The following trusts claim that anonymous donations received by them during the financial year 2025-26 are not liable to tax under section 115BBC:

(i) A charitable trust referred to in section 11 which applied the entire amount of anonymous donations for purposes of the trust during the relevant financial year.

(ii) A trust established wholly for religious purposes which applied 85% of the amount of anonymous donations for the purposes of the objects of the trust during the relevant financial year.

Examine the validity of the claim made by the trusts.

SOLUTION

(i) Section 115BBC provides for levy of tax @ 30% on anonymous donation received by, *inter alia*, charitable trusts or institutions referred to in section 11 in the following manner:

(a) the amount of income-tax calculated @30% on the aggregate of anonymous donations received in excess of 5% of the total donations received by the assessee or one lakh rupees, whichever is higher; and

(b) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of the anonymous donations received in excess of 5% of the total donations received by the assessee or ₹ 1 lakh, as the case may be.

Further, section 13(7) provides that the exemption provisions contained in sections 11 and 12 shall not be applicable in respect of any anonymous donation liable to tax under section 115BBC. As such, application of the anonymous donations received by the charitable trust for charitable purposes does not confer any exemption from tax.

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Therefore, the claim for non-taxability under section 115BBC of anonymous donations received by the charitable trust is not valid in law.

However, a view may be taken that anonymous donation upto higher of 5% of total donations or ₹ 1 lakh, which is taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 would apply.

(ii) Section 115BBC(2) provides that the provisions contained in section 115BBC(1) relating to the taxability of anonymous donations are not applicable to any trust or institution created or established wholly for religious purposes. As such, the trust established wholly for religious purposes is not liable to be taxed in respect of the anonymous donations received by it. Therefore, the claim made by the trust is valid in law. The application or non-application of such anonymous donation for the purposes of trust during the relevant financial year is not germane to the issue of taxability under section 115BBC.

9. Taxation of specified income of NPOs chargeable to tax by charitable trusts/institutions [Section 115BBI]

(i) Rate of tax on Specified Income

As per section 115BBI specified income of a trust/institution availing exemption under the first regime [section 10(23C)(iv)/(v)/(vi)/(via))] or second regime [Section 11], would be chargeable at the rate of 30%.

(ii) No deduction for expenditure or allowance

Further, no deduction in respect of any expenditure or allowance or set-off of any loss would be allowed under any provisions of the Income-tax Act, 1961 while computing specified income.

(iii) Meaning of "Specified Income"

"Specified income" means:

(a) income accumulated or set apart in excess of 15% of the income, where such accumulation is not allowed under any specific provision of the Income-tax Act, 1961.

(b) deemed income on account of violation of certain conditions stipulated for accumulation of income under section 11(3) and corresponding provision in section 10(23C).

(c) deemed income on account of violation of deemed application provisions specified under 11(1B) read with *Explanation 1* below to section 11(1).

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(d) any income which is not exempt under section 10(23C) on account of violation of the provisions of clause (b) of the third proviso to section 10(23C) i.e., invested in impermissible mode or which is not excluded from the total income as per section 13(1)(d).

(e) any income which is applied for the benefit of any specified prohibited person referred to in section 13(3).

(f) any income derived from a property held under trust for a charitable purpose which tends to promote international welfare in which India is interested to the extent to which such income is not applied towards charitable purposes outside India.

ILLUSTRATION 15

SR Trust is a registered charitable trust under section 12AB. During the P.Y.2025-26, the trust had applied ₹ 5 lakh for the benefit of the trustee and ₹ 3 lakh for the benefit of Mr. Satish, who has donated ₹ 15 lakh to the trust upto 31.3.2026. Also, an amount of ₹ 2 lakh set apart in the P.Y.2023-24 by the trust for charitable purposes u/s 11(2) has been utilized in the P.Y.2025-26 for making donation to another registered charitable trust with similar object as SR Trust. What is the amount of "specified income" liable to tax@30% under section 115BBI for A.Y. 2026-27?

SOLUTION

Section 115BBI provides for levy of tax @ 30% on certain "specified income" of a trust. Section 115BBI defines "specified income" to include income which has been applied for the benefit of prohibited persons u/s 13(3), which includes, *inter alia*, trustee of the trust and a person who has made substantial contribution to the trust (i.e., whose total contribution during the relevant P.Y. exceeds ₹ 1 lakh or in aggregate upto 31.3.2026 is more than ₹ 10,00,000). Specified income also includes deemed income on account of violation of certain conditions stipulated in section 11(3) for accumulation of income. Donation to another charitable trust out of accumulated income is one such violation. Accordingly, "specified income" of SR Trust liable to tax@30% under section 115BBI for A.Y. 2026-27 would be ₹ 10 lakh [₹ 5 lakh (amount applied for the benefit of the trustee) + ₹ 3 lakh (amount applied for the benefit of Mr. Satish) + ₹ 2 lakh (donation made to another trust out of accumulated income of an earlier previous year].

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10. Tax on accreted income of certain trusts and institutions [Chapter XII-EB]

(1) Background for introduction of Exit Tax

(i) As per section 2(24), "income" includes any voluntary contribution received by a charitable trust or institution or a fund.

(ii) Sections 11 and 12 and section 10(23C)(iv)/(v)/(vi)/(via) provide exemption to trusts or institutions or funds or education institutions or hospitals in respect of income derived from property held under trust and voluntary contributions, subject to the conditions stipulated thereunder.

(iii) The exemption is subject to the condition that the income derived from property held under trust should be applied for charitable purposes; and where such income cannot be applied during the previous year, it has to be accumulated and invested in the modes prescribed and applied for such purposes in accordance with specified conditions.

(iv) If the accumulated income is not applied in accordance with the conditions provided in the said section within a specified time, then such income is deemed to be taxable income of the trust or the institution. Section 12AA or 12AB or section 10(23C) (iv) /(v)/ (vi)/ (via) provides for registration/approval of the trust or institution which entitles them to be able to get the benefit of sections 11 and 12 and section 10(23C) (iv) /(v)/ (vi)/ (via). It also provides the circumstances under which the registration can be cancelled. Section 13 of the Act provides for the circumstances under which exemption under section 11 or 12 or section 10(23C) (iv) /(v)/ (vi)/ (via) in respect of whole or part of income would not be available to a trust or institution or funds or education institutions or hospitals.

(v) A society or a company or a trust or an institution carrying on charitable activity may –

(1) voluntarily wind up its activities and dissolve; or

(2) merge with any other charitable or non-charitable institution; or

(3) convert into a non-charitable organization.

There is, however, no specific provision in the income-tax law as to how the assets of such a charitable institution should be dealt with.

(vi) Under section 11, certain amount of income of prior period can be brought to tax on failure of certain conditions. However, there is no provision in the Income-tax Act, 1961, which ensure that the corpus and asset base of the trust accreted over a period

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of time, with promise of it being used for charitable purpose, continues to be utilised for charitable purposes and is not used for any other purpose.

(vii) Consequently, it is always possible for charitable institutions to transfer assets to a non-charitable institution.

(viii) In order to ensure that the benefit conferred over a period of time by way of exemption is not misused and to plug the gap in law that allows the charitable trusts having built up corpus/wealth through exemptions being converted into non-charitable organisation with no tax consequences, Chapter XII-EB imposes additional income-tax in the nature of an exit tax when the organization is converted into a non-charitable organization or gets merged with a non-charitable organization or does not transfer the assets to another charitable organisation.

(ix) Upto A.Y.2022-23, the provisions of the Chapter XII-EB comprising of sections 115TD, 115TE and 115TF were made applicable to only the trusts or institutions under the second regime. With effect from A.Y. 2023-24, the provisions of Chapter XII-EB also extended to trusts or institutions or fund approved under first regime.

For this purpose, term "specified person" has been inserted to include within its ambit the trust or institution under first regime and provisions of section 115TD, 115TE and 115TF has been amended.

(x) For the purposes of section 115TD, 115TE and 115TF, "Specified person" means

(a) any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C)(iv)/ (v)/ (vi)/(via); or

(b) a trust or institution registered under section 12AA or section 12AB.

(2) Salient Features:

	Section	Provision
(i)	115TD(1)	**<u>Circumstances where levy of tax on accreted income is attracted</u>**: The accreted income of a specified person shall be taxable at the maximum marginal rate@34.944% on – (1) conversion into a form not eligible for grant of registration under section 12AA or section 12AB or approval under section 10(23C) (iv) /(v)/ (vi)/ (via); or

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		(2) merger with an entity not having similar objects and registered under section 12AA or section 12AB or approved under section 10(23C) (iv) /(v)/ (vi)/ (via); or (3) non-distribution of assets on dissolution to any other specified person within a period of 12 months from the end of the month in which the dissolution takes place. This levy of exit tax shall be in addition to income chargeable in the hands of the entity. W.e.f. A.Y. 2025-26, section 12AC has been inserted to provide that where a trust or institution approved under the first regime or registered under the second regime, as the case may be, merges with another trust or institution, the exit tax provisions contained in Chapter XII-EB i.e., exit tax would not apply if – • the other trust or institution has same or similar objects. • the other trust or institution is approved under the first regime or registered under the second regime; and • the said merger fulfils the conditions as may be prescribed.
(ii)	115TD(3)	**Deemed conversion into non-eligible form - Circumstances**: A specified person shall be deemed to have been converted into any form not eligible for registration under section 12AA or section 12AB or approval under section 10(23C) (iv) /(v)/ (vi)/ (via) in a previous year, if, — (i) the registration granted to it under section 12AA or section 12AB or approval under section 10(23C) (iv) /(v)/ (vi)/ (via) has been cancelled; or (ii) it has adopted or undertaken modification of its objects which do not conform to the conditions of registration and,— (a) it has not applied for fresh registration under section 12AA or section 12AB or approval under section 10(23C)(iv) /(v)/ (vi)/ (via) in the said previous year; or (b) it has filed application for fresh registration u/s 12AA or 12AB or approval under section 10(23C) (iv)/(v)/(vi)/(via) but the said application has been rejected; or (iii) it has failed to make an application for – (a) reapproval/re-registration; or

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		(b) renewal of approval/registration where the period of approval/registration is due to expire; or (c) final approval/registration within the period specified under clause (i)/(ii)/(iii) of the first proviso to section 10(23C) or clause (i)/(ii)/(iii) of section 12A(1)(ac), as the case may be, which expires in the said previous year.
(iii)	115TD(2)	**Meaning of Accreted Income**: Aggregate FMV of total assets of the specified person as on the specified date ***Less*** Total liability of the specified person computed in accordance with the prescribed method of valuation *[See Method of Valuation prescribed by CBDT given in pages 10.75 to 10.80]*
		Notes – (1) Accreted income attributable to any asset which is established to have been directly acquired by the specified person out of its agricultural income exempt under section 10(1) would be ignored. Liability, in relation to such asset, also has to be ignored. (2) Accreted income attributable to any asset acquired by the specified person during the period beginning from the date of its creation or establishment and ending on the date from which the registration under section 12AA or section 12AB or approval under section 10(23C) (iv) /(v)/ (vi)/ (via) became effective[6], if the specified person has not been allowed any benefit of sections 11 and 12 or approval under section 10(23C) (iv) /(v)/ (vi)/ (via) during the said period, would be ignored. Liability, in relation to such asset, also has to be ignored. (3) The asset and the liability of the charitable organisation which have been transferred on dissolution to another charitable trust or institution registered under section 12AA or section 12AB or a fund / institution / trust / university / educational institution / hospital / medical institution approved under section 10(23C)

[6]*Where the benefit under sections 11 and 12 or section 10(23C) (iv) /(v)/ (vi)/ (via) have been allowed to the trust or institution in respect of any previous year or years beginning prior to the date from which the registration or approval under section 12AA or 12AB or under section 10(23C) (iv) /(v)/ (vi)/ (via) became effective, then, the registration or approval shall be deemed to have become effective from the first day of the earliest previous year. Accordingly, accreted income attributable to asset acquired during the said period has to be considered. Liability in relation to such asset has to be reduced.*

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		within specified time have to be ignored while calculating accreted income.
		Meaning of specified date [*Explanation* below section 115TD(7)]:

	Case	Specified Date
(i)	conversion of the trust or institution registered u/s 12AA/12AB or approved under section 10(23C) (iv) /(v)/ (vi)/ (via) into a form not eligible for registration u/s 12AA/12AB or under section 10(23C) (iv) /(v)/ (vi)/ (via)	The date of conversion
(ii)	merger with an entity not having similar objects or not registered u/s 12AA/12AB or not approved u/s 10(23C)(iv)/(v)/(vi)/ (via)	The date of merger
(iii)	non-distribution of assets on dissolution to any charitable institution registered u/s 12AA/12AB or approved u/s 10(23C) within a period twelve months from dissolution.	The date of dissolution

Date of conversion [*Explanation* below section 115TD(7)]:

	Case	Specified Date
(i)	Where the registration u/s 12AA/12AB or approval granted under section 10(23C) (iv) /(v)/ (vi)/ (via) has been cancelled	The date of the order cancelling registration u/s 12AA/12AB or approval under section 10(23C) (iv)/ (v)/(vi)/ (via)
(ii)	Where it has adopted or undertaken modification of its objects which do not conform to the conditions of registration/ approval and has not made an application for fresh registration/approval or the application made has been rejected.	The date of adoption or modification of any object.
(iii)	Where it has failed to make an application for – (a) reapproval/re-registration, (b) renewal of approval/ registration where the period of approval/ registration is due to expire, or	The last date for making an application for registration or approval

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			(c) final approval/registration within the period specified under clause (i)/(ii)/(iii) of the first proviso to section 10(23C) or clause (i)/(ii)/(iii) of section 12A(1)(ac), as the case may be, which expires in the said previous year.	
(iv)	115TD(4)	**<u>Exit tax payable even if no income-tax is payable by the specified person</u>**: Even if no income-tax is payable by the specified person on its total income, tax on accreted income shall be payable by the trust or institution, like any other additional income-tax.		
(v)	115TD(5)	**Period within which tax on accreted income has to be paid to the credit of the Central Government:** The principal officer or the trustee of the specified person, as the case may be, and the specified person shall also be liable to pay the tax on accreted income to the credit of the Central Government **<u>within fourteen days from,—</u>**		

	Circumstance	Relevant date
(1)	Where the registration or approval granted u/s 12AA/12AB or u/s 10(23C)(iv)/(v)/ (vi)/(via) has been cancelled	the date on which – (a) the period for filing appeal under section 253 against the order cancelling the registration expires and no appeal has been filed by the specified person; (or) (b) the order in any appeal, confirming the cancellation of the registration, is received by the specified person.
(2)	(i) Where the trust has modified its objects and has not applied for fresh registration u/s 12AA/12AB or approval under section 10(23C)(iv)/ (v)/ (vi)/ (via) (ii) where the trust has failed to apply for –	the end of the previous year

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				(a) re-registration/re-approval; or (b) renewal of registration/ approval, where the period of validity of registration or approval set to expire; or (c) final registration/ approval within the specified time period which expires in the relevant P.Y.	
			(3)	Where the trust has modified its objects and has filed application for fresh registration u/s 12AA/12AB or approval under section 10(23C)(iv)/ (v)/(vi)/(via) but the same was rejected	the date on which – (a) the period for filing appeal under section 253 against the order rejecting the application expires an no appeal has been filed by the specified person; (or) (b) the order in any appeal, confirming the cancellation of the application, is received by the specified person
			(4)	Where trust has merged with an entity not having similar objects or not registered u/s 12AA/12AB or not approved under section 10(23C) (iv) /(v)/ (vi)/ (via)	the date of merger
			(5)	Where the trust fails to transfer upon dissolution all its assets to another registered trust or institution or approved fund or institution within 12 months from the end of the month in which the dissolution takes place	the date on which the period of 12 months expires.

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(vi)	115TD(6)	**No credit available for tax paid on accreted income:** The tax on accreted income shall be treated as final payment of tax in respect of such income for which no credit can be taken by the specified person or any other person.
(vii)	115TD(7)	**Non-availability of deduction under any other provision of the Act**: No deduction is allowable under any other provision of the Act to the specified person or any other person in respect of the income which has been charged to tax or the tax thereon.
(viii)	115TE	**Interest for non-payment of tax within prescribed time**: In case of failure of payment of tax within the prescribed time, a simple interest@1% p.m. or part of it shall be applicable for the period of non-payment. **Period of non-payment:** Beginning from: The date immediately after the last date on which such tax was payable Ending with: The date on which the tax is actually paid.
(ix)	115TF	**Circumstance when specified person is deemed to be assessee-in-default**: The principal officer or the trustee and specified person shall be deemed to be assessee-in-default for non-payment of tax and all provisions related to the recovery of taxes shall apply. Further, in the case of transfer of assets upon dissolution of the trust or institution to a recipient, which is not a charitable organisation, the recipient of assets of the trust shall also be liable to be held as assessee-in-default in case of non-payment of tax and interest. However, in such a case, the recipient's liability shall be limited to the extent to which the assets received by him is capable of meeting the liability.

Note - As per section 115TD(2), "Accreted Income" means the aggregate FMV of total assets of the specified person as on the specified date less total liability of such specified person computed in accordance with the prescribed method of valuation. Accordingly, Rule 17CB provide for method of valuation of assets and liabilities.

Method of valuation for the purposes of section 115TD(2)

Rule	Provision
(1)	The aggregate fair market value of the total assets of the specified person, shall be the aggregate of the fair market value of all the assets in the balance sheet **as reduced by—**

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	(i) any amount of income-tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act, and (ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset.
(2)	The fair market value of the asset shall be determined in the following manner, namely –

(I) Shares and securities		
(a)	**Quoted shares and securities**	(i) the **average of the lowest and highest price of such shares and securities** quoted on a recognised stock exchange as on the specified date; or (ii) where on the specified date, there is **no trading** in such shares and securities on a recognised stock exchange, the **average of the lowest and highest price of such shares and securities on a recognised stock exchange on a date immediately preceding the specified date** when such shares and securities were traded on a recognised stock exchange,
(b)	**Unquoted equity shares**	$\frac{(A+B-L)\times(PV)}{PE}$ where, A = book value of all the assets in the balance sheet (other than bullion, jewellery, precious stone, artistic work, shares, securities, and immovable property) as reduced by- (i) any amount of income-tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act; and (ii) any amount shown in the balance sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

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				B = fair market value of bullion, jewellery, precious stone, artistic work, shares, securities and immovable property as determined in the manner provided in this rule; L= book value of liabilities shown in the balance sheet, but not including the following amounts, namely: — (i) representing contingent liabilities other than arrears of dividends payable in respect of the paid-up capital in respect of equity shares; (ii) the amount set apart for payment of dividends on preference shares and equity shares; (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation; (iv) any amount representing provision for taxation, other than amount of income-tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto; (v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities; (vi) any amount of cumulative preference shares; PE = total amount of paid up equity share capital as shown in the balance-sheet; PV = the paid up value of such equity share.
		(c)	**Shares and securities other than equity shares**	The fair market value of shares and securities other than equity shares shall be estimated to be price it would fetch if sold in the open market on the specified date on the basis of the

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			valuation report from a merchant banker or an accountant in respect of such valuation.
	II. Immovable property		
		The fair market value of an immovable property shall be higher of the following: (a) price that the property shall ordinarily fetch if sold in the open market on the specified date on the basis of the valuation report from a registered valuer; and (b) stamp duty value as on the specified date.	
	III. A business undertaking		
		The fair market value of a business undertaking, held by a specified person, shall be its net assets determined in accordance with the following formula: Fair market value = (A + B - L), The value of A, B and L would be determined in the same manner as discussed above in the case of unquoted equity shares.	
	IV. Any other asset		
		The fair market value of any asset, other than those referred to in (I), (II) and (III), shall be the price that the asset shall ordinarily fetch if sold in the open market on the specified date on the basis of valuation report from a registered valuer. However, in case no valuer is registered for valuation of such assets, the valuation report shall be obtained from a valuer who is a member of any one of the professional valuer bodies viz. Institution of Valuers, Institution of Surveyors (Valuation Branch), Institution of Government Approved Valuers, Practicing Valuers Association of India, the Indian Institution of Valuers, Centre for Valuation Studies, Research and Training, Royal institute of Chartered Surveyors; India Chapter, American Society of Appraisers, USA; Appraisal institute, USA or a valuer who is appointed by any public sector bank or public sector undertakings for valuation purposes.	
(3)	The total liability of the specified person shall be the book value of liabilities in the balance sheet on the specified date but not including the following amounts, namely - (i) capital fund or accumulated funds or corpus, by whatever name called; (ii) reserves or surpluses or excess of income over expenditure, by whatever name called; (iii) any amount representing contingent liability; (iv) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;		

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	(v) any amount representing provision for taxation, other than the amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of income-tax claimed as refund under the Act, to the extent of the excess over the income-tax payable with reference to the income in accordance with the law applicable thereto.
Expla-nation	**Meaning of certain terms**

Term	Meaning
Accountant	A fellow of the Institute of Chartered Accountants of India within the meaning of the Chartered Accountants Act, 1949 who is not appointed by the specified person as an auditor;
Balance sheet	The Balance Sheet of such specified person (including the notes annexed thereto and forming part of the accounts) as drawn up on the specified date which has been audited by an accountant.
Quoted share or security	A share or security quoted on any recognised stock exchange with regularity from time to time, where the quotations of such shares or securities are based on current transaction made in the ordinary course of business;
Specified date	The date referred to in *Explanation* to section 115TD of the Act.

Meaning of specified date [*Explanation* below section 115TD]:

	Case	Specified Date
(i)	Conversion into a form not eligible for registration u/s 12AA/12AB *or* approved u/s 10(23C)(vi)/(v)/(vi)/(via)	The date of conversion

Date of conversion

(a) date of order cancelling registration or approval

(b) date of adoption or modification of any object

(c) last date for making an application for renewal of registration/ approval or re-registration/re-approval where the period of validity set to expire or final registration/approval

(ii)	merger with an entity not having similar objects or not registered u/s 12AA/12AB or not approved u/s 10(23C)(vi)/(v)/(vi)/(via)	The date of merger
(iii)	non-distribution of assets on dissolution to any charitable	The date of dissolution

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			institution registered u/s 12AA/12AB or approved u/s 10(23C) within a period twelve months from dissolution	
	Stamp duty value	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.		
	Unquoted share and security	Share or security which is not a quoted share or security.		

10.3 TAXATION OF DISCRETIONARY TRUSTS

Section 164 deals with taxation of trustees of discretionary trusts. This section applies in the case of a representative assessee referred to in section 160(1)(iii)/(iv) in a case where any income or part thereof is not specifically receivable on behalf of or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown.

The representative assessees referred to in clauses (iii) and (iv) of section 160(1) are the Court of Wards, the Administrator General, the Official Trustee or any receiver or manager including any person whatever his designation who in fact manages the property on behalf of another, appointed by or under any order of a Court and a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise (including any Wakf Validating Act, 1913).

Such a discretionary trust will be liable to tax at the maximum marginal rate of income-tax on their entire income.

With a view to obviating hardship in genuine cases where the circumstances are such that tax evasion could not be considered to be main purpose of creating a trust, certain exceptions have been specified where the trust would not be taxed at the maximum marginal rate. The exceptions are as under:

(1) Where none of the beneficiaries has any other income chargeable to tax exceeding the maximum amount not chargeable to income-tax in the case of an AOP and none of the beneficiaries is a beneficiary under any other trust; or

(2) Where the relevant income or part of the relevant income is receivable under a trust declared by any person by a will and such trust is the only trust so declared under the will.

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(3) the relevant income or part of relevant income is receivable under a trust created before 1.3.1970 by a non-testamentary instrument and the Assessing Officer is satisfied that the trust was so created bona fide exclusively for benefit of the dependent relatives of settlor or where the settlor is a HUF for the benefit of the members of such families in circumstances where such relatives or members are mainly dependent on the settlor for their support and maintenance.

(4) In cases where the relevant income is receivable by the trustee on behalf of provident fund, superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or professions.

In the above four cases the income of the trustees will not be taxed at the maximum marginal rate. The relevant income or part of relevant income will be taxable as if it were the total income of an AOP.

Where any income in respect of which a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise, is liable as a representative assessee consists of, or includes, profits and gains of business, the above concessional treatment i.e. assessing the income at the rate applicable to an AOP will apply only if such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

For the purposes of these provisions, a trust under which a discretionary power is given to the trustees to decide the allocation of the income every year or a right is given to the beneficiary to exercise the option to receive the income or not each year will all be regarded as discretionary trusts and assessed accordingly. This is made clear in *Explanation 1* to section 164 which provides as under:

(a) Any income in respect of which the Court of Wards, the Administrator General, the Official Trustee, receiver, manager or trustee appointed under a trust declared by a duly executed instrument in writing (including Wakf deed) is liable as a representative assessee or any part thereof shall be regarded as not being specifically receivable on behalf or for the benefit of any person unless the person on whose behalf or for whose benefit such income or such part thereof is receivable during the previous year is expressly stated in the order of the Court or the instruments of trust or wakf deed, as the case may be, and is identifiable as such on the date of such order, instrument or deed.

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(b) The individual shares of the person on whose behalf or for whose benefit such income or part thereof is receivable will be regarded as indeterminate or unknown unless the individual shares of such persons are expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and are ascertainable as such on the date of such order, instrument or deed.

This Explanation seeks to prevent trustees and beneficiaries from manipulating the arrangements in such a manner that a discretionary trust is converted into a specific trust whenever it suits them tax-wise.

(1) Income from property held under trust wholly for charitable or religious purposes [Section 164(2)]: In case the relevant income, (in respect of which the shares of the beneficiaries are indeterminate or unknown), is derived from property held under trust wholly for charitable or religious purpose or which is of the nature referred to in section 2(24)(iia) [voluntary contributions received by a trust] or which is of the nature referred to in sub-section (4A) of section 11 [business income received by a trust], the tax shall be charged on so much of the income as is not exempt under section 11 or section 12 as if the income not so exempt were the relevant income of an association of persons.

However, where the whole or any part of the relevant income is not exempt under section 11 or section 12 because any income thereof is for the benefit of prohibited persons or the rules with regard to investments in specified channels have not been followed, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

(2) Income from property held under trust partly for charitable or religious purposes and partly for other purposes [Section 164(3)]: In case the relevant income is derived from property held under trust partly for charitable or religious purposes and partly for other purposes or which is of the nature referred to in section 2(24)(iia) (voluntary contributions received by a trust) or which is of the nature referred to in sub-section (4A) of section 11 (business income received by a trust) and the individual share of the beneficiaries in the income applicable to purposes other than charitable or religious purposes is not known, tax liability will be the aggregate of the following:

(a) the tax which would be chargeable on that part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income, if any, which is exempt under section 11 as if such part (or such part so reduced) were the total income of the association of persons; and

(b) the tax on that part of the relevant income which is applicable to purposes other than charitable or religious purposes, and which is either not specifically receivable on

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behalf of or for the benefit of any one person or in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate.

However, in the following cases, income will be charged to tax as if it were income of an association of persons:

(a) where none of the beneficiaries has any other income chargeable to tax exceeding the maximum amount not chargeable to income-tax in the case of an AOP and none of the beneficiaries is a beneficiary under any other trust; or

(b) where the relevant income is receivable under a trust created by will and such trust is the only trust so declared by him; and

(c) where the trust is a non-testamentary one created before March 1, 1970 for the exclusive benefit (to the extent it is not utilised for charitable or religious purposes) of relatives of the settler mainly dependent on the settler for their support or maintenance or where settler is a Hindu undivided family, for the exclusive benefit of its members so dependent upon it.

Where the relevant income consists of or includes profits and gains of business, the preceding concessional method of taxation shall apply only if the income is receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

Where the whole or any part of the relevant income is not exempt under section 11 or section 12 because any income thereof is for the benefit of prohibited persons or the rules with regard to investment in specified channels have not been followed, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

(3) **Taxation of Oral Trusts [Section 164A]:** Oral Trust is a trust which is not declared by a duly executed instrument in writing. As per section 164A, any income which a trustee receives or is entitled to receive on behalf of or for the benefit of any person under an oral trust will be chargeable to income tax at the maximum marginal rate.

However, such trust shall be deemed to be a trust declared by a duly executed instrument in writing if a statement in writing, signed by the trustee or trustees, setting out the purpose or purposes of the trust, particulars as to the trustee or trustees, the beneficiary or beneficiaries and the trust property, is forwarded to the Assessing Officer within three months from the date of declaration of the trust.

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(4) **Case where part of trust income is chargeable [Section 165]:** In cases where only some portion of the trust's income to which the beneficiary or beneficiaries is/are entitled is taxable and the other portion is not taxable, the taxable portion of the income received by him from the trust as a beneficiary shall be only such portion thereof as bears to the whole income of the trust. In other words, where a part only of the trust income is chargeable to tax under this Act, the beneficiaries' share of the income should be taken to be that derived proportionately from the chargeable and non-chargeable portions of the trust income.

10.4 SPECIAL PROVISIONS RELATING TO INCOME OF POLITICAL PARTIES [SECTION 13A]

Section 13A of the Income-tax Act, 1961 grants exemption from tax to political parties in respect of their income specified below:

The aforesaid categories of income would qualify for exemption provided additional conditions for availing the benefit of the said section which are as under are met :

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Meaning of "Political Party" and "Electoral bond":

Political Party	A political party registered under section 29A of the Representation of the People Act, 1951
Electoral Bond	A bond issued by a scheduled bank (as authorised by the Central Government) under a scheme notified by the Central Government.

ILLUSTRATION 16

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2026 in following case shall be subject to tax in the A.Y. 2026-27:

A political party, duly registered under section 29A of the Representation of the People Act, 1951, received rent of ₹ 1,25,000 per month of one of its building let out to a bank from 01.06.2025.

SOLUTION

Rent received by the political party from the bank is an income chargeable under the head "Income from house property". However, according to the provisions of section 13A, income from, *inter alia*, house property shall not be included in total income of a political party registered under section 29A of the Representation of the People Act, 1951, provided the political party fulfils the conditions as specified therein including furnishing a return of income for the previous year in accordance with the provisions of section 139(4B) on or before the due date under section 139. Therefore, if the stipulated conditions are fulfilled by the political party, rent of ₹ 1,25,000 per month received by the registered political party from letting out of its building to a bank would not be included in its total income.

ILLUSTRATION 17

The books of account maintained by a National Political Party registered with Election Commission for the year ended on 31.3.2026 discloses the following receipts:

		₹
(a)	*Rent of property let out to a departmental store at Chennai*	*6,00,000*
(b)	*Interest on deposits other than banks*	*5,00,000*
(c)	*Contribution of ₹ 21,000 each from 100 persons (who have secreted their names)*	*21,00,000*
(d)	*Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each*	*2,50,000*
(e)	*Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)*	*21,00,000*
(f)	*Net profit of cafeteria run in the premises at Delhi*	*3,00,000*

Compute the total income of the political party for the assessment year 2026-27, with reasons for inclusion or otherwise.

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SOLUTION

The total income of a political party registered with the Election Commission is to be computed as per section 13A under which the income derived from house property, income from other sources and income by way of voluntary contributions received from any person, on fulfilling of the conditions as mentioned thereunder, are exempt from tax. However, in this case, since cash contribution in excess of ₹ 2,000 is received from 1000 persons, the political party has violated the condition of receipt of donation through account payee cheque/draft or prescribed electronic modes. Further, the political party has also violated the condition of maintenance of records in case of donations exceeding ₹ 20,000 received otherwise than by way of electoral bonds. Hence, its total income has to be computed as under without providing for exemption available under section 13A:

Computation of total income of National Political Party

	Particulars	₹
(a)	The rent of the property of ₹ 6 lacs located at Chennai [assuming the same to be the Gross Annual Value] less 30% of ₹ 6 lacs, being deduction u/s 24	4,20,000
(b)	Interest received on deposits	5,00,000
(c)	Contribution from 100 persons (who have secreted their names) of ₹ 21,000 each	21,00,000
(d)	Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each	2,50,000
(e)	Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)	21,00,000
(f)	Net profit of cafeteria at Delhi	3,00,000
Total Income		**56,70,000**

Note – Alternatively, the political party can contend that only ₹ 45 lakh is taxable on account of non-maintenance of records and receipt of cash donations, in which case the total income would be computed as under:

Computation of total income of National Political Party

	Particulars	₹
(a)	Rent of the property of ₹ 6 lacs located at Chennai	Exempt
(b)	Interest received on deposits	Exempt
(c)	Contribution from 100 persons (who have secreted their names) of ₹ 21,000 each	21,00,000
(d)	Contribution from 10 persons by way of electoral bonds of ₹ 25,000 each	Exempt
(e)	Cash contribution @ ₹ 2,100 each from 1,000 members (recorded in books of account)	21,00,000
(f)	Net profit of cafeteria at Delhi	3,00,000
	Total Income	**45,00,000**

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Note: *It is presumed that the conditions regarding maintenance of books of account, audit, submission of report under section 29C of the Representation of the People Act, 1951 and filing of return of income under section 139(4B) are fulfilled by the political party, and hence it is eligible for exemption of income under section 13A.*

10.5 SPECIAL PROVISIONS RELATING TO VOLUNTARY CONTRIBUTIONS RECEIVED BY ELECTORAL TRUSTS [SECTION 13B]

(1) **Voluntary contribution treated as income:** Any voluntary contribution received by an electoral trust (as may be approved by the CBDT in accordance with the scheme to be made by the Central Government) shall be treated as its income under section 2(24).

(2) **Conditions for availing exemption under section 13B:** Any voluntary contributions received by an electoral trust would be exempt, if such electoral trust:

(I) distributes to a registered political party during the previous year, 95% of the aggregate donations received by it during the year along with the surplus if any, brought forward from any earlier previous year and

(II) function in accordance with the rules made by the Central Government.

(3) **Functions of an electoral trust:** Accordingly, the Central Government has notified Rule 17CA which provides that the following shall be the functions of an electoral trust referred to in section 13B –

(i) The electoral trust may receive voluntary contributions from

(a) an individual who is a citizen of India;

(b) a company which is registered in India; and

(c) a firm or Hindu undivided family or an Association of persons or a body of individuals, resident in India.

(ii) A receipt indicating the following shall be issued by the trust immediately on receipt of any contribution indicating the following:

(a) name and address of the contributor;

(b) Permanent account number of the contributor or passport number in the case of a citizen who is not a resident;

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(c) amount and mode of contribution including name and branch of the Bank and date of receipt of such contribution;

(d) name of the electoral trust;

(e) Permanent account number of the electoral trust;

(f) date and number of approval by the prescribed authority; and

(g) Name and designation of the person issuing the receipt.

(iii) The electoral trust shall not accept contributions-

(a) from an individual who is not a citizen of India or from any foreign entity whether incorporated or not;

(b) from any other electoral trust which has been registered a company under section 25 of the Companies Act, 1956[7] and approved as an electoral trust under the Electoral Trusts Scheme, 2013;

(c) from a Government company as defined in section 2(45) of the Companies Act, 2013; and

(d) from a foreign source as defined in section 2(j) of the Foreign Contribution (Regulation) Act, 2010.

(iv) The electoral trust shall accept contributions only by way of an account payee cheque drawn on a bank or account payee bank draft or by electronic transfer to its bank account and shall not accept any contribution in cash.

(v) The electoral trust shall not accept any contribution without the PAN of the contributor, who is a resident and the passport number in the case of a citizen of India, who is not a resident.

(vi) A political party registered under section 29A of the Representation of the People Act, 1951 shall be an eligible political party and an electoral trust shall distribute funds only to the eligible political parties.

(vii) (a) The electoral trust may, for the purposes of managing its affairs, spend upto 5% of the total contributions received in a year subject to an aggregate limit of ₹ 5 lakh in the first year of incorporation and ₹ 3 lakh in subsequent years;

[7]Section 8 of the Companies Act, 2013

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(b) the total contributions received in any financial year alongwith the surplus from any earlier financial year, if any, as reduced by the amount spent on managing its affairs, shall be the distributable contributions for the financial year;

(c) an electoral trust shall be required to distribute the distributable contributions received in a financial year, referred to in point (b) above, to the eligible political parties before 31st March of the said financial year, subject to the condition that at least 95% of the total contributions received during the financial year along with the surplus brought forward from earlier financial year, if any, are distributed.

(viii) The trust shall obtain a receipt from the eligible political party indicating the name of the political party, its permanent account number, registration number, amount of fund received from the trust, date of the receipt and name and designation of person signing such receipt.

(ix) The electoral trust shall not utilize any contributions for the direct or indirect benefit of the members or contributors, or for any of the following persons, namely:

(a) the members (including members of its Executive Committee, Governing Committee or Board of Directors) of the electoral trust;

(b) any relative of such Members;

(c) where such member or contributor is a Hindu undivided family, a member of that Hindu undivided family;

(d) any person who has made a contribution to the trust;

(e) any person referred in section 13(3); and

(f) any concern in which any of the persons referred to in clauses (a),(b),(c),(d) and (e) has a substantial interest.

(x) (a) An electoral trust shall keep and maintain such books of account and other documents in respect of its receipts, distributions and expenditure as may enable the computation of its total income in accordance with the provisions of the Act;

(b) The electoral trust shall also maintain a list of persons from whom contributions have been received and to whom the same have been distributed, containing the name, address and permanent account number (PAN) of each such person

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along with the details of the amount and mode of its payment including the name and branch of the bank.

(xi) Every electoral trust shall get its accounts audited by an accountant as defined in the *Explanation* below section 288(2) and furnish the audit report in Form No.10BC along with particulars forming part of its Annexure, to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, having jurisdiction over the electoral trust, on or before the due date specified for furnishing the return of income by a company under section 139.

(xii) An electoral trust shall maintain a regular record of proceedings of all meetings and decisions taken therein.

(xiii) Every electoral trust shall furnish a certified copy of list of contributors and a list of political parties, to whom sums were distributed in the manner prescribed in (vii) above, to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, every year along with the audit report;

(xiv) Any change in the shareholders, subsequent to the approval granted under the Electoral Trusts Scheme, 2013 shall be intimated to the Board within thirty days of such change.

Section 2(22AAA) defines 'Electoral Trust' to mean a trust so approved by the CBDT, in accordance with the scheme made in this regard by the Central Government.

In exercise of the powers conferred by section 2(22AAA), the Central Government, has through *Notification No.9/2013 dated 31.1.2013*, notified the Electoral Trusts Scheme, 2013 to lay down the procedure for grant of approval to an electoral trust which will receive voluntary contributions and distribute the same to political parties.

Eligibility

A company registered for the purposes of section 25 of the Companies Act, 1956 satisfying all of the following conditions shall be eligible to make an application for approval as an electoral trust, namely –

1. The company should be registered on or after 1.4.2012 for the purposes of section 25 of the Companies Act, 1956;

2. The name of the company registered for the purposes of section 25 of the Companies Act, 1956 has to include the phrase "electoral trust";

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3. The sole object of the electoral trust should be to distribute the contributions received by it to the political party, registered under section 29A of the Representation of the People Act, 1951;

4. The electoral trust should have a permanent account number.

Criteria for Approval

An electoral trust shall be considered for approval if it fulfills all of the following conditions, namely –

1. The company registered for the purposes of section 25 of the Companies Act, 1956, which satisfies the above conditions;

2. The object of the electoral trust shall not be to earn any profit or pass any direct or indirect benefit to its members or contributors, or to any person referred to in section 13(3) or any person referred to in Rule 17CA(10) of the Rules;

3. It has made adequate arrangement for recording the receipts from the contributors in accordance with Rule 17CA;

4. The stipulations contained in Rule 17CA for functioning of the electoral trust are specifically included in the articles of association of the company registered for the purposes of section 25 of the Companies Act, 1956.

Renewal of approval

1. The approval shall be valid for the assessment year relevant to the financial year in which such application has been made and for a further period, not exceeding three assessment years, as may be specified in the approval.

2. The electoral trust may apply for renewal of approval at any time during the financial year immediately preceding the last assessment year, for which the approval has been originally granted, and such renewal of approval may be granted after examining the application in the same manner as laid out for approval in this scheme.

Withdrawal of approval

1. The CBDT may withdraw the approval granted under this Scheme if it is satisfied that the electoral trust has ceased its activities or its activities are not genuine or are not carried out in accordance with all or any of the conditions laid down under this Scheme or the provisions of Rule 17CA of the Rules, or any other condition imposed in the approval granted.

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2. In order to ascertain whether an electoral trust, after its approval, is functioning in accordance with the provisions of Rule 17CA of the Rules, the CBDT may call for information or documents as it may deem fit from the electoral trust or may get an enquiry conducted in this regard by an income-tax authority or any other agency.

3. If the Commissioner of Income-tax or the Director of Income-tax is satisfied that an approved electoral trust is not fulfilling any of the conditions specified under this Scheme or the conditions subject to which approval was granted to it or does not function in accordance with Rule 17CA, he may, after making appropriate enquiries, furnish a report to the CBDT in this regard and the Board may take such action on the report as it may deem fit.

4. An order for withdrawal of the approval shall be passed after giving the electoral trust an opportunity of being heard, and shall record the reasons in writing for the withdrawal of approval.

5. A copy of the order withdrawing the approval shall be sent to the applicant, the Assessing Officer and the Commissioner of Income-tax or the Director of Income-tax, as the case may be.

10.6 TAXATION REGIME FOR SECURITIZATION TRUSTS AND ITS INVESTORS

(1) Meaning of Securitisation Trust [Clause (d) of *Explanation* below section 115TCA]:

"Securitisation trust" means a trust being a special purpose distinct entity or a special purpose vehicle (as per the guidelines on securitisation of standard assets issued by RBI) or a trust setup by a securitisation company or a reconstruction company, which fulfils such conditions, as may be prescribed.

(2) Exemption of income of securitisation trust from the activity of securitisation:

The income of securitisation trust from the activity of securitisation shall be exempt under section 10(23DA).

(3) Taxability of income from securitisation trust in the hands of the investor [Section 115TCA(1)]:

Section 115TCA(1) provides that any income accruing or arising to, or received by, a person, being an investor from the securitisation trust, out of investments made in the securitisation trust, shall be taxable in the hands of investor in the same manner as if the investor had made investment directly in the underlying assets and not through the trust.

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(4) Nature of income paid or credited by securitisation trust in the hands of the investor [Section 115TCA(2)]:

The income paid or credited by the securitisation trust shall be deemed to be of the same nature and in the same proportion in the hands of the investor of the securitisation trust, as if it had been received by, or had accrued and arisen to, the securitisation trust during the previous year.

(5) Deemed credit to investor [Section 115TCA(3)]:

If the income accruing or arising to, or received by, the securitisation trust, during a previous year has not been paid or credited to the investor, the same shall be deemed to have been credited to the account of the said person on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year.

(6) Statement specifying the details of nature of income to be furnished to investor and prescribed income-tax authority [Section 115TCA(4)]:

The securitisation trust shall provide breakup regarding nature and proportion of its income and such other relevant details to the investors and also to the prescribed income-tax authority in the prescribed form and verified in the prescribed manner, within the prescribed period.

(7) Income taxed in the year of accrual not taxable again in the year of payment [Section 115TCA(5)]:

Where income has been included in the total income of the investor in a previous year, on account of it having accrued or arisen in the said previous year, the same shall not be included in the total income of such person in the previous year in which such income is actually paid to him by the securitisation trust.

(8) Deduction of tax at source in respect of income payable to investor [Section 194LBC]:

Tax deduction at source under section 194LBC shall be effected by the securitisation trust at the time of payment or credit of income to the account of the investor, whichever is earlier.

S. No	Payee	Rate of TDS
(i)	Resident payees	***10%***
(ii)	Non-corporate non-residents and foreign companies	Rates in force

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Where any income as aforesaid is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and tax has to be deducted at source. The account to which such income is credited may be called "Suspense account" or by any other name.

(9) Application for low or nil deduction of tax at source:

The facility for the investors to obtain low or nil deduction of tax certificate would be available; the investor can make an application to the Assessing Officer, and he can, on an application made by the assessee in this behalf, issue a certificate under section 197 in this behalf for no deduction of income-tax or deduction of income-tax at a lower rate.

(10) Meaning of certain terms:

Explanation	Term	Meaning
(a)	Investor	A person who is holder of any securitised debt instrument or securities, or security receipt issued by the securitisation trust
(b)	Securities	Debt securities issued by a Special Purpose Vehicle as referred to in the guidelines on securitisation of standard assets issued by RBI

10.7 SCHEME FOR TAXATION OF REAL ESTATE INVESTMENT TRUST (REIT) AND INFRASTRUCTURE INVESTMENT TRUST (INVIT) [CHAPTER XII-FA – SECTION 115UA]

(1) The SEBI has notified the regulations relating to two categories of investment vehicles namely, the Real Estate Investment Trust (REIT) & Infrastructure Investment Trust (Invit).

(2) The SEBI (Real Estate Investment Trusts) Regulations, 2014 ("REIT Regulations") provide a framework for registration and regulation of Real Estate Investment Trusts ("REIT's").

Salient features of the REIT Regulations, as approved by the SEBI:

(a) REITs shall be set up as a trust and registered with SEBI. It shall have parties such as Trustee, Sponsor group, inducted sponsor and Manager.

(b) The trustee of a REIT means a person who holds the REIT assets in trust for the benefit of the unit holders, in accordance with these regulations. The trustee has to registered with the Board as Debenture Trustee and should not be an associate of the sponsor(s) or manager.

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(c) REIT shall invest in commercial real estate assets, on a freehold or leasehold basis, either directly or through a holdco and/or special purpose vehicles (SPVs). Real estate for the purpose of REIT Regulations means land and any permanently attached improvements to it, whether leasehold or freehold and includes buildings, sheds, garages, fences, fittings, fixtures, warehouses, car parks, etc. and any other assets incidental to the ownership of real estate but does not include mortgage.

(d) Once registered, the REIT shall raise funds through an initial offer. Subsequent raising of funds may be through follow-on offer, rights issue, qualified institutional placement, etc.

(e) Units of REITs shall be mandatorily listed on a recognized Stock Exchange and REIT shall make continuous disclosures in terms of the listing agreement.

(f) Not less than 80% of the value of the REIT assets shall be invested in completed and rent and/or income generating properties.

Upto 20% of the value of REIT assets shall be invested in following:

(1) developmental properties, whether directly or through a company or LLP;

(2) mortgage backed securities;

(3) listed/ unlisted debt of companies/body corporates in real estate sector;

(4) equity shares of companies which are listed on a recognized stock exchange in India which derive not less than 75% of their operating income from Real Estate activity;

(5) unlisted equity shares of companies which derive not less than 75% of their operating income from real estate activity

(6) government securities;

(7) unutilized FSI of a project where it has already made investment;

(8) TDR acquired for the purpose of utilization with respect to a project where it has already made investment;

(9) money market instruments or cash equivalents.

(g) REIT shall distribute not less than 90% of the net distributable cash flows, subject to applicable laws, to its unitholders, at-least on a half yearly basis.

(h) A REIT shall not invest in units of other REITs.

(3) Likewise, the SEBI (Infrastructure Investment Trusts) Regulations, 2014 ("InvIT Regulations") provide a framework for registration and regulation of Infrastructure Investment Trusts ("InvITs").

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(4) The Finance (No.2) Act, 2014 had introduced a special taxation regime for providing the manner of taxability of –

(i) income in the hands of business trusts; and

(ii) income distributed by such business trusts in the hands of the unit holders.

Section 2(13A) of the Income-tax Act, 1961 defines a business trust to mean a trust registered as an Infrastructure Investment Trust (Invit) under SEBI (Infrastructure Investment Trusts) Regulations, 2014 or as a Real Estate Investment Trust (REIT) under SEBI (Real Estate Investment Trusts) Regulations, 2014.

Chapter XII-FA contains the special provisions relating to business trusts. Section 115UA(1) provides that any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder, as it had been received by, or accrued to the business trust.

However, as per section 115UA(3A), any sum other than the following components of income–

(i) interest and dividend (received from SPV and distributed to unit holders)

(ii) rental income from directly owned real estate assets distributed to unitholders

(iii) income chargeable to tax in the hands of the business trust under section 115UA(2)

received by a unit holder from a business trust which is chargeable to tax under section 56(2)(xii) in the hands of unitholders under the head "Income from Other Sources" would not be deemed to be of same nature. Such sum chargeable to tax under section 56(2)(xii) would include repayment of debt or amount paid against redemption of units to the unit holders.

(5) Exemption of certain income to business trust [Section 10(23FC)]

Section 10(23FC) exempts any income of a business trust by way of-

- interest or dividend received or receivable from a Special Purpose Vehicle (SPV). Thus, the business trust enjoys a pass-through status in respect of interest or dividend received or receivable from a SPV.

"SPV" means any Indian company, -

(i) in which the REIT holds or proposes to hold not less than 50% of the equity share capital or interest;

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(ii)	which holds not less than 80% of its assets directly in properties and does not invest in other special purpose vehicles; and
(iii)	which is not engaged in any activity other than holding and developing property and any other activity incidental to such holding or development;

(6) Exemption of Rental income of REIT from directly owned real estate asset [Section 10(23FCA)]

Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the business trust.

(7) Any distributed income referred to in section 115UA received by unit holders is exempt in their hands under section 10(23FD) to the extent it does not comprise of

- interest referred to in sub-clause (a) of section 10(23FC) (interest income from SPV distributed to unitholders) or
- dividend income referred to in section 10(23FC)(b) from a special purpose vehicle which has exercised option under section 115BAA and distributed to unit holders or
- rental income referred to in section 10(23FCA) (rental income from directly owned real estate assets).

(8) Section 115UA(2) provides that subject to the provisions of sections 111A and 112, the total income of a business trust shall be chargeable to tax at the maximum marginal rate.

(9) Section 56(2)(xii) provides that any specified sum received by a unit holder from a business trust during the previous year with respect to unit held by him at any time during the previous year would be chargeable to tax in the hands of unit holder under the head "Income from other sources.

Specified sum is to be computed in the following manner:

Specified sum = A (-) B (-) C (which shall be zero if sum of B and C is greater than A)	
A	aggregate of sum distributed by the business trust with respect to such unit, during the previous year or during any earlier previous year or years, to such unit holder, who holds such unit on the date of distribution of sum or to any other unit holder who held such unit at any time prior to the date of such distribution, which is - (a) not in the nature of interest and dividend referred to in section 10(23FC) or rental income referred to in section 10(23FCA); and

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	(b) not chargeable to tax in the hands of the business trust under section 115UA(2).
B	amount at which such unit was issued by the business trust; and
C	amount charged to tax under this clause in any earlier previous year;

(10) Section115UA(3) provides that distributed income or any part thereof, which is in the nature of

- **interest income** received by the business trust from the SPV or
- **dividend income** received or receivable by the business trust from a SPV which has exercised the option under section 115BAA or
- **rental income** from real estate assets owned directly by the REIT [referred to in section 10(23FCA)]

is deemed to be the income of the unit holder in the previous year of distribution and subject to tax in the hands of the unit holder in that year.

(11) Any person responsible for making payment of income distributed on behalf of the business trust to a unit holder is required to furnish a statement to the unit holder and the prescribed authority within the prescribed time.

The statement should be in the prescribed form and manner. It should contain the particulars of the nature of income paid during the previous year as well as the other details as may be prescribed [Section 115UA(4)].

(12) Under section 139(4E), a business trust is mandatorily required to furnish a return of its income or loss in every previous year. All the provisions of the Income-tax Act, 1961 would apply as if it were a return required to be furnished under section 139(1).

(13) The scheme of taxability of income in the hands of the business trust, unit holders, sponsors etc. is briefed in the table given hereunder –

	Transaction	Section	Tax and TDS implications
(1)	**Transfer of listed units of the business trust by the unit holders**		**Tax implications in the hands of unit holders:** ➢ STT leviable on trading of listed units on a recognized stock exchange.
		2(42A)	➢ The period of holding of units of business trust to qualify as "long-term capital assets" is "more than 12 months".

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		112A	➢ Long-term capital gains upto ₹ 1.25 lakh would be exempt in the hands of the unitholders; Long-term capital gain exceeding ₹ 1.25 lakh would be taxable @12.5% *plus* surcharge, if applicable, and health and education cess @4%.
		111A	➢ **Short-term capital gains** would be subject to tax @ 20% (*plus* surcharge, if applicable, and *cess@4%*).
(2)	**Exchange of shares in SPV by sponsor for units of Business Trust**	47(xvii)	**Tax implications in the hands of the sponsor:** ➢ Such exchange is not treated as a transfer. Hence, taxability of capital gains on such transfer deferred to the time of disposal of units by the sponsor.
		112A & 111A	➢ The sponsor would get the same tax treatment on offloading of units under an Initial offer on listing of units as it would have been available had he offloaded the underlying shareholding through an IPO. STT shall be levied on sale of such units of business trust which are acquired in lieu of shares of SPV, under an initial offer at the time of listing of units of business trust in the like manner as in the case of sale of unlisted equity shares under an IPO. The benefit of concessional tax regime of tax @ 20%, as the case may be, on STCG and @ 12.5%, as the case may be, on LTCG exceeding ₹ 1.25 lakh under section 112A shall be available to the sponsor on sale of units received in lieu of shares of SPV subject to levy of STT.
		49(2AC)	➢ For computing capital gains in the hands of the sponsor, cost of acquisition of units would be deemed to be the cost of acquisition of shares to the sponsor;
		2(42A)	➢ For computing capital gains in the hands of the sponsor, the period of holding of units to include the period of holding of shares for determining whether the capital gains are long-term or short-term.

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(3)	**Interest income of business trust from SPV**		**Tax implications in the hands of the business trust & unit holders and TDS implications in the hands of the SPV & business trust**: ➢ Pass-through status for interest received by business trust from SPV:
		10(23FC)	➢ Interest income is not taxable in the hands of the business trust; and
		194A(3)(xi)	➢ SPV is not required to deduct tax at source on interest paid to business trust.
			Tax consequences on distribution of such income by the business trust to the unitholders:
		115UA(3)	The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of interest received or receivable from a SPV is deemed as income of unit holder.
		115A(1)(a)(iiac)	▪ Interest income taxable in the hands of the unit holders – ○ @5%, in case of unit holders, being non-corporate non-residents or foreign companies; and ○ at normal rates of tax, in case of resident unit holders.
		194LBA	▪ Business trust to deduct tax at source on interest component of income distributed to unit holders at the time of payment or credit of income to the account of the unit holder, whichever is earlier: ○ @5%, in case of unit holders, being non-corporate non-residents or foreign companies; and ○ @10%, in case of resident unit holders.
(4)	**Interest payments to non-resident lenders on ECBs by the business trust**	194LC	**TDS implications in the hands of business trust**: ➢ An Indian Company or a business trust paying interest income to a non-resident, not being a company, or to a foreign company is liable to deduct TDS@5%

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			[Such interest would attract tax in the hands of the non-resident lenders @5% as per section 115A]. ▪ The above concessional rate of TDS@5% is applicable to interest in respect of money borrowed by the Indian Company or the business trust in foreign currency from a source outside India – (i) Under a loan agreement between 1st July 2012 and 30th June, 2023. (ii) By issuing long term infrastructure bonds between 1st July 2012 to 1st October 2014. (iii) By issuing long term bond including long term infrastructure bonds between 1st October 2014 and 30th June, 2023. (iv) By way of issue of rupee denominated bond on or before 30th June, 2023. ▪ However, tax is required to be deducted @4% in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or rupee denominated bond between 1st April, 2020 and 30th June, 2023, which is listed only on a recognised stock exchange located in any IFSC [Such interest would attract tax in the hands of the non-resident lenders @4% as per section 115A]. ▪ Further, tax is required to be deducted @9% in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or rupee denominated bond on or after 1st July, 2023, which is listed only on a recognised stock exchange located in any IFSC [Such interest would attract tax in the hands of the non-resident lenders @9% as per section 115A]

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(5)	**Dividend received by the business trust from SPV**		**Tax implications in the hands of the SPVs, business trust and unit holders and TDS implications in the hands of the SPV & business trust**:
		10(23FC)(b)	➢ **Pass-through status for dividend received by business trust from SPV:** - Dividend received or receivable from a special purpose vehicle, by the business trust would be exempt in its hands; - Consequently, SPV is not required to deduct tax at source on dividend paid to business trust.
		115UA(3)	➢ **Tax consequences on distribution of such income by the business trust to the unitholders:** The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of dividend received or receivable from a SPV, which has exercised option under section 115BAA, is deemed as income of unit holder.
		10(23FD)	▪ Dividend income taxable in the hands of the unit holders – ○ 10%[8], in case of unit holders, being non-corporate non-residents or foreign companies; and ○ at normal rates of tax, in case of resident unit holders. (However, in case where SPV has not exercised option under section 115BAA, dividend income distributed by the business trust would be exempt in the hands of the unit-holders)
		194LBA	▪ Business trust to deduct tax at source on dividend component of income distributed to unit holders at the time of

[8] On harmonious interpretation of law and on the principle that in case of non-resident, the TDS rates should not be less than the tax rates, distributed income, being dividend would be taxable @10%. However, on independent reading of section 115A, it is possible to take a view that the tax rate for such dividend income is 20%.

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			payment or credit of income to the account of the unit holder, whichever is earlier, where SPV has exercised option under section 115BAA: ○ @ 10%, in case of unit holders, being non-corporate non-residents or foreign companies; and ○ @10%, in case of resident unit holders. (However, in a case where SPV has not exercised option under section 115BAA, no tax is required to be deducted at source by the business trust on dividend income distributed by it to the unitholders)
(6)	**Capital gains on disposal of assets by the Business Trust**	115UA(2)	**Tax implications in the hands of the Business Trust and Unit holders**: ➢ Capital gains is chargeable at the applicable rates in the hands of the Business Trust: ▪ In case of long-term capital gains, the provisions of section 112 ***or 112A***, as the case may be would apply; ▪ In case of short-term capital gains on sale of listed shares, the provisions of section 111A would apply; ▪ Short-term capital gains, other than the gains subject to tax under section 111A, would be subject to maximum marginal rate.
		10(23FD)	➢ If such capital gains are further distributed to unitholders, the component attributable to capital gains would be exempt in the hands of the unit holders.
(7)	**Rental income arising to REIT from real estate property directly held by it**	10(23FCA)	➢ **Rental income of REIT from directly owned real estate asset** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the business trust

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		194-I	➢ **Rental income received or credited to a REIT** Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset, owned directly by such business trust, tax is **not** deductible at source.
		115UA(3)	➢ **Distributed income received by unit holder** The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed as income of unit holder.
		194LBA	➢ **Distribution by REIT to unit holders of rental income from real estate assets directly owned by it** ► TDS@10% in case of distribution to a resident unit holder ► TDS at rates in force in case of distribution to a non-resident unit holder.
(8)	**Repayment of debt / Amount paid against redemption of units to unitholders**	56(2)(xii)	➢ Any sum other than the following components of income – (a) Interest and dividend received from SPV and distributed to unitholders (b) Rental income from real estate assets directly owned by it; and (c) Income chargeable to tax in the hands of the business trust u/s 115UA(2) received by a unitholder from a business trust is chargeable to tax in the hands of unit holder under the head "Income from other sources". It would be computed in the manner specified under section 56(2)(xii).
(9)	**Income of business trust [Other than interest and**	115UA(2)	**Tax implication in the hands of the Business Trust and Unit holders**: ➢ Long-term capital gains chargeable to tax u/s 112 or u/s 112A

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	dividend from SPV, rental income from real estate property]		➢ Short-term capital gains chargeable to tax u/s 111A ➢ Any other income of the trust is chargeable to tax at the maximum marginal rate.
		10(23FD)	➢ The above income distributed to unit holders would be exempt in their hands.

ILLUSTRATION 18

A business trust, registered under SEBI (Real Estate Investment Trusts) Regulations, 2014, gives particulars of its income for the P.Y.2025-26:

(1) Interest income from Beta Ltd. – ₹ 4 crore;

(2) Dividend income from Beta Ltd. – ₹ 2 crore;

(3) Short-term capital gains on sale of listed shares of Beta Ltd.– ₹ 1.5 crore;

(4) Short-term capital gains on sale of developmental properties – ₹ 1 crore

(5) Interest received from investments in unlisted debentures of real estate companies – ₹ 10 lakh;

(6) Rental income from directly owned real estate assets – ₹ 2.50 crore

Beta Ltd. is an Indian company in which the business trust holds 70% of the shareholding.

Discuss the tax consequences of the above income earned by the business trust in the hands of the business trust and the unit holders, assuming that the business trust has distributed ₹ 10 crore to the unit holders in the P.Y.2025-26 (Assume that Beta Ltd. does not opt to pay tax under section 115BAA).

SOLUTION

Tax consequences in the hands of the business trust and its unit holders

(1) **Interest income of ₹ 4 crore from Beta Ltd.:** There would be no tax liability in the hands of business trust due to pass-through status enjoyed by it under sub-clause (a) of section 10(23FC) in respect of interest income from Beta Ltd., being the special purpose vehicle. Therefore, Beta Ltd. is not required to deduct tax at source on interest payment to the business trust.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of interest income received or receivable from a SPV is deemed income of the unit holder as per section 115UA(3).

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The business trust has to deduct tax at source under section 194LBA –

- @ 10%, on interest component of income distributed to resident unit holders; and
- @ 5%, on interest component of income distributed to non-corporate non-resident and foreign companies' unit holders.

The interest component of income received from the business trust in the hands of each unitholder would be determined in the proportion of 4/11.1, by virtue of section 115UA(1).

(2) **Dividend income of ₹ 2 crore from Beta Ltd.:** The dividend distributed by the SPV to the business trust is exempt by virtue of section 10(23FC). Any distributed income referred to in section 115UA, which is in the nature of dividend income received or receivable from SPV, in a case where the SPV has exercised the option under section 115BAA, is taxable in the hands of unitholders by virtue of section 10(23FD). However, since Beta Ltd., being a SPV does not opt for section 115BAA, dividend component is exempt in the hands of the unitholders. Consequently, business trust is not required to deduct tax at source on the dividend component distributed to the unitholders.

(3) **Short-term capital gains of ₹ 1.50 crore on sale of listed shares of Beta Ltd.:** As per section 115UA(2), the business trust is liable to pay tax@20% under section 111A in respect of short-term capital gains on sale of listed shares of special purpose vehicle. There would, however, be no tax liability on the capital gain component of income distributed to unit holders, by virtue of the exemption contained in section 10(23FD).

(4) **Short-term capital gains of ₹ 1 crore on sale of developmental properties:** It is taxable at maximum marginal rate in the hands of the business trust as per section 115UA(2). There would be no tax liability in the hands of the unit holders on the capital gain component of income distributed to them, by virtue of the exemption contained in section 10(23FD).

(5) **Interest of ₹ 10 lakh received in respect of investment in unlisted debentures of real estate companies:** Such interest is taxable at maximum marginal rate, in the hands of the business trust, as per section 115UA(2). However, there would be no tax liability in the hands of the unit holders on the interest component of income distributed to them, by virtue of section 10(23FD).

(6) **Rental income of ₹ 2.50 crore from directly owned real estate assets:** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the trust as per section 10(23FCA).

Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset held directly by such REIT, no tax is deductible at source under section 194-I.

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The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit holder as per section 115UA(3). The business trust has to deduct tax at source@10% under section 194LBA in case of distribution to a resident unit holder and at rates in force in case of distribution to a non-resident unit holder.

The rental income component received from the business trust in the hands of each unitholder would be determined in the proportion of 2.5/11.1, by virtue of section 115UA(1).

10.8 SPECIAL TAXATION REGIME FOR INVESTMENT FUNDS AND INCOME RECEIVED FROM SUCH FUNDS [CHAPTER XII-FB] [SECTIONS 115UB, 10(23FBA) & 10(23FBB)]

(1) Tax liability of the unit holders:

Any income accruing or arising to, or received by, a person, being a unit holder of an investment fund, out of investments made in the investment fund shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person had the investments made by the investment fund, been made directly by him [Section 115UB(1)].

Note – Accordingly, income in the hands of the non-resident investor from offshore investments routed through Category I or Category II AIFs, being a deemed direct investment outside India by the non-resident investor, is not taxable in India under section 5(2) of the Act [Circular No. 14/2019, dated 3.7.2019].

(2) Exemption of income of investment fund other than income under the head profits and gains from business and profession [Section 10(23FBA)]

The Scheme provides for exemption of income, other than income chargeable under the head "Profits and gains of business or profession", in the hands of investment fund. The income in the nature of profits and gains of business or profession shall be taxable in the hands of the investment fund.

(3) Exemption to unit holder of income under the head "Profits and gains from business or profession" of investment fund [Section 10(23FBB)]

Income accruing or arising to, or received by, a unit holder of an investment fund, being that proportion of income which is of the same nature as income chargeable under the head

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"Profits and gains of business or profession" at investment fund level, shall be exempt under section 10(23FBB). This implies that all income from investment fund is taxable in the hands of unit holders except income under the head "PGBP".

(4) TDS in respect of income of units of investment fund to unit holders [Section 194LBB]

Investment fund to deduct tax at source on any income (other than the proportion of income which is of the same nature as income chargeable under the head "Profits and gains of business or profession" which is taxable at investment fund level) payable by the investment fund to a unit holder

- @10%, in case of payable to a resident unit holder
- at rates in force in case of payable to a non-corporate non-resident or foreign company unit holder

In case of income payable to a non-corporate non-resident or foreign company unit holder, no deduction is to be made in respect of any income that is not chargeable to tax under the Act.

Such tax has to be deducted at the time of credit of such income to the account of the payee or at the time of payment, whichever is earlier.

For this purpose, any such income credited to any account, whether called "suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be the credit of such income to the account of the payee, and the provisions of section 194LBB shall apply accordingly.

(5) Pass - through status for current year losses:

If in any year there is a loss under any head of income at the fund level and such loss cannot be or is not wholly set-off against income under any other head of income of the said previous year, then out of such losses,

(i) the loss arising to the Investment Fund under the head "Profits & Gains of Business or Profession" shall not be allowed to be passed through to the investors but has to be carried over at fund level to be set off against income of the next year in accordance with the provisions of Chapter VI

(ii) loss other than loss under the head "profits and gains from business or profession" would not be allowed be passed through to the investors if such loss has arisen in respect of a unit which has not been held by the unit holder for a period of at least 12 months [Section 115UB(2)].

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Note – By implication, losses other than those referred to in (i) and (ii) above, which cannot be wholly set-off against current year income, would be passed on to the unit holders to be carry forward and set-off in their individual hands in accordance with the provisions of Chapter VI.

(6) Pass through status for losses accumulated as on 31.3.2019:

Losses, other than loss under the head "profits and gains from business or profession", if any, accumulated at the level of investment fund as on 31.3.2019, shall be

- deemed to be the loss of a unit holder who held the unit as on 31.3.2019 in respect of the investment made by him in the investment fund in the same manner as it were the loss incurred by him had he made such investments directly and
- shall be allowed to be passed through to the investors for the remaining period calculated from the year in which the loss has occurred for the first time taking that year as the first year and set off against their income in accordance with the provisions of Chapter VI.

Further, such accumulated losses shall not be available to the investment fund on or after 1.4.2019.

(7) Nature of income in the hands of unitholders:

The income paid or credited by the investment fund shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder as if it had been received by, or had accrued or arisen to, the investment fund during the previous year. [Section 115UB(3)].

(8) Tax on total income:

As per section 115UB(4), the total income of the investment fund is chargeable to tax as follows:

Investment Fund	Rate of tax
A company or a firm	Rate or rates specified in the Finance Act of the relevant year (30%/25%, as the case may be, for a company and 30% for firm for A.Y.2026-27)
Other than a company or a firm	Maximum marginal rate

(9) Deemed credit on the last day of the previous year:

If the income accruing or arising to, or received by, an investment fund, during a previous year is not paid or credited to the unitholders, it shall be deemed to have been credited to the

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account of the unit-holder on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year [Section 115UB(6)].

Income taxed in the year of accrual not taxable again in the year of payment [*Explanation 2* below section 115UB]:

It has been clarified that any income which has been included in the total income of the unit holder of an investment fund in a previous year, on account of it having accrued or arisen in the said previous year, would not be included in his total income in the previous year in which such income is actually paid to him by the investment fund.

(10) Summary:

The following table gives a summary of the above provisions:

	Particulars	Investment Fund	Unit holder
(i)	**Income under the head "Profits and gains of business or profession"** of the Investment Fund	Taxable	Exempt
(ii)	Income, **other than profits and gains of business or profession**	Exempt. Tax to be deducted on such income distributed to unitholders - @10%, in case of resident payee - at rates in force in case of non-resident payee	Taxable, as if he had directly made the investment.
(iii)	**Loss** under the head "**Profits and gains of business or profession"** incurred by the investment fund	To be carried forward for set-off as per Chapter VI at the Fund level	Not passed on to investors
(iv)	Loss (other than loss referred to in (iii) above) where such loss has arisen in respect of unit which has not been held by the **unit holder for a period of at-least 12 months**	The Act is silent relating to the permissibility or otherwise of carry forward of these losses in the hands of investment funds.	Not allowed to be carried forward by the unitholder. He cannot set-off such losses against his income.

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(v)	Losses (other than losses referred to in (iii) and (iv) above) remaining after set-off against current year income.	Not allowed to be carried forward for set-off by the Investment Fund	Unit-holder can carry forward and set-off such losses against his income as per Chapter VI

Note – Losses, other than business losses, accumulated at the level of the investment fund as on 31.3.2019 would be deemed to be the loss of the unit holder who held the unit as on 31.3.2019 in respect of the investments made by him in the investment fund, in the same manner as it were the loss incurred by him had he made such investments directly. Such loss can be carried forward by the unitholder for the remaining period calculated from the year in which the loss had occurred for the first time taking that year as the first year. Accordingly, he can set-off such loss in accordance with the provisions of Chapter VI. The loss so deemed to be the loss of the unitholder shall not be available to the investment fund on or after 1.4.2019.

(11) Statement to be furnished:

The person responsible for crediting or making payment of the income on behalf of an investment fund and the investment fund are required to furnish, within the prescribed time, to the person who is liable to tax in respect of such income and to the prescribed income-tax authority, a statement in the prescribed form and verified in the prescribed manner. Such statement should give details of the nature of the income paid or credited during the previous year and such other relevant details as may be prescribed [Section 115UA(7)].

(12) Every investment fund has to compulsorily file its return of income or loss under section 139(4F), if it is not required to do so under any other provision of section 139. The provisions of the Act would apply as if such return of income or loss were a return required to be furnished under section 139(1).

(13) Meaning of certain terms:

	Term	Meaning
(a)	Investment fund	Any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012, made under the Securities and Exchange Board of India Act, 1992 or regulated under the International Financial Services Centers Authority (Fund Management) Regulations, 2022 made

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		under the International Financial Services Center Authority Act, 2019;
(b)	Trust	A trust established under the Indian Trusts Act, 1882 or under any other law for the time being in force.
(c)	Unit	Beneficial interest of an investor in the investment fund or a scheme of the investment fund and shall include shares or partnership interests.

ILLUSTRATION 19

The following are the particulars of income of four investment funds for P.Y. 2025-26:

Particulars	*A*	*B*	*C*	*D*
	₹ in lakh			
Business Income		*2*	*(2)*	*5*
Capital Gains	*16*	*14*	*(6)*	*20*
Income from other sources	*4*	*4*	*8*	*(2)*

Compute the total income of the investment funds and each unitholder for A.Y. 2026-27, assuming that:

(1) each investment fund has 20 unitholders each having one unit held by them for a period exceeding 24 months; and

(2) income from investment in the investment fund is the only income of the unitholder.

If Investment Fund C has the following income components for A.Y. 2027-28, what would be the total income of the fund and the unit holder for that year?

Business Income ₹ 2 lakh

Capital Gains ₹ 9 lakh

Income from Other Sources ₹ 8 lakh.

SOLUTION

Computation of total income of the investment fund for A.Y. 2026-27

Particulars	A	B	C	D
	₹			
Business Income	Nil	2,00,000	Nil	3,00,000
Total Income	**Nil**	**2,00,000**	**Nil**	**3,00,000**

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Computation of total income of a unit holder of the following Investment funds for A.Y. 2026-27

Particulars	A	B	C	D
	₹			
Capital Gains	80,000	70,000	-	1,00,000
Income from other sources	20,000	20,000	30,000	-
Total Income	**1,00,000**	**90,000**	**30,000**	**1,00,000**

Notes:

(i) The total income of Investment Fund B would be chargeable to tax @30% if the fund is a firm and @30%/25%, as the case may, if the fund is a company and at the maximum marginal rate, in any other case.

(ii) In case of Investment Fund D, the loss from other sources ₹ 2 lakh is set-off against business income of ₹ 5 lakh.

(iii) In case of Investment Fund C, the business loss of ₹ 2 lakh is set-off against income from other sources of ₹ 8 lakh. Loss of ₹ 6 lakh under the head "Capital gains" cannot be set-off against income under any other head. The same can be carried forward by the Unitholder for set-off in the subsequent years since, the units are held for a period of 12 months or more.

For A.Y. 2027-28, brought forward capital loss of ₹ 30,000 [₹ 6 lakh/20] can be set-off against capital gains of ₹ 45,000 [₹ 9 lakh/20] by the unit-holder since, the period of holding of units is 24 months or more. Business income of ₹ 2 lakh would be taxable in the hands of the Investment Fund. Income from other sources of ₹ 40,000 (₹ 8 lakh/20) would be taxable in the hands of the unitholders.

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SIGNIFICANT SELECT CASES

1	***New Noble Educational Society v. CCIT (2022) 448 ITR 594 (SC)***	
	Issue	**Analysis & Decision**
	Does the requirement under section 10(23)(vi) to solely engage itself in education mean that such institution cannot have objects not related to education? Also, is it necessary that the profits of business referred to in the seventh proviso to section 10(23C) be the profits of such business incidental to educational activity and not any other activity?	**Relevant provision of law**: Under section 10(23C)(vi), income of a university or educational institution existing solely for educational purposes and not for the purposes of profit, approved by the Principal Commissioner or Commissioner would be exempt. As per the second proviso to section 10(23C), the Principal Commissioner or Commissioner, on receipt of application from an institution under clause (ii) or clause (iii) of the first proviso thereof, shall call for documents or information from it or make such enquiries to satisfy himself about the genuineness of the activities of the institution and compliance of such requirements of any other law for the time being in force by it as are material for the purpose of achieving its objects. As per the seventh proviso to section 10(23C), the exemption provisions under section 10(23C)(vi) would not apply in relation to income of the educational institution, being profits and gains of business, 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. **Issue under consideration**: The issue under consideration is whether the requirement under section 10(23)(vi) to solely engage itself in education mean that such institution cannot have objects not related to education. Also, is it necessary that profits of business referred to in the seventh proviso to section 10(23C) be the profits of such business incidental to educational activity and not any other activity. **Analysis and Conclusion**: The Supreme Court, made the following observations and conclusions: (a) The requirement of the charitable institution, society or trust, etc., to "solely" engage itself in

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		education or educational activities, and not engage in any activity of profit, means that such institutions cannot have objects which are unrelated to education. In other words, all objects of the society, trust, etc., must relate to imparting education or be in relation to educational activities. The term "solely" is not the same as "predominant/mainly". The term "solely" means to the exclusion of all others. (b) Where the objective of the institution appears to be profit-oriented, such institutions would not be entitled to approval under section 10(23C). At the same time, where surplus accrues in a given year or set of years *per se*, it is not a bar, provided such surplus is generated in the course of providing education or educational activities. (c) The seventh proviso to section 10(23C), as well as section 11(4A) refer to profits which may be "incidentally" generated or earned by the charitable institution. In the present case, the same is applicable only to those institutions which impart education or are engaged in activities connected to education. (d) The reference to "business" and "profits" in the seventh proviso to section 10(23C) and section 11(4A) merely means that the profits of business which is "incidental" to educational activity—i.e., relating to education such as sale of text books, providing school bus facilities, hostel facilities, etc. However, where institutions provide their premises or infrastructure to other entities, trusts, societies, etc., for the purposes of conducting workshops, seminars or even educational courses (which the concerned trust is not actually imparting) and outsiders are permitted to enrol in such seminars, workshops, courses, etc., then the income derived from such activity cannot be characterised as part of education or "incidental" to the imparting education.

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		Additionally, the Supreme Court also held that wherever registration of trust or charities is obligatory under State or local laws, the concerned trust, society, other institution, etc., seeking approval under section 10(23C) should also comply with provisions of such State laws. This would enable the Commissioner or concerned authority to ascertain the genuineness of the trust, society, etc. This reasoning is reinforced by the recent insertion of another proviso of section 10(23C) with effect from April 1, 2021.
2.	***ACIT (Exemptions) v. Ahmedabad Urban Development Authority (and other appeals) (2022) 449 ITR 1 (SC)***	
	Issue	**Analysis & Decision**
	When can an activity be considered as trade, commerce or business for attracting the provisions of the proviso to section 2(15)?	**Relevant provision of law**: As per section 2(15), 'charitable purpose' includes relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, as per the proviso to section 2(15), "advancement of any other object of general public utility" shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless,- (1) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and (2) the aggregate receipts from such activity or activities, during the previous year, does not exceed 20% of the total receipts, of the trust or institution undertaking such activity or activities, for the previous year.

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		As per section 11(4A), for the purpose of availing the beneficial provisions of section 11(1)/(2)/(3) and (3A), the business must be incidental to the objectives of the trust and the trust has to maintain separate books of account in respect of such business. Likewise, the seventh proviso to section 10(23C) provides that for the purpose of availing exemption under section 10(23C)(iv)/(v)/(vi)/(via), the business should be incidental to the attainment of its objectives and separate books of accounts are maintained by the trust in respect of such business. **Issue under consideration**: The issue under consideration is when an activity can be considered as trade, commerce or business for attracting the provisions of the proviso to section 2(15). **Analysis**: The first consideration would be whether the activity concerned was or is in any manner covered by the objects clause. Thereafter, if the accounts disclose that the amounts paid are nominal mark-up over and above the cost incurred towards supplying the services, the activity may fall within the description of one advancing the general public utility. If on the other hand, there is a significant mark-up over the actual cost of service, the next step would be ascertain whether the quantitative limit in the proviso to section 2(15) is adhered to. **It is only in the event of the trust actually carrying on an activity in the course of achieving one of its objects, and earning income which should not exceed the quantitative limit prescribed at the relevant time, that it can be said to be driven by charitable purpose.** Section 11(4A) [and Seventh proviso to section 10(23C)] must be interpreted harmoniously with section 2(15), with which there is no conflict. **Carrying out activity in the nature of trade, commerce or business, or service in relation to such activities, should be conducted in the course of achieving the object of general public utility, and the income, profits or surplus or gains must, therefore, be incidental.** The requirement in section 11(4A) [and Seventh proviso to section 10(23C)] of maintaining separate books of account is

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		also in line with the necessity of demonstrating that the quantitative limit prescribed in the proviso to section 2(15), has not been breached. **Conclusion**: The conclusions arrived at by way of this judgment, neither precludes any assessee (whether statutory or non-statutory) advancing objects of general public utility, from claiming exemption, nor the taxing authorities from denying exemption, in the future, if the receipts of the relevant year exceed the quantitative limit. The assessing authorities must on a yearly basis, scrutinize the record to discern whether the nature of the assessee's activities amount to "trade, commerce or business" based on its receipts and income (i. e., whether the amounts charged are on cost-basis, or significantly higher). If it is found that they are in the nature of "trade, commerce or business", then it must be examined whether the quantified limit (as amended from time to time) in proviso to section 2(15), has been breached, thus disentitling them to exemption.
3.	***CIT v. St. Peter's Educational Society (2016) 385 ITR 66 (SC)***	
	Issue	**Analysis & Decision**
	Would imparting education/training in specialized field like communication, advertising etc. and awarding diplomas/ certificates constitute an "educational purpose" for grant of exemption u/s 10(23C)(vi)?	Institutions engaged in providing specialized training in certain fields and awarding diplomas and certificates are also eligible for tax exemption in terms of section 10(23C)(vi). It is not mandatory for such institutions to impart education in formalized manner or conduct only recognized educational courses. Further, when corporates depute employees for gaining specialized knowledge, such imparting of knowledge by the institution would not mean that the institution is engaged in the activity of general public. Making of profit incidentally will not make the institution as existing for making profit.

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TEST YOUR KNOWLEDGE

Questions

1. *A trust, unless created for "charitable purpose", does not qualify to claim exemption under Chapter III of the Act. In this context, explain the meaning of "charitable purpose" and examine whether the following objects constitute part of it:*

   (i) Rural reconstruction and upliftment of the masses through Cottage Industry.

   (ii) Welfare of industrial workers with a stipulation that the workers of settlor of trust have got preference over others.

2. *Ramji Charitable Trust has filed return of income for the Assessment Year 2026-27 in December 2026 and applied only 50% of its income for specified purposes. It intends to accumulate the balance 35% of income to be spent in future years. Accordingly, it filed its Statement in Form 10 in August, 2026 and deposited the money so accumulated in post office savings bank account. While completing the assessment, the Assessing Officer disallowed the accumulated income of 35% and taxed the same on the ground that the trust has filed its return of income after the due date for filing return of income. Discuss the validity of the action of the Assessing Officer in this case.*

3. *An institution operating for promotion of education claiming exemption under section 11 since 1994 furnishes the following data for the assessment year 2026-27:*

S. No.	Particulars	₹ in crores
(i)	Fees collected from students	14
(ii)	Construction of a new computer science laboratory	0.50
(iii)	Land acquired to be used as a cricket field for the students	2
(iv)	Amount earmarked and set apart for construction of an arts block within the next 4 years.	4

   Compute the total income of the institution for the A.Y. 2026-27.

4. *A public charitable trust registered under section 12AB, for the previous year ending 31.3.2026, derived gross income of ₹ 21 lakhs, which consists of the following:*

		(₹ in Lacs)
(a)	Income from properties held by trust (net)	10
(b)	Income (net) from business (incidental to main objects)	4
(c)	Voluntary contributions from public	7

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The trust applied a sum of ₹ 11.60 lacs towards charitable purposes during the year which includes repayment of loan taken for construction of orphanage ₹ 3.60 lacs. The entire expenditure incurred on construction of orphanage was allowed as application of income in the P.Y. 2020-21.

Determine the taxable income of the trust for the assessment year 2026-27.

5. *Work out, from the following particulars, the amount of capital gain which shall be deemed to have been applied for charitable or religious purpose arising out of sale of a capital asset utilized for the purposes of trust to the extent of 60%:*

Particulars	₹
Cost of transferred asset	2,40,000
Sale consideration	3,60,000
Cost of new asset purchased	3,00,000

6. *An electoral trust approved by the CBDT is not liable to income-tax in respect of voluntary contribution received and other income - Examine the correctness of the statement.*

7. *Helpage is a charitable trust set up on 1.4.2010 with the object of providing relief to the poor. Later on, in April, 2012, it changed its object to medical relief. It applied for registration on the basis of its new object, i.e., medical relief, on 1.9.2012 and was granted registration under Section 12AA on 1.2.2013.*

   On 1.4.2025, Helpage got merged with Poor Aid, is not eligible for registration under section 12AB or approval under section 10(23C). All the assets and liabilities of the erstwhile trust became the assets and liabilities of Poor Aid. The trust appointed a registered valuer for the valuation of its assets and liabilities. From the following particulars (including the valuation report), calculate the tax liability in the hands of the trust arising as a result of such merger:

   (i) Land

Location	Date of purchase	Stamp duty value on 1.4.2025	Value which the land would fetch, if sold in the open market on 1.4.2025	Book Value on 1.4.2025
		₹	₹	₹
Noida	1.9.2010	55 lakhs	58 lakhs	50 lakhs
Gurgaon	1.9.2013	100 lakhs	120 lakhs	110 lakhs

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(ii) Shares

Type of shares	Date of purchase	Face value of each share	Purchase price of each share	Price at which each share is quoted on BSE as on 1.4.2025		Open market value as on 1.4.2025#
				Highest price	Lowest price	
		₹	₹	₹	₹	₹
5000 Quoted equity shares of A Ltd.	1.5.2014	100	110	320	300	
2000 Preference shares of B Ltd.	1.9.2015	100	100	-	-	180

 # on the basis of report of Merchant Banker

(iii) Liabilities

Book value of liabilities on 1.4.2025 = ₹ 120 lakhs. This includes –

(a) Corpus fund ₹ 12 Lakhs.

(b) Provision for taxation ₹ 8 lakhs; and

(c) Reserves and Surplus ₹ 18 lakhs

8. "Serving the poor", a charitable trust, is registered under section 12AB of the Act. On 1.4.2025, it got merged with another entity not eligible for registration under section 12AB or approval under section 10(23C).

All the assets and liabilities of the erstwhile trust became the assets and liabilities of the merged entity.

The trust appointed a registered valuer for the valuation of its assets and liabilities. From the following particulars (including the valuation report), calculate the tax liability in the hands of the trust arising as a result of such merger:

(i) Stamp duty value of land held ₹ 15 lakhs. However, if this land is sold in the open market, it would ordinarily fetch ₹ 17 lakhs. The book value of the land is ₹ 20 lakhs.

(ii) 75,000 equity shares in Ink Ltd. traded in Delhi Stock Exchange. The lowest price per share on 1.4.2025 was ₹ 75 and the highest price on that day was ₹ 85. The book value was ₹ 67 lakhs.

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(iii) 55,000 preference shares held in N Ltd. The shares will fetch ₹ 44 lakhs, if they are sold in the open market on 1.4.2025 Book value was ₹ 25 Lakhs.

(iv) Corpus fund as on 1.4.2025 ₹ 15 Lakhs.

(v) Outside liabilities ₹ 90 lakhs

(vi) Provision for taxation ₹ 5 lakhs.

(vii) Liabilities in respect of payment of various utility bills ₹ 6 lakhs.

Answers

1. Section 2(15) defines "charitable purpose" to include relief of the poor, education, medical relief, yoga, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. However, "advancement of any other object of general public utility" would not be a charitable purpose, if it involves carrying on of any activity in the nature of trade, commerce or business or, any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity or the retention of such income, by the concerned entity.

"Advancement of any other object of general public utility" would continue to be a "charitable purpose", if the total receipt from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business does not exceed 20% of the total receipts of the trust in the previous year, and such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(i) The Supreme Court has, in *Thiagarajar Charities vs. Addl. CIT (1997) 225 ITR 1010,* observed that "cottage industry" is associated with the idea of a small, simple enterprise or industry in which employees work in their own houses or in a small place, gathered together for the purpose, using their own equipments and is usually found in rural areas or so carried on, by the poorer section of the society. In substance, the activity of rural reconstruction and upliftment of masses through cottage industry is to afford relief to the poor and consequently, it is for charitable purpose.

(ii) The welfare of industrial workers with a stipulation that the workers of settlor of trust have preference over others would also constitute "charitable purpose" within the

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meaning of section 2(15). The Patna High Court has, *in CIT v. Tata Steel Charitable Trust (1993) 203 ITR 764*, observed that exemption under section 11(1) can be availed only if the following conditions are satisfied –

(1) the trust is created for a charitable purpose; and

(2) no part of the income of such trust enures or has been used or applied directly or indirectly for the benefit of any person referred to in section 13(3).

The list of persons contained in section 13(3) does not include employees of the settlor of the trust. Section 13(3)(d), which includes any relative of the author, can have no application because "relative" means a person connected by birth or marriage with another person. A person having relationship pursuant to a contract like that of an employer and an employee cannot be said to be a relative. The High Court concluded that it was immaterial that any employee of the settler of the trust had acquired any benefit out of the income of the trust as an ordinary member of the community. Therefore, the application of part of the income of the trust for the benefit of the employees of the settler cannot disentitle the trust from claiming exemption under section 11.

2. Section 11(2) provides that a charitable trust has to apply 85% of its income to charitable purposes and where 85% of its income is not applied for such purposes, the trust may accumulate or set apart either the whole or part of its income for future application for such purposes in India. The requirement of the Act is that the trust has to make an application/intimation in the prescribed form, for accumulation of income, specifying the purpose and the period (not exceeding 5 years). The application should be filed or furnished before the assessing authority two months prior to the due date specified under section 139(1). Further, the money so set apart or accumulated should be invested/deposited in any one or more of these modes or forms specified under section 11(5).

In case the statement in Form 10 is submitted in August, 2026 and the amount accumulated was deposited in post office savings bank account, which is a mode specified in section 11(5). However, the benefit of accumulation would not be available if the return of income is not furnished on or before the due date of filing of return of income under section 139(1). In this case, trust has not filed its return on or before the due date under section 139(1). The return of income was filed only in December, 2026. Therefore, the action of the Assessing Officer, in this case, is valid.

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3. Computation of total income of the institution for the A.Y. 2026-27

Particulars	₹ (in crores)
Fees received	14.00
Less : 15% (exempt even if not spent for the objects of the institution)	2.10
	11.90
Less: Amount applied for charitable purposes	
Actual amount spent on construction of computer science lab **(See Note 1)**	0.50
Actual amount spent on purchase of land for cricket field **(See Note 1)**	2.00
	2.50
	9.40
Less : Accumulated for specified purpose **(See Note 2)**	4.00
Total Income	**5.40**

Notes:

(1) The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Land acquired and meant for use as cricket field for students is a capital expenditure incurred for promoting the objects of the institution and hence, eligible for deduction. Likewise, the amount spent on construction of computer science laboratory is also eligible for deduction.

(2) Section 11(2) provides that a trust/institution can accumulate or set apart its income for a specified purpose by furnishing statement in prescribed format to the concerned Assessing Officer. However, the period for which the funds can be accumulated cannot exceed 5 years. The amount so accumulated should be invested in the forms and modes specified in section 11(5). In this case, the institution has to furnish statement in Form 10 two months prior to the due date of filing return of income to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for which the income is being accumulated or set apart, which shall, in no case, exceed five years. Further, the institution has to invest ₹ 4 crore in the specified forms and modes.

Note – *Section 11(2) stipulates the conditions for accumulation, on fulfillment of which the income so accumulated or set apart would not be included in the total income of the previous year of the trust. The condition stipulated in clause (c) of Section 11(2) is that*

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the statement in Form 10 has to be furnished at least 2 months prior to the due date of filing of return of income u/s 139(1). However, as per section 13(9), the income accumulated would not be excluded from total income if Form 10 is not submitted on or before the due date under section 139(1). Section 13(9) permits exclusion of accumulated income from total income of the previous year, if Form 10 is filed on or before the due date under section 139(1). CBDT Circular No.6/2023 dated 24.5.2023 clarifies that the statement of accumulation in Form No. 10 is required to be furnished at least two months prior to the due date of furnishing return of income so that it may be taken into account while auditing the books of account. However, the accumulation/deemed application shall not be denied to a trust as long as the statement of accumulation/deemed application is furnished on or before the due date of furnishing the return as provided in section 139(1).

4. Computation of taxable income of public charitable trust

	Particulars	₹
(i)	Income from property held under trust (net)	10,00,000
(ii)	Income (net) from business (incidental to main objects)	4,00,000
(iii)	Voluntary contributions from public	7,00,000
	Voluntary contribution made with a specific direction towards corpus are alone to be excluded under section 11(1)(d). In this case, there is no such direction and hence, included.	
		21,00,000
	Less: 15% of the income eligible for retention / accumulation without any conditions	3,15,000
		17,85,000
	Less: Amount applied for the objects of the trust	
	(i) Amount spent for charitable purposes (₹ 11,60,000 - ₹ 3,60,000)	8,00,000
	(ii) Repayment of loan for construction of orphan home (See Note below)	-
	Taxable Income	**9,85,000**

Note - As per *Explanation 4(ii)* to section 11(1), any application for charitable or religious purposes, from any loan or borrowing in the concerned year, shall not be treated as application of income for charitable or religious purposes. However, the amount not so treated as application, shall be treated as application in the year in which the loan is repaid. The Fourth proviso to *Explanation 4(ii)* to section 11(1) clarifies that this provision will, however, not apply where application is from loan or borrowing made on or before 31.3.2021.

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Since the amount spent on construction of orphanage was allowed as deduction in the P.Y. 2020-21, repayment of loan taken for such purposes will not be allowed as application as it would tantamount to double deduction.

5. In this case, since the asset which is transferred is utilized for the purposes of the trust only to the extent of 60%, only the proportionate amount (i.e., 60%) of the capital gain would be regarded as having been applied for charitable or religious purposes.

As per section 11(1A), where a capital asset held under trust is transferred, and only a part of the net consideration is utilized for acquiring a new capital asset, only so much of the capital gain as is equal to the amount, if any, by which the amount so utilized exceeds the cost of the transferred asset shall be considered to have been applied for the objects of the trust.

In this case, only a part of the net consideration of ₹ 3,60,000 is utilized for acquiring the new capital asset costing ₹ 3,00,000. The amount utilized in acquiring the new asset (i.e., ₹ 3,00,000) exceeds the cost of the transferred asset (i.e., ₹ 2,40,000) by ₹ 60,000.

Therefore, only 60% of (₹ 3,00,000 – ₹ 2,40,000) = 60% of ₹ 60,000 = ₹ 36,000 is deemed to be applied for the objects of the trust.

6. Section 13B provides exemption in respect of voluntary contribution received by an electoral trust approved by the CBDT in accordance with the scheme to be made by the Central Government.

Voluntary contribution received by an electoral trust would be treated as its income under section 2(24), but shall be exempt under section 13B if the trust distributes to a registered political party during the year, 95% of the aggregate donations received by it during the year along with surplus brought forward from any earlier years. Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules framed by the Central Government.

It may be noted that the exemption under section 13B will be available only in respect of voluntary contribution received by an electoral trust. The exemption cannot be claimed in respect of any other income of the electoral trust.

Therefore, the given statement is not correct.

7. As per section 115TD, the accreted income of "Helpage", a charitable trust, registered under section 12AA which is merged with Poor Aid, an entity not entitled for registration under section 12AB or approval under section 10(23C), would be chargeable to tax at the rate of 34.944% [30% plus surcharge @12% plus cess@4%].

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Computation of accreted income and tax liability in the hands of the Helpage trust arising as a result of merger with Poor Aid

Particulars	Amount (₹)
Aggregate FMV of total assets as on 1.4.2025, being the specified date (date of merger) **[See Working Note 1]**	1,39,10,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**	82,00,000
Accreted Income	**57,10,000**
Tax Liability @ 34.944% of ₹ 57,10,000 (rounded off)	**19,95,300**
Working Notes:	
(1) Aggregate fair market value of total assets on the date of merger	
- **Land at Noida, being immovable property, purchased on 1.9.2010**	-
Since the trust was registered only on 1.2.2013 and benefit of section 11 and 12 was available to the trust only from A.Y.2013-14, relevant to P.Y.2012-13, being the previous year in which the application for registration is made, the value of land purchased in P.Y.2010-11, in respect of which benefit under sections 11 and 12 was not availed, has to be ignored for computing accreted income.	
- **Land at Gurgaon, being an immovable property, purchased on 1.9.2013**	1,20,00,000
[The fair market value of land would be higher of ₹ 120 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and ₹ 100 lakhs, being stamp duty value as on the specified date, i.e., 1.4.2025]	
- **Quoted equity shares of A Ltd. [5,000 x ₹ 310 per share]**	15,50,000
[₹ 310 per share, being the average of the lowest (₹ 300) and highest price (₹ 320) of such shares on the specified date]	
- **Preference shares of B Ltd. [2,000 x ₹ 180 per share]**	
[The fair market value which it would fetch if sold in the open market on the specified date i.e., FMV on 1.4.2025]	3,60,000
	1,39,10,000
(2) Total liability	
- Reserves and Surplus ₹ 18 lakhs [not includible]	-
- Corpus Fund of ₹ 12 lakhs [not includible]	-
- Provision for taxation ₹ 8 lakhs [not includible]	-
- Other Liabilities	
[₹ 120 lakhs - ₹ 18 lakhs - ₹ 12 lakhs - ₹ 8 lakhs]	82,00,000
	82,00,000

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8. As per section 115TD, the accreted income of "Serving the poor", a charitable trust, registered under section 12AA which merged with an entity not entitled for registration under section 12AB or approval under section 10(23C), would be chargeable to tax at maximum marginal rate @ 34.944% [30% plus surcharge @12% plus cess@4%].

Computation of accreted income and tax liability in the hands of the trust arising as a result of merger with the "not eligible" entity for A.Y. 2026-27

Particulars	Amount (₹)
Aggregate FMV of total assets as on 1.4.2025, being the specified date (date of merger) **[See Working Note 1]**	1,21,00,000
Less: Total liability computed in accordance with the prescribed method of valuation **[See Working Note 2]**	96,00,000
Accreted Income	**25,00,000**
Tax Liability @ 34.944% of ₹ 25,00,000	**8,73,600**
Working Notes:	
(1) Aggregate fair market value of total assets on the date of merger	
- **Land, being an immovable property**	17,00,000
[The fair market value of land would be higher of ₹ 17 lakhs i.e., price that the land would ordinarily fetch if sold in the open market and ₹ 15 lakhs, being stamp duty value as on the specified date]	
- **Quoted equity shares in Ink Ltd. [75,000 x ₹ 80 per share]**	60,00,000
[₹ 80 per share, being the average of the lowest (₹ 75) and highest price (₹ 85) of such shares on the date of merger]	
- **55,000 preference shares of N Ltd.**	
[The fair market value which it would fetch if sold in the open market on the date of merger i.e., FMV on 1.4.2025]	44,00,000
	1,21,00,000
(2) Total liability	
- Outside liabilities	90,00,000
- Corpus Fund of ₹ 15 lakhs [not includible]	-
- Provision for taxation ₹ 5 lakhs [not includible]	-
- Liabilities in respect of payment of various utility bills [since this liability is an ascertained liability]	6,00,000
	96,00,000

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CHAPTER 11

TAX PLANNING, TAX AVOIDANCE AND TAX EVASION

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **distinguish** between tax planning, tax avoidance and tax evasion;
- **analyse** whether a specified activity resulting in reduction of tax liability would be considered as tax planning, tax avoidance or tax evasion;
- **examine** the doctrine of form and substance in the context of tax planning;
- **analyse** the provisions of General Anti-avoidance Rules (GAAR)
- **examine** the applicability of General Anti-avoidance Rules (GAAR) *vis-a-vis* Specific Anti-avoidance Rules (SAAR)

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CHAPTER OVERVIEW

11.1 TAX PLANNING, TAX AVOIDANCE AND TAX EVASION – AN OVERVIEW

Tax planning involves an intelligent application of the various provisions of the direct tax laws to practical situations in such a manner as to reduce the tax impact on the assessee to the minimum. A thorough understanding of the principles, practices and procedures of tax laws and the ability to apply such knowledge to various practical situations is expected at the final level.

A thorough up-to-date knowledge of tax laws is a pre-requisite for a successful study of tax planning techniques. Not only an up-to-date knowledge of the statute is necessary, but one must also be aware of the contents of the various circulars issued by the CBDT and also of case laws in the form of various decisions of the Courts. One of the best methods to study tax planning in action is to analyze the case laws. In view of this position, students should realise the importance and usefulness of keeping track of the judgments of the Supreme Court and of various High Courts reported in tax law journals from time to time. Students should make it a point to go through the relevant cases and understand the issues involved and the rationale of the judgments. Of course, tax planning in any particular case would depend on the facts and circumstances of that particular case.

Apart from the above, students are advised to go through the articles on tax laws published in tax journals and financial papers. With this brief introduction, let us go into the basic concepts of tax planning.

(1) **Concept of tax planning**: Before entering into a transaction or before starting a business, one normally considers its profitability and other aspects. Amongst other aspects, the tax implications of the transactions of the business have to be thought out before actually embarking on

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the deal. Otherwise, one may be caught unwittingly in huge tax liability. Planning from the point of view of taxation helps in generating greater savings of investible surplus.

Tax planning may be defined as an arrangement of one's financial affairs in such a way that, without violating in any way the legal provisions, full advantage is taken of all tax exemptions, deductions, concessions, rebates, allowances and other reliefs or benefits permitted under the Act so that the burden of taxation on the assessee is reduced to the minimum.

It involves arranging one's financial affairs by intelligently anticipating the effects which the tax laws will have on the arrangements now being adopted. As such it is a very stimulating intellectual exercise.

Any tax planning scheme should be a natural one and should not give an appearance of an artificial arrangement on the face of it. The tax planner or the tax adviser should exercise great care and caution in designing any tax planning scheme as its failure will result in great difficulties and heavy burden of tax on the assessee for whom the scheme is evolved.

In relation to income-tax, the following may be noted as illustrative instances of tax-planning measures:

(a) Varying the residential status taking into consideration the number of days of stay in India to be a resident, in case of an individual.

(b) Choosing the suitable form of assessable entity (Individual, HUF, Firm, Co-operative society, Association of persons, Company, Trust, etc. to obtain optimal tax concessions).

(c) Exercising the option to shift out of default regime under section 115BAC and paying tax as per the normal provisions of Income-tax law in case of Individual, HUF, AOPs or BOI.

(d) Exercising the option to pay tax as per concessional tax regimes under section 115BAA or 115BAB in case of corporate assessee subject to satisfaction of certain conditions and non-allowability of certain exemptions or deductions.

(c) Choosing suitable forms of investment (share capital, loan capital, lease, mortgages, tax exempt investments, priority sector, etc.), considering deductions available in respect of interest or dividend etc.

(d) Programmed replacement of assets to take advantage of the provisions governing depreciation.

(e) Programmed sale of capital assets depending upon the period of holding and deductions specifically available for assets held for long term.

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(f) Diversification of the business activities (hotel industry, agro-based industry etc.) considering the various profit-linked and investment-linked benefits available under the provisions of the Act.

(g) The use of the concept of commercial expediency to claim deduction in respect of expenditure, in computing business income.

(2) Tax planning, tax evasion and tax avoidance: Three methods of reducing taxes have been developed in most countries of the world over a period of time.

Methods of reducing taxes

- Tax planning
- Tax evasion
- Tax avoidance

The dividing line between tax evasion and tax avoidance is very thin. The Direct Taxes Enquiry Committee (Wanchoo Committee) has tried to draw a distinction between the two items in the following words.

"The distinction between 'evasion' and 'avoidance', therefore, is largely dependent on the difference in methods of escape resorted to.

Tax Planning

- Availing tax exemptions or tax privileges offered by the Government, strictly in accordance with law.

Tax evasion

- Manoeuvre involving an element of deceit, misrepresentation of facts, falsification of accounting calculations or downright fraud. In simple terms, tax evasion refers to any attempt to avoid payment of taxes by using illegal means.

Tax avoidance

- Between two extremes i.e., tax planning and tax evasion, a vast domain for selecting a variety of methods which, though technically satisfying the requirements of law, in fact, circumvent it with a view to eliminate or reduce tax burden.

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Common forms of tax evasion

- Misrepresentation or suppression of facts;
- Failure to record investments in books of account;
- Claim of expenditure not substantiated by any evidence;
- Recording of any false entry in books of account;
- Failure to record any receipt in books of account having a bearing on total income; and
- Failure to report any international transaction or deemed international transaction or specified domestic transaction under Chapter X.

These constitute misreporting of income attracting penalty@200% under section 270A.

(3) **Judicial thinking—A brief study:** The judicial attitude towards tax avoidance schemes is very strict and the landmark judgment of the Supreme Court in *M/s. Mc Dowell and Co. Ltd. vs. Commercial Tax Officer (1985) 154 ITR.148 (SC*) is proof of the same. Though this decision was rendered in the context of A.P. General Sales Tax Act, the principles emerging out of this decision will have relevance to direct taxes also.

Before discussing the relevant observations of the Supreme Court in relation to tax avoidance scheme it will be instructive to have an idea of the development in judicial thinking in England since our own judicial thinking on the subject has been largely derived from English thinking.

English Scene: In *Inland Revenue Commissioner vs. Duke of Westminster 1936 AC 1* it was held "Every man is entitled if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."

After the World War II and the consequent huge profiteering and racketeering the attitude of the courts towards the avoidance of tax perceptibly changed and hardened. Commenting on a tax avoidance scheme, the court observed that it scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers.

It was felt that there must be some limit to the devices which courts can put up with in order to defeat the fiscal intentions of the legislature. A very significant departure from the Westminster Principle was made in *Ramsay vs. Inland Revenue Commissioners (1982) AC 300*. It was felt in that case that even though the doctrine that courts could not go behind a given genuine document or transaction to some supposed underlying substance was a cardinal principle, it must not be overstated or over-extended. While obliging the courts to accept documents or transactions, found to be genuine,

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as such, the doctrine did not compel the court to look at the document or transaction in blinkers isolated from any context to which it properly belonged. If it could be seen that a document or transaction was intended to have effect as a part of a nexus or series of transactions or as an ingredient of a wider transaction intended as a whole, there was nothing in the doctrine to prevent it being so regarded. To do so was not to prefer form to substance or substance to form. It was the task of the court to ascertain the legal nature of any transaction to which it was sought to attach a tax consequence and if that emerged from a series or combination of transactions, intended, apart as such, as was that series or combination which might be regarded.

Thus, two points were established. The first was a significant change in the approach adopted by the court with regard to its judicial role towards tax avoidance scheme. The second was that it was crucial when considering any such scheme to take the analysis far enough to determine where the profit, gain or loss was really to be found. It was also stated that the fact that the court accepted that each step in a transaction was a genuine step producing its intended legal results did not confine the court to consider each step in isolation for the purpose of assessing the fiscal results. Thus, we can say that the true principle of the decision in Ramsey was that the fiscal consequence of a preordained series of transactions intended to operate as such, are generally to be ascertained by considering the result of the series as a whole and not by dissecting the scheme and considering each transaction separately.

In *I.R.C. vs. Burmah Shell Co. Ltd. (1982) STC 30 (Burmah)* and *Furniss (Inspector of Taxes) vs. Dawson (1984) 1 All E.R.530*, it was held that where tax avoidance was targeted through a series of transactions with no commercial or substantial value but with the only aim of avoiding tax, the Courts have to ignore the transactions and the tax liability has to be determined as if these transactions never took place.

Indian Scenario: In *CIT vs. A. Raman & Co. 1 SCR 10,* the Supreme Court followed the dictum of the Westminster's case. It observed that avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. The taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon consideration of morality but on the operation of the Income-tax Act, 1961. Legislative injunction in taxing statutes may not, except on pain of penalty, be violated but it may lawfully be circumvented. The same view was expressed in *CIT vs. Kharwar (1969) 72 ITR 603 (SC)* as follows:

"The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction, if the parties have chosen to conceal by a device the legal relation, it is open for the taxing authorities to unravel the device and to determine the true character of relationship. The legal effect of a transaction, however, cannot be displaced by probing into the substance of the transaction."

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However, the Supreme Court in *Mc Dowell's* case clearly departed from the above views and expressly disassociated itself with the earlier observations of the Supreme Court echoing the sentiments of Westminster principle. The court enumerated the evil consequences of tax avoidance as follows:

(1) Substantial loss of much needed public revenue.

(2) Serious disturbance caused to the economy of the country by the piling up mountains of black money, directly causing inflation.

(3) Large hidden loss to the community by some of the best brains of the country involved in perpetual litigation.

(4) Sense of injustice and inequality which tax avoidance arouses in the minds of those who are unwilling or unable to profit from it.

(5) The unethical practice of transferring the burden of tax liability to the shoulders of the guileless, good citizens from those of the 'artful dodgers'.

The court felt that there was as much moral sanction behind taxation laws as behind any other welfare legislation and avoidance of taxation was not ethical.

In the view of the Court, the proper way to construe a taxing statute while considering a device to avoid tax was not to ask whether the provisions should be construed literally or liberally, nor whether the transaction was not unreal and not prohibited by the statute, but whether the transaction was as device to avoid tax and whether the transaction was such that the judicial process might record its approval to it.

The court felt that it was neither fair nor desirable to expect the legislature to intervene and take care of every device to avoid taxation. It was up to the court to take stock to determine the nature of the new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices could be related to the existing legislation with the aid of emerging techniques of interpretation as was done in Ramsey's case to expose the devices for what they are really worth and to refuse to give judicial benediction.

The Supreme Court emphasised that tax planning may be legitimate provided it is within the framework of law and colorable devices cannot be part of tax planning. It is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. The Supreme Court also recommended that it is the obligation of every citizen to pay the taxes honestly without resorting to subterfuge.

Tax planning may be legitimate provided it is within the framework of law

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Another significant case decided by the Supreme Court, though involving a dispute relating to payment of bonus, is worthy of reference at this stage as it also reflects the same thinking as in *Mc Dowell's* case. In *Associated Rubber Industries case (1986) 157 ITR 77(SC)*, a new wholly owned subsidiary company was created with no asset of its own except investments transferred by the holding company with no business income, except receiving dividend from the transferred investments. The Supreme Court held that on facts, the purpose of such a transfer of investments was nothing but to reduce the gross profits of the holding company and thereby to reduce the payment of bonus. There was no direct evidence that the subsidiary was formed as a device to reduce the gross profits of the principal company for whatever purpose. But Justice Chinnappa Reddy in passing his judgment was following the principles earlier laid down by him in *Mc Dowell's* case and was of the opinion that the transfer of shares was nothing but a device like tax evasion to avoid a welfare legislation like the Payment of Bonus Act. It was observed that it is the duty of the Court in every case where ingenuity is expended to avoid liability to taxation and welfare legislation, to get behind the smoke screen and discover the true state of affairs.

The above decision seems to have introduced a new doctrine that it is upto the court to take stock, weigh out sophisticated legal devices and expose the devices for what they really are. The fact that this new doctrine has started gaining ground very fast is seen from a quick succession of decisions, after *Mc Dowell* in *Kartikeya vs. Sarabhai* and in *Associated Rubber's* case. The above change in the trend of judicial thinking clearly shows that the line of demarcation between Tax Planning and Tax avoidance.

In order to curb tax avoidance, provisions such as

- applicability of transfer pricing provisions in respect of specified domestic transactions,
- treating any transaction with the person located in the notified jurisdiction areas to be treated as international transaction,
- General Anti-avoidance Rules,
- provisions relating to furnishing of Tax Residency Certificate for claiming benefit of double tax avoidance agreements

have been introduced.

The decision in *Mc Dowell's* case and the subsequent developments have evoked lot of debate in all legal and tax circles.

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The Gujarat High Court in *CIT vs. Smt. Minal Rameshchandra (1987) 61 CTR (Guj) 80* had occasion to consider the impact of *Mc Dowell's* case. The following propositions appear to emerge from the same.

(i) *Mc Dowell's* case and observations therein cannot be ignored and these are binding on all courts.

(ii) *Mc Dowell's* case and observation therein should be understood in the context of questioning the legitimacy of the use of artificial and transparent device and sham practices to circumvent the law.

(iii) Where the arrangement cannot be dismissed as an artificial tax device (and not as a legitimate transaction), the subject can be taxed only having "regard to strict letter of the law and not merely to the spirit of the statute or the substance of the law" and had been consistently laid down earlier. In this sense there is no radical departure from law, prior to Mc Dowell case.

In *CWT. vs. Arvind Narottam [1988] 173 ITR 479 (SC)* Judge Sabyasachi Mukharji J. made the following significant observations:

(i) Where the language of the deed of settlement is plain and admits no ambiguity there is no scope for considerations of tax avoidance.

(ii) One would wish as noted by Chinnappa Reddy in Mc Dowell's case that one could get the enthusiasm of Justice Holmes that taxes are the price of civilization and one would like to pay that price to buy civilization. But the question which many ordinary taxpayers very often in a country of shortages (with ostentatious consumption and deprivation for the large masses) ask is does he with taxes buy civilization or does he facilitate the waste and ostentation of the few. Unless waste and ostentation in government spending are avoided or eschewed no amount of moral sermons would change people's attitude to tax avoidance.

(iii) Where the true effect on the construction of the deeds is clear, appeal to discourage tax avoidance is not a relevant consideration".

In the light of the above development, we have to ascribe a proper meaning to the concept of tax-planning. We can take a cue from the structure of our tax laws.

Our tax laws tend to serve a dual purpose of collecting revenue and of achieving certain social objectives. There are in-built tax incentives which promote savings and investments in new enterprises and facilitate the development of backward areas. A lot of exemptions and incentives are provided in all the direct taxes. If an assessee takes maximum advantage of these incentives,

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exemptions etc. and enlarges the scope of his disposable resources, there can be no objection because the legislature wants the optimum utilisation of these incentives to promote economic activity in the country. The complexity of our tax-laws makes it impossible for even an intelligent assessee to comprehend them properly and avail all the reliefs which may be genuinely provided by such laws. Moreover, the interaction of other laws such as MRTP Act, FERA, Companies Act etc. make the exercise much more complicated. It requires, therefore, meticulous planning to bring down the tax commitments keeping in view not only the statutes but also the judge-made law. We may say that the above area properly belongs to tax-planning. In this sense there is nothing unethical about tax-planning.

Due to constant changes in the law and new court decisions, it is always necessary to have a continuous review in relation to all matters of tax planning so that appropriate changes are introduced without delay.

(4) Doctrine of form and substance: One of the reasons which prompts a taxpayer to resort to tax planning is the existence of the doctrine of form and substance. The principle involved in this doctrine is simple. How far Court may stretch the wording of a Statute to cover a particular set of facts, where those facts have clearly been created by a tax payer in order to avoid or minimise his tax and the literal interpretation of the Statute is not, at first sight apt to cover them? Is it possible to ignore the form of a transaction and determine the substance thereof?

Landmark Judgments wherein the doctrine of form and substance played a major role in decision making:

(i) In *Commissioner of Income tax vs. Motor and General Stores (P) Ltd. (1967) 66 ITR 692,* the Supreme Court had observed that in the absence of any suggestion of bad faith or fraud the true principle is that the taxing statute has to be applied in accordance with the legal rights of the parties to the transaction. According to the court, when the transaction is embodied in a document the liability to tax depends upon the meaning and content of the language used in accordance with the ordinary rules of construction. The House of Lords in *Duke of Westminster vs. ICR (1936) 19 ATC 498* held that in considering the substance of the transaction, the legal form cannot be disregarded.

(ii) It was held in *CIT vs. B.M. Kharwar (1969) 72 ITR 603 (SC)* that the taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by device the legal relation, it is open to the taxing authority to unravel the device and to determine the true character of the relationship. However, the legal effect of a transaction cannot be displaced by probing into 'the substance of the transaction'. This principle applies alike to cases in which the legal relation is recorded in a

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formal document and to cases where it has to be gathered from the evidence - oral and documentary - and the conduct of the parties to the transaction. However, this view of the Supreme Court has now been expressly disapproved by the Supreme Court in *Mc Dowell & Co. Ltd.'s case.*

(iii) Justice Shah, in *Ram Laxman Sugar Mills vs. CIT (1967) 66 ITR 613, 617 (SC),* has stated that to ascertain the legal effect of a transaction, the court seeks, in the first instance, to determine the intention of the parties and if ambiguous expressions are used, the court may normally adopt such interpretation consistent with the parties thereto having acted on the assumption of its validity. Thus, any claim made by a taxpayer will be scrutinized from the point of view of his intention and if there was any intention to defraud the revenue, the court will consider the transaction or the claim as fraud.

Thus, we can say that unless there is clear evidence of *malafide* intention resulting in a form which is a "colorable device" or "mere legal facade" or "non-genuine" form the tax authorities are not justified in disregarding the legal form and probing into the substance of the transaction.

Principles governing the form and substance: Theory of interpretation of a taxing statute:

(i) It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability while, if it is entered into in another form which is equally lawful, it may not. In considering, whether a transaction attracts tax or not, the form of the transaction put through by the assessee is to be considered and not the substance thereof.

(ii) The above rule cannot naturally apply where the transaction, as put through by the assessee, is not genuine but colourable or is a mere device. For here, the question is not one between 'form' and 'substance' but between appearance and truth.

(iii) In deciding whether the transaction is a genuine or colourable one, it will be open to the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction.

(iv) Where the authorities are charged under the Act with the duty of determining the nature or purpose of and payment or receipt on the facts of a case, it is open to them to work at the substance of the matter and the formal aspect may be ignored.

(v) Where the terms of a transaction are embodied in a document, it should not be construed only in its formal or technical aspect. While the words used should be looked at, too much importance should not be attached to the name or label given by the parties and the document

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should be interpreted so as to accord with the real intention of the parties as appearing from the instrument.

As noted earlier, the decisions of the Supreme Court in the cases of *Mc Dowell, Karthikeya Sarabhai and Associated Rubber Industries,* clearly show a preference for the 'substance' over the 'form', if the circumstances of the case warrant such a preference. Where the transactions are genuine, perfectly authentic and not sham, the mere fact that the transaction results in less liability or no liability to tax should not put the transaction to a legal scrutiny questioning the substance of the transaction, attributing a motive behind it. It is up to the Court to take stock of the situation, weigh out sophisticated legal devices and expose the devices for what they really are.

(5) **Doctrine of Precedence:** Doctrine of Precedence would be applicable in case of tax laws. The following principles which govern the rule of precedence may be noted.

- **Supreme Court:**

  (i) The Supreme Court judgments are *absolutely binding* on all the courts, Tribunals and authorities.

  (ii) Not only the *ratio decidendi*[1], but also *obiter dicta*[2] of the Supreme Court are binding on all the Courts.

  (iii) When there are two irreconcilable decisions of the Supreme Court on some point of law, the decision of a larger Bench shall prevail.

  (iv) When there are two irreconcilable decisions of two Benches of similar strength, the decision later in time will have to be followed by the lower courts.

  (v) The Supreme Court judgments cannot be ignored by the lower courts though such judgments are *per incuriam.*

  (vi) The Supreme Court, though expected to follow its own judgments, is not bound to follow them and in appropriate cases it can review its earlier judgment.

- **High Courts:**

  (i) A Division Bench of a High Court is generally bound by its earlier decision, but it may refuse to follow the same if the earlier judgment is *per incuriam*[3].

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[1] *the rationale for deciding a case*
[2] *things said by the way (additional observations, remarks, and opinions given while deciding a case)*
[3] *Without referring to the statutory provision*

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(ii) If the Division Bench of a High Court does not agree with its earlier judgment it will have to either follow the same or refer the issue to a Full Bench.

(iii) A Division Bench of High Court is bound to follow a decision of the Full Bench of the same High Court.

(iv) A single judge of a High Court is bound by a decision of a Division Bench or of the Full Bench of the same High Court.

(v) A single judge of a High Court is not bound to follow the decision of another single judge, though he is expected to follow the same.

(vi) All the lower authorities, Commissioner (Appeals) and Tribunals are absolutely bound to follow the decision of a High Court within whose jurisdiction they function. Here, the High Court decisions include decision of a single judge.

(vii) The lower authorities and courts can ignore a decision of a High Court only if it is overruled by a larger Bench of the same High Court, or by the Supreme Court or by a later enactment.

- **Others:**

(i) The Assessing Officer and the Commissioner, while acting under section 263, cannot refuse to follow the decision of the High Court. They cannot pass orders which are inconsistent with the decisions of the High Court within whose jurisdiction they function, even for the purpose of keeping the issue alive.

(ii) In all Indian Acts like the Income-tax Act, 1961, to keep the uniformity of law, a High Court should normally follow the decision of another High Court, unless it finds an overriding reason not to follow the same.

(iii) The lower appellate authorities are bound to follow the decision of another High Court, though they do not function within the jurisdiction of the said High Court, if there is no contrary decision of any other High Court.

(iv) The Assessing Officer or the Commissioner need not follow the decision of another High Court if the department has not accepted the said decision and has taken the matter to Supreme Court.

(v) The Bench of the Appellate Tribunal, should generally follow the orders of other Benches of the Tribunal, unless those orders of the Tribunal are *per incuriam.*

(vi) An order of a Full Bench of a Tribunal is binding on the ordinary Bench of the Tribunal.

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(vii) If an ordinary bench of a Tribunal does not agree with an order of another Bench of the Tribunal, and that order of another Bench of the Tribunal is not *per incuriam*, the Bench cannot differ from the view taken by the other Bench. It can only get the matter referred to a larger Bench. But this is subject to the general rule that as far as possible, the Bench should try to follow the orders of the Benches.

(viii) The Tribunal orders are binding on the Commissioner (Appeals) falling within the territorial jurisdiction of the Tribunal passing the order in question.

(ix) The Assessing Officer and the Commissioner are bound by the order of the Tribunal (falling within the jurisdiction of the Tribunal unless the Department has not accepted the decision of the Tribunal.)

Summary for Quick Reference of Doctrine of Precedence:

Decision of	Will precede over the decision of
Supreme Court	
Supreme Court	All the Courts, Tribunals and authorities
Larger Bench of Supreme Court	Smaller Bench of Supreme Court
Supreme Court at a later point in time (if same strength)	Supreme Court at an earlier point in time
High Court	
High Court (even if single judge decision)	All the lower authorities, Commissioner (Appeals), Joint Commissioner (Appeals) and Tribunals functioning within the jurisdiction of the High Court
Full Bench of High Court	Division Bench of same High Court and single judge of same High Court
Division Bench of High Court	Single Judge of same High Court
Appellate Tribunal	
Full Bench of a Tribunal	Ordinary Bench of the Tribunal
Tribunal	Assessing Officer, Commissioner and Commissioner (Appeals)

11.2 GENERAL ANTI-AVOIDANCE RULES

There is a growing concern amongst the revenue in many countries that taxpayers structure transactions to reduce the tax costs. The Base Erosion and Profits Shifting (BEPS) project of the

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Organization for Economic Cooperation and Development ("OECD") along with G-20 countries sort to tackle this issue. The BEPS Action plans have come out with various recommendations on the issue, both to address it within the international treaty framework (for example, introducing the principle purpose test, limitation of benefits clause, amending the permanent establishment clause, etc.) and in the domestic tax law context (for example, controlled foreign corporation rules, equalization levy, etc.).

Tax avoidance is not defined in taxing statutes. Tax avoidance is, nevertheless, the outcome of actions taken by the assessee, none of which or no combination of which is illegal or forbidden by the law as such. International literature on the subject tends to describe it in the following ways:

- Tax avoidance involves the legal exploitation of tax laws to one's own advantage.
- 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 in the law.
- An arrangement entered into solely or primarily for the purpose of obtaining a tax advantage.

Taxpayers consider it their legitimate right to arrange their affairs in a manner as to pay the least tax possible. However, tax authorities internationally consider aggressive tax planning schemes by taxpayers to erode the tax base unnaturally, particularly when effective rates of tax diminish significantly. Several countries have, therefore, legislated to prevent tax avoidance in various ways

The General Anti-Avoidance Rules (GAAR) provisions aim at combating 'impermissible tax avoidance'. Many countries, like the United Kingdom, China, South Africa, Australia, Canada and Brazil have incorporated General Anti-Avoidance Rules in their domestic tax laws to deal with aggressive tax planning.

The Indian GAAR

In India, the GAAR concept was initially introduced in the Direct Taxes Code Bill, 2009 [DTC Bill, 2009]. Later, a Revised Discussion Paper was released. The Direct Taxes Code Bill, 2010 [DTC Bill, 2010] proposed to introduce GAAR from 1st April 2012 onwards. The GAAR provisions were introduced in the Income-tax Act, 1961 *vide* the Finance Act, 2012 by insertion of new Chapter X-A. Chapter X-A was substituted by the Finance Act, 2013.

The Government subsequently set up a panel under Parthasarathy Shome to review the proposals. The Committee suggested that the rules be deferred by three years to 2016-17, arguing that more time is needed to create administrative machinery for its implementation and called for intensive training of officials.

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The Shome Committee Report explains the need for and rationale of GAAR as under:

(i) GAAR has been enacted as a codification of the proposition that, while interpreting the tax legislation, substance should be selected over a legal form.

(ii) Transactions have to be real and are not to be looked at in isolation.

(iii) The fact that the transactions are legal, does not imply that they are acceptable with reference to the underlying meaning embedded in the fiscal statute.

(iv) Thus, where there is no business purpose except to obtain a tax benefit, the GAAR provisions would not allow such a tax benefit to be availed through the tax statute. These propositions have comprised part of jurisprudence in direct tax laws as reflected in various judicial decisions.

The GAAR provisions codify this 'substance over form' basis of the tax law.

The CBDT, vide Press Release dated January 27, 2017, clarified that the GAAR provisions shall be effective from A.Y.2018-19 onwards, i.e., financial year 2017-18 onwards. The provisions of GAAR are contained in Chapter X-A of the Income-tax Act, 1961. The necessary procedures for application of GAAR and conditions under which it shall not apply, have been enumerated in Rules 10U to 10UC of the Income-tax Rules, 1962.

Prior to A.Y. 2018-19, the Act contained only Specific Anti-Avoidance Rules (SAARs) to prevent tax avoidance. SAAR targets known tax planning schemes which are commonly used by taxpayers but are not acceptable owing to misuse or abuse of tax laws, or they result in a consequence unintended in the law. In the Act, the following may, *inter alia*, be considered specific examples of SAAR -

(i) Section 40A(2) on excessive or unreasonable payments to related parties not deductible

(ii) Section 80-IA(8) on transactions with tax exempt entities to be valued at market value.

(iii) Sections 92 to 92F on transfer pricing regulations applicable to international transactions. These provisions are also made applicable to specified domestic transactions by the Finance Act, 2012.

(iv) Section 93 on avoidance of tax by transfer of income to non-residents through transfer of assets, rights or interest.

(v) Section 94 on avoidance of tax by certain transactions in securities.

(vi) Section 94A on transactions with persons located in notified jurisdictions.

(vii) Section 2(22)(e) on deemed dividend.

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(viii) Section 40(a)(i) and (ia) on the disallowance of expenses for non-deduction of tax at source.

(ix) Section 9 on scope of 'income deemed to accrue or arise in India'. The Finance Act, 2012 had widened its scope to overcome the Supreme Court's ruling in Vodafone and some other cases.

(x) *Explanations 1 to 13* to section 43(1) on determination of actual cost of assets ignoring agreements, etc., in certain cases.

Tax treaties also provide certain anti-avoidance rules for instance, the Limitation of Benefit (LOB) Clause and concept of Beneficial Ownership.

The above list of provisions relating to SAAR other than section 94 are discussed in the respective chapters of the Study Material. Before moving to the discussion on provisions of GAAR, let's understand section 94.

Special provisions for avoidance of tax by certain transactions in securities [Section 94]

Section 94 aims at preventing avoidance of tax by an assessee by sale or purchase of securities under different circumstances.

Dividend and Income Stripping transactions [Section 94(7)]

(a) If any person buys or acquires any securities or unit within a period of three months prior to the record date and

(b) such person sells or transfers –

  (i) such securities **within a period of three months** after such date, or

  (ii) such unit within a period **of nine months after such date** and

(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then, the loss, if any, arising therefrom shall be ignored for the purposes of computing his income chargeable to tax. Such loss would be ignored to the extent of the amount of dividend or income received or receivable on such securities or unit.

Note *– Since dividend and income from units of mutual fund specified under section 10(23D) and UTI is taxable in the hands of shareholders/unitholders, the provisions of section 94(7) are currently not relevant in relation to such income.*

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In case of dividend from units of business trust, the same would be taxable in the hands of unitholders, if the Special Purpose Vehicle (SPV) exercises the option under section 115BAA, in which case the provisions of section 94(7) would not be attracted. However, if the SPV does not exercise option under section 115BAA, dividend component of income distributed to unit-holders would be exempt in the hands of unit-holders, in which case the provisions of section 94(7) would be attracted if the person buys and sells or transfers units within the specified period mentioned above.

Bonus Stripping Transactions [Section 94(8)]

According to section 94(8), where

(a) any person buys or acquires any securities or units within a period of **three months** prior to the record date;

(b) such person is allotted additional securities or units without any payment on the basis of holding such securities or units on such date;

(c) such person sells or transfers all or any of the securities or units referred to in (a) above within a period of **nine months** after such date, while continuing to hold all or any of the additional securities or units referred to in (b), then –

(i) the loss on sale of original securities or units sold within a period of 9 months after the record date will be ignored for the purpose of computing his income chargeable to tax and

(ii) the amount of such loss so ignored will be deemed to be the cost of purchase or acquisition of the bonus securities or units referred to in (b) above, held by him on the date of such sale or transfer.

Meaning of certain terms

	Term	Meaning
(i)	Record date	Such date as may be fixed by - (i) a company; or

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		(ii) a mutual fund or the Administrator of the specified undertaking or the specified company as referred to in the Explanation to section 10(35); (iii) A business trust (iv) An Alternative Investment Fund defined under regulation 2(1)(b) of the SEBI (AIF) Regulations, 2012 made under the SEBI Act, 1992 for the purposes of entitlement of the holder of the securities or units, as the case may be, to receive dividend, income, or additional securities or unit without any consideration, as the case may be.
(iii)	Securities	The term includes stocks and shares.
(iv)	Unit	It means (i) unit of a business trust (ii) unit of a mutual fund specified in section 10(23D) or unit of the Unit Trust of India. (iii) beneficial interest of an investor in an Alternative Investment Fund, and shall include shares or partnership interests.

Applicability of General Anti-Avoidance Rule [Section 95]

(i) Section 95 of the Act with regard to the applicability of GAAR provides that an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising there from may be determined subject to the provisions of this Chapter.

(ii) The section further clarifies that the provisions of this Chapter may be applied to any step in, or a part of, the arrangement as they are applicable to the arrangement.

(iii) The section starts with a non-obstante clause which means, if there is a conflict with provisions in other sections, then this section shall prevail over other conflicting provisions.

(iv) The term arrangement referred to in section 95 of the Act, has been defined in section 102(1) and means any step in, or a part or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding;

The term 'Step' has been defined in section 102(9) to include a measure or an action, particularly one of a series taken in order to deal with or achieve a particular thing or object in the arrangement.

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Example 1

Facts:

M/s India Chem Ltd. is a company incorporated in India. It sets up a unit in a Special Economic Zone (SEZ) in F.Y. 2019-20 for manufacturing of chemicals. It claims 50% deduction of profits earned from that unit in F.Y. 2025-26 and subsequent years as per section 10AA of the Act. Is GAAR applicable in such a case?

Interpretation:

There is an arrangement of setting up of a unit in SEZ which results in a tax benefit. However, this is a case of tax mitigation where the tax payer is taking advantage of a fiscal incentive offered to him by complying with the conditions imposed and economic consequences of the provisions in the legislation e.g., setting up the business unit in SEZ area. Hence, the Revenue would not invoke GAAR as regards this arrangement.

Example 1A

Facts:

In the above example 1, let us presume M/s India Chem Ltd. has another unit for manufacturing chemicals in a non-SEZ area. It then diverts its production from such manufacturing unit and shows the same as manufactured in the tax exempt SEZ unit, while doing only the process of packaging there. Is GAAR applicable in such a case?

Interpretation:

This is a case of misrepresentation of facts by showing production of non-SEZ unit as production of SEZ unit. Hence, this is an arrangement of tax evasion and not tax avoidance.

Tax evasion, being unlawful, can be dealt with directly by establishing correct facts. GAAR provisions will not be invoked in such a case.

Example 1B

Facts:

In the above example 1A, let us presume that M/s India Chem Ltd. does not show production of non-SEZ unit as a production of SEZ unit but transfers the product of non-SEZ unit at a price lower than the fair market value to SEZ unit and does only some insignificant activity in SEZ unit. Thus, it is able to show higher profits in SEZ unit than in non-SEZ unit, and consequently claims higher deduction in computation of income. Can GAAR be invoked to deny the tax benefit?

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Interpretation:

As there is no misrepresentation of facts or false submissions, it is not a case of tax evasion. The company has tried to take advantage of tax provisions by diverting profits from non-SEZ unit to SEZ unit. This is not the intention of the SEZ legislation. However, such tax avoidance is specifically dealt with through the provisions contained in section 10AA(9), as per which provisions of section 80-IA(8) would get attracted in such a case. Further, if the aggregate of such transactions entered into in the relevant previous year exceed the threshold of ₹ 20 crore, domestic transfer pricing regulations under section 92BA would be attracted. Hence, the Revenue need not invoke GAAR in such a case, though GAAR and SAAR can co-exist as per clarification given in the CBDT Circular.

Example 1C

Facts:

In the above example 1B, let us presume, that both units in SEZ area (say A) and non-SEZ area (say B) work independently. M/s India Chem Ltd. started taking new export orders from existing as well as new clients for unit A and gradually, the export from unit B declined. The company offered lower profits from unit B in computation of income. Can GAAR be invoked on the ground that there has been shifting or reconstruction of business from unit B to unit A for the main purpose of obtaining tax benefit?

Interpretation:

The issue of tax avoidance through shifting/reconstruction of existing business from one unit to another has been specifically dealt with in section 10AA of the Act. Hence, the Revenue need not invoke GAAR in such a case, though GAAR and SAAR can co-exist as per clarification given in the CBDT Circular.

Impermissible Avoidance Agreement [Section 96]

(1) An impermissible avoidance arrangement (IAA) means an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and also any of the following tests is satisfied:

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(2) **The purpose test of obtaining tax benefit and tainted element test as under clauses (a) to (d)** above are **twin conditions** that satisfy an impermissible avoidance arrangement. The purpose test requires that the main purpose or one of the main purposes is to obtain tax benefit. The term "tax benefit" has been defined in section 102 clause (10) as under -

(a) a reduction or avoidance or deferral of tax or other amount payable under this Act; or

(b) an increase in a refund of tax or other amount under this Act; or

(c) a reduction or avoidance or deferral of tax or other amount that would be payable under this Act, as a result of a tax treaty; or

(d) an increase in a refund of tax or other amount under this Act as a result of a tax treaty; or

(e) a reduction in total income or

(f) an increase in loss,

in the relevant previous year or any other previous year.

(3) **The first tainted element** refers to non-arm's length dealings where an arrangement creates rights and obligations, which are not normally created between parties dealing at arm's length. As there are specific transfer pricing regulations (SAAR) applicable to international transactions and certain specified domestic transactions, this tainted element is to be

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examined only in those transactions which are not covered by Transfer Pricing regulations and where the main purpose of the arrangement is to obtain tax benefit.

(4) **The second tainted** element refers to an arrangement which results in misuse or abuse of the provisions of the Act. It implies cases where the law is followed in letter or form but not in spirit or substance, or where the arrangement results in consequences which are not intended by the legislation, revealing an intent to misuse or abuse the law.

Example 2

Facts:

Under the provisions of a tax treaty between India and country F4, any capital gains arising from the sale of shares of Indco, an Indian company, would be taxable only in F4 if the transferor is a resident of F4 except where the transferor holds more than 10% interest in the capital stock of Indco. A company, A Ltd., being resident in F4, makes an investment in Indco through two wholly owned subsidiaries (K Ltd. and L Ltd.) located in F4. Each subsidiary holds 9.95% shareholding in the Indian Company, the total adding to 19.9% of equity of Indco. The subsidiaries sell the shares of Indco and claim exemption as each is holding less than 10% equity shares in the Indian company. Can GAAR be invoked to deny treaty benefit?

Interpretation:

The above arrangement of splitting the investment through two subsidiaries appears to be with the intention of obtaining tax benefit under the treaty. Further, there appears to be no commercial substance in creating two subsidiaries as they do not change the economic condition of investor A Ltd. in any manner (i.e. on business risks or cash flow), and reveals a tainted element of abuse of tax laws. Hence, the arrangement can be treated as an impermissible avoidance arrangement by invoking GAAR. Consequently, treaty benefit

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would be denied by ignoring K and L, the two subsidiaries, or by treating K and L as one and the same company for tax computation purposes.

(5) **The third tainted** element refers to an arrangement which lacks commercial substance or is deemed to lack commercial substance.

(6) **The fourth element** refers to an arrangement which is entered into, or carried out, by means of, or in a manner which is normally not employed for a bona fide purpose. In other words, it means an arrangement that possesses abnormal features. This is not a purpose test but a manner test.

Arrangement to lack commercial substance [Section 97]

Another alternate condition of an impermissible avoidance arrangement is that the arrangement lacks commercial substance or is deemed to lack commercial substance in whole or in part.

(1) Under section 97, certain arrangements have been deemed to lack commercial substance as under –

(a) the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or

(b) it involves or includes—

(i) round trip financing;

(ii) an accommodating party;

(iii) elements that have effect of offsetting or cancelling each other; or

(iv) a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction; or

(c) it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit (but for the provisions of this Chapter) for a party.

(d) it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained (but for the provisions of this Chapter)

(2) Clause (a) is the codification of **substance v. form doctrine**. It implies that where the substance of an arrangement is different from what is intended to be shown by the form of

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the arrangement, then the tax consequence of a particular arrangement should be assessed based on the —substance of what took place. In other words, it reflects the inherent ability of the law to **remove the corporate veil and look beyond form**.

(3) Sub-clause (i) of clause (b) deems an arrangement, which includes round tripping of funds, to lack commercial substance. For this purpose, the phrase round trip financing has been further defined. Round trip financing includes any arrangement in which, through a series of transactions—

(a) funds are transferred among the parties to the arrangement; and

(b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter),

without having any regard to—

(A) whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;

(B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or

(C) the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.

Example 3

Facts:

Indco incorporates a Subco in a LTJ (Low Tax Jurisdiction) with equity of US $100. Subco gives a loan of US $ 100 to another Indian company (X Ltd.) at the rate of 10% p.a. X Ltd. claims deduction of interest payable to Subco from the profit of business. There is no other activity in Subco. Can GAAR be invoked in such a case?

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Interpretation:

The arrangement appears to avoid payment of tax on interest income by Indco in case loan is directly provided by Indco to X Ltd. The arrangement involves round tripping of funds even though the funds emanating from Indco are not traced back to Indco in this case. Hence, the arrangement may be deemed to lack commercial substance.

Consequently, in the case of Indco, Subco may be disregarded and the interest income may be taxed in the hands of Indco.

(4) Sub-clause (ii) of clause (b) deems an arrangement which includes an accommodating party to lack commercial substance. For this, the phrase "accommodating party" has been further defined. A party to an arrangement shall be an accommodating party, if the main purpose of the direct or indirect participation of that party in the arrangement, in whole or in part, is to obtain, directly or indirectly, a tax benefit (but for the provisions of this Chapter) for the assessee whether or not the party is a connected person in relation to any party to the arrangement.

It means that where a party is included in an arrangement mainly for obtaining tax benefit to the taxpayer, then such party may be treated as an accommodating party and consequently the arrangement shall be deemed to lack commercial substance. Also, it is not necessary that such party should be connected to the taxpayer.

(5) Sub-clause (iii) of clause (b) deems an arrangement, which includes elements that have effect of offsetting or cancelling each other to lack commercial substance.

(6) Sub-clause (iv) of clause (b) deems an arrangement, which disguises value, source or location etc. of funds, to lack commercial substance. In other words, such arrangements have an element of deceit as regards funds.

(7) Clause (c) deems an arrangement to lack commercial substance where it involves the location of an asset or of a transaction or of the place of residence of any party and such location is without any substantial commercial purpose. It means if a particular location is selected for an asset or transaction or residence, and such selection has no substantial commercial purpose, then such arrangement shall be deemed to lack commercial substance.

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Example 4

Facts:

(i) Y Ltd. is a company incorporated in country C1. It is a non-resident in India.

(ii) Z Ltd. is a company resident in India.

(iii) A Ltd. is a company incorporated in country F1 and it is a 100% subsidiary of Y Ltd.

(iv) A Ltd. and Z Ltd. form a joint venture company X Ltd. in India after the date of commencement of GAAR provisions. There is no other activity in A Ltd.

(v) The India-F1 tax treaty provides for non-taxation of capital gains in the source country and country F1 charges no capital gains tax in its domestic law.

(vi) A Ltd. is also designated as a permitted transferee of Y Ltd. Permitted transferee means that though shares are held by A Ltd, all rights of voting, management, right to sell etc., are vested in Y Ltd.

(vii) As per the joint venture agreement, 49% of X Ltd's equity is allotted to A Ltd. and 51% is allotted to Z Ltd.

(viii) Thereafter, the shares of X Ltd. held by A Ltd. are sold to C Ltd., a company connected to the Z Ltd. group.

As per the tax treaty with country F1, capital gains arising to A Ltd. are not taxable in India. ***As per the India – Country C1 tax treaty, capital gains is chargeable to tax in the source country.*** *Can GAAR be invoked to deny the treaty benefit?*

Interpretation:

The arrangement of routing investment through country F1 results in a tax benefit. Since there is no business purpose in incorporating company A Ltd. in country F1 which is an LTJ, it can be said that the main purpose of the arrangement is to obtain a tax benefit. The alternate course available in this case is direct investment in X Ltd. joint venture by Y Ltd. The tax benefit would be the difference in tax liabilities between the two available courses.

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The next question is, does the arrangement have any tainted element? It is evident that there is no commercial substance in incorporating A Ltd. as it does not have any effect on the business risk of Y Ltd. or cash flow of Y Ltd. As the twin conditions of main purpose being tax benefit and the existence of a tainted element are satisfied, GAAR may be invoked.

Additionally, as all rights of shareholders of X Ltd. are being exercised by Y Ltd instead of A Ltd, it again shows that A Ltd lacks commercial substance.

Hence, it is possible to invoke GAAR in this case.

(8) In section 97(4), the following factors are considered relevant but not sufficient for determining whether an arrangement lacks commercial substance or not, namely—

(i) the period or time for which the arrangement (including operations therein) exists;

(ii) the fact of payment of taxes, directly or indirectly, under the arrangement;

(iii) the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.

Consequence of impermissible avoidance arrangement [Section 98]

(1) If an arrangement is declared to be an impermissible avoidance arrangement, then the consequences may include denial of tax benefit or a benefit under a tax treaty. The consequence may be determined in such manner as is deemed appropriate in the circumstances of the case. Certain illustrations of the manner have been provided, namely:—

(a) disregarding, combining or re-characterizing any step in, or a part or whole of, the impermissible avoidance arrangement;

(b) treating the impermissible avoidance arrangement as if it had not been entered into or carried out;

(c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;

(d) deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount;

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(e) reallocating amongst the parties to the arrangement—

(i) any accrual, or receipt, of a capital or revenue nature; or

(ii) any expenditure, deduction, relief or rebate;

(f) treating—

(i) the place of residence of any party to the arrangement; or

(ii) the situs of an asset or of a transaction,

at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or

(g) considering or looking through any arrangement by disregarding any corporate structure.

(2) It has also been provided that –

(i) any equity may be treated as debt or *vice versa*;

(ii) any accrual, or receipt, of a capital nature may be treated as of revenue nature or vice versa; or

(iii) any expenditure, deduction, relief or rebate may be recharacterised.

Treatment of connected persons and accommodating party [Section 99]

(1) As per section 99, for the purposes of Chapter X-A, in determining whether a tax benefit exists—

(i) the parties who are connected persons in relation to each other may be treated as one and the same person;

(ii) any accommodating party may be disregarded;

(iii) such accommodating party and any other party may be treated as one and the same person;

(iv) the arrangement may be considered or looked through by disregarding any corporate structure.

(2) The term 'connected person' is defined in section 102(4). Connected person means any person who is connected directly or indirectly to another person and includes –

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If Connected Person is an				A Company/Firm/AOP/BOI/HUF having substantial interest in the business of the person or any director/partner/member or any relative of such director/partner/member	A Company/Firm/AOP/BOI/HUF whose director/partner/member has substantial interest in the business of the person or family or any relative of such director/partner/member	Any person who carries on business – being an individual or any relative of such person has substantial interest in the business of that other person – being a company/ Firm/AOP/BOI/HUF or any director /partner/member or any relative of such director/partner/member has substantial interest in the business of that other person
Individual: any relative or who has substantial interest in the business of the person or any relative of such individual	**Company:** any director or relative of such director	**Firm/ AOP/ BOI:** any partner/ member or relative of such partner/member	**HUF:** Any member or relative of such member			

Framing of guidelines under Income-tax Rules [Section 101]

The provisions of Chapter XA have to be applied in accordance with such guidelines and subject to such conditions as may be prescribed. These guidelines are contained in Rules 10U to 10UC.

(1) As per Rule 10U, the provisions of General Anti Avoidance Rule are not applicable to

(a) an arrangement where the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed a sum of rupees three crores.

(b) a Foreign Institutional Investor -

(i) who is an assessee under the Act;

(ii) who has not taken benefit of an agreement referred to in section 90 or section 90A as the case may be; and

(iii) who has invested in listed securities, or unlisted securities, with the prior permission of the competent authority, in accordance with the Securities and Exchange Board of India (Foreign Institutional Investor) Regulations, 1995 and such other regulations as may be applicable, in relation to such investments.

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(c) a person, being a non-resident, in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly, in a Foreign Institutional Investor.

(d) any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investments made before the 1st day of April, 2017 by such person.

However, the provisions of GAAR shall apply to any arrangement [other than specified in (d) above], irrespective of the date on which it has been entered into, in respect of the tax benefit obtained from the arrangement on or after the 1st day of April, 2017.

(2) Where a part of an arrangement is declared to be an impermissible avoidance arrangement, the consequences in relation to tax shall be determined with reference to such part only [Rule 10UA].

(3) The Assessing Officer shall, before making a reference to the Commissioner under section 144BA(1), issue a notice in writing to the assessee seeking objections, if any, to the applicability of provisions of GAAR in his case [Rule 10UB(1)].

Implementation of GAAR Provisions under the Income-tax Act, 1961

Clarifications on certain queries about implementation of GAAR [Circular No.7 of 2017 dated 27-1-2017]

The provisions of Chapter X-A of the Income-tax Act, 1961 relating to General Anti-Avoidance Rule came into force from 1st April, 2017. Certain queries were received by the Board about implementation of GAAR provisions. The Board constituted a Working Group in June, 2016 for this purpose. The Board has considered the comments of the Working Group and the following clarifications were issued:

Question no. 1: *Will GAAR be invoked if SAAR applies?*

Answer: *It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislation. The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.*

Question no. 2: *Will GAAR be applied to deny treaty eligibility in a case where there is compliance with LOB test of the treaty?*

Answer: *Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR.*

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Question no. 3: *Will GAAR interplay with the right of the taxpayer to select or choose method of implementing a transaction?*

Answer: *GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.*

Question no. 4: *Will GAAR provisions apply where the jurisdiction of the FPI is finalised based on non-tax commercial considerations and such FPI has issued P-notes referencing Indian securities? Further, will GAAR be invoked with a view to denying treaty eligibility to a Special Purpose Vehicle (SPV), either on the ground that it is located in a tax friendly jurisdiction or on the ground that it does not have its own premises or skilled professional on its own roll as employees.*

Answer: *For GAAR application, the issue, as may be arising regarding the choice of entity, location etc., has to be resolved on the basis of the main purpose and other conditions provided under section 96 of the Act. GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction of FPI is finalized based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply.*

Question no. 5: *Will GAAR provisions apply to (i) any securities issued by way of bonus issuances so long as the original securities are acquired prior to 01 April, 2017 (ii) shares issued post 31 March, 2017, on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference Shares (CCPS), Foreign Currency Convertible Bonds (FCCBs), Global Depository Receipts (GDRs), acquired prior to 01 April, 2017; (iii) shares which are issued consequent to split up or consolidation of such grandfathered shareholding?*

Answer: *Grandfathering under Rule 10U(1)(d) will be available to investments made before 1st April 2017 in respect of instruments compulsorily convertible from one form to another, at terms finalized at the time of issue of such instruments. Shares brought into existence by way of split or consolidation of holdings, or by bonus issuances in respect of shares acquired prior to 1st April 2017 in the hands of the same investor would also be eligible for grandfathering under Rule 10U(1)(d) of the Income-tax Rules, 1962.*

Question no. 6: *The expression "investments" can cover investment in all forms of instrument - whether in an Indian Company or in a foreign company, so long as the disposal thereof may give rise to income chargeable to tax. Grandfathering should extend to all forms of investments including lease contracts (say, aircraft leases) and loan arrangements, etc.*

Answer: *Grandfathering is available in respect of income from transfer of investments made before 1st April, 2017. As per Accounting Standards, 'investments' are assets held by an enterprise for earning income by way of dividends, interest, rentals and for capital appreciation. Lease contracts*

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and loan arrangements are, by themselves, not 'investments' and hence grandfathering is not available.

Question no. 7: *Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial precedents etc.?*

Answer: *Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.*

Question no. 8: *Will a Fund claiming tax treaty benefits in one year and opting to be governed by the provisions of the Act in another year attract GAAR provisions? An example would be where a Fund claims treaty benefits in respect of gains from derivatives in one year and in another year set-off losses from derivatives transactions against gains from shares under the Act.*

Answer: *GAAR provisions are applicable to impermissible avoidance arrangements as under section 96. In so far as the admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR provisions.*

Question no. 9: *How will it be ensured that GAAR will be invoked in rare cases to deal with highly aggressive and artificially pre-ordained schemes and based on cogent evidence and not on the basis of interpretation difference?*

Answer: *The proposal to declare an arrangement as an impermissible avoidance arrangement under GAAR will be vetted first by the Principal Commissioner / Commissioner and at the second stage by an Approving Panel, headed by judge of a High Court. Thus, adequate safeguards are in place to ensure that GAAR is invoked only in deserving cases.*

Question no. 10: *Can GAAR lead to assessment of notional income or disallowance of real expenditure? Will GAAR provisions expand the scope of charging provisions or scope of taxable base and/or disallow the expenditure which is actually incurred and which otherwise is admissible having regard to diverse provisions of the Act?*

Answer: *If the arrangement is covered under section 96, then the arrangement will be disregarded by application of GAAR and necessary consequences will follow.*

Question no. 11: *A definite timeline may be provided such as 5 to 10 years of existence of the arrangement where GAAR provisions will not apply in terms of the provisions in this regard in section 97(4).*

Answer: *Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor under section 97(4) to determine whether an arrangement lacks commercial substance.*

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Question no. 12: *It may be ensured that in practice, the consequences of a transaction being treated as an 'impermissible avoidance arrangement' are determined in a uniform, fair and rational basis. Compensating adjustments under section 98 of the Act should be done in a consistent and fair manner. It should be clarified that if a particular consequence is applied in the hands of one of the participants, there would be corresponding adjustment in the hands of another participant.*

Answer: *Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner. In the event of a particular consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of another participant will not be made. GAAR is an anti-avoidance provision with deterrent consequences and corresponding tax adjustments across different taxpayers could militate against deterrence.*

Question no. 13: *Tax benefit of INR 3 crores as defined in section 102(10) may be calculated in respect of each arrangement and each taxpayer and for each relevant assessment year separately. For evaluating the main purpose to be obtaining of tax benefit, the review should extend to tax consequences across territories. The tax impact of INR 3 crores should be considered after taking into account impact to all the parties to the arrangement i.e. on a net basis and not on a gross basis (i.e. impact in the hands of one or few parties selectively).*

Answer: *The application of the tax laws is jurisdiction specific and hence what can be seen and examined is the Tax Benefit' enjoyed in Indian jurisdiction due to the 'arrangement or part of the arrangement'. Further, such benefit is assessment year specific. Further, GAAR is with respect to an arrangement or part of the arrangement and therefore limit of INR 3 crores cannot be read in respect of a single taxpayer only.*

Question no. 14: *Will a contrary view be taken in subsequent years if arrangement held to be permissible in an earlier year?*

Answer: *If the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in a subsequent year.*

Question no. 15: *No penalty proceedings should be initiated pursuant to additions made under GAAR at least for the initial 5 years.*

Answer: *Levy of penalty depends on facts and circumstances of the case and is not automatic. No blanket exemption for a period of five years from penalty provisions is available under law. The assessee, may at his option, apply for benefit u/s 273A if he satisfies conditions prescribed therein.*

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TEST YOUR KNOWLEDGE

Questions

1. *Distinguish between Tax planning and Tax Evasion.*

2. *Specify with reason, whether the following acts can be considered as (i) Tax planning; or (ii) Tax management; or (iii) Tax evasion.*

   (i) *Mr. P deposits ₹ 1,00,000 in PPF account so as to reduce his total income from ₹ 5,90,000 to ₹ 4,90,000.*

   (ii) *SQL Ltd. maintains a register of tax deduction at source effected by it to enable timely compliance.*

   (iii) *An individual tax payer making tax saver deposit of ₹ 1,00,000 in a nationalised bank.*

   (iv) *A partnership firm obtaining declaration from lenders/depositors in Form No. 15G/15H and forwarding the same to income-tax authorities.*

   (v) *A company installed an air-conditioner costing ₹ 75,000 at the residence of a director as per terms of his appointment but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.*

   (vi) *RR Ltd. issued a credit note for ₹ 80,000 as brokerage payable to Mr. Ramana who is the son of the managing director of the company. The purpose is to increase the total income of Mr. Ramana (paying tax as per default tax regime u/s 115BAC) from ₹ 11,20,000 to ₹ 12,00,000 and reduce the income of RR Ltd. correspondingly.*

   (vii) *A company remitted provident fund contribution of both its own contribution and employees' contribution on monthly basis before due date.*

3. *Examine the doctrine of form and substance in the context of tax planning.*

4. *The merger of a loss making company with a profit making one results in losses setting off profits, a lower net profit and lower tax liability for the merged company. Would the losses be disallowed by applying GAAR?*

5. *A choice is made by a company by acquiring an asset on lease over outright purchase. The company claims deduction for lease rentals in case of acquisition through lease rather than depreciation as in the case of purchase of the asset. Would the lease rent payment, being higher than the depreciation, be disallowed as expense under GAAR?*

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6. *M/s Global Architects Inc is a company incorporated in country F1. It is engaged in the business of providing architectural design services all over the world. It receives an offer from Lovely Resorts Pvt Ltd, an Indian company, for design and development of resorts all over India.*

   India-F1 tax treaty provides that architectural services are technical services and payment for the same to a company may be taxed in India. However, if such professional services are provided by a firm or individual, then payment for such services are taxable only if the firm has a fixed base in India or stay of partners/ employees in India exceed 180 days. Limitation of benefit clause does not exist in tax treaty between India-F1.

   M/s Global Architects Inc forms a partnership firm with a third party (director of the company) having only a nominal share in the F1. The firm enters into an agreement to carry out the services in India. The company seconded its trained manpower to the firm.

   Thus, the partnership firm claimed the treaty benefit and no tax was paid in India. Can such an arrangement be examined under GAAR?

Answers

1. Tax planning is carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimizing tax liability. Tax planning is an arrangement by which full advantage is taken of the concessions and benefits conferred by the statute, without violation of legal provisions. Tax evasion on the other hand is an attempt to reduce tax liability by dubious or artificial methods or downright fraud. It is illegal and denies the State its legitimate share of tax.

2. Tax Planning / Tax Management / Tax Evasion

	Answer	Reason
1.	**Tax planning**	Depositing money in PPF and claiming deduction under section 80C is as per the provisions of law.
2.	**Tax management**	Maintaining a register of payments subject to TDS helps in complying with the obligations under the Income-tax Act, 1961.
3.	**Tax planning**	Making a tax saver deposit of ₹ 1,00,000 in a nationalized bank for claiming deduction under section 80C by an individual is a permitted tax planning measure under the provisions of income-tax law.
4.	**Tax management**	Obtaining declaration from lenders/depositors in Form No. 15G/15H by a partnership firm and forwarding the same to Income-tax authorities is in the nature of compliance with statutory obligation under the Income-tax Act, 1961.

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5.	**Tax evasion**	An air conditioner fitted at the residence of a director as per the terms of his appointment would be a furniture qualifying for depreciation @10%, whereas an air conditioner fitted in a factory would be a plant qualifying for a higher depreciation @15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability. Treatment of air-conditioner fitted at the residence of a director as a plant fitted at the factory would tantamount to furnishing of false particulars in an attempt to evade tax.
6.	**Tax evasion**	Issuance of a credit note for ₹ 80,000 by RR Ltd. as brokerage payable to Mr. Ramana, the son of the Managing Director, to increase his total income from ₹ 11.2 lakh to ₹ 12.00 lakh and to correspondingly reduce the company's total income is a method of reducing the tax liability of the company by recording a fictitious transaction. The company is liable to tax at a flat rate of 30%/25%/22%, as the case may be, whereas Mr. Ramana would not be liable to pay any tax as per the default regime under section 115BAC, since his total income does not exceed ₹ 12,00,000, consequent to which he would be eligible for tax rebate of entire tax amount under section 87A. Reducing tax liability by recording a fictitious transaction would tantamount to tax evasion.
7.	**Tax management**	Remitting of own contribution to provident fund and employees contribution to provident fund on a monthly basis before the due date is proper compliance with the statutory obligations.

3. The following are certain principles enunciated by the Courts on the question as to whether it is the form or substance of a transaction, which will prevail in income-tax matters:

(i) **Form of transaction is to be considered in case of genuine transactions -** It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability whereas, if it is entered into in another form which is equally lawful, it may not. Therefore, in considering whether a transaction attracts tax or not, the form of the transaction put through is to be considered and not the substance. **However, this rule applies only to genuine transactions.** [*CIT v. Motor and General Stores (P) Ltd. v. CIT (1967) 66 ITR 692(SC).*

(ii) **True legal relation is the crucial element for taxability -** It is open for the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction. The taxing authority is entitled as well as bound to determine the true legal relation resulting from a transaction. The true legal relation arising from a

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transaction alone determines the taxability of a receipt arising from the transaction *[CIT v. B.M. Kharwar (1969) 72 ITR 603 (SC)]*

(iii) **Substance (i.e. actual nature of expense) is relevant and not the form –** Under section 97, an arrangement shall be deemed to lack commercial substance if the substance or effect of the arrangement as a whole, is inconsistent with or differs significantly from, the form of its individual steps or a part. Accordingly, such arrangement would be impermissible avoidance arrangement and be subject to GAAR. However, GAAR provisions will be applicable only to an arrangement where the tax benefit in the relevant A.Y. arising, in aggregate to all parties to the arrangement exceeds ₹ 3 crores. The Income-tax Act, 1961 also contains Specific Anti-avoidance provisions to address the concern of tax avoidance.

Some examples where Supreme Court has upheld substance over form are -

(a) In case of an expenditure, the mere fact that the payment is made under an agreement does not preclude the department from enquiring into the actual nature of the payment [*Swadeshi Cotton Mills Co. Ltd. v. CIT (1967) 63 ITR 57(SC)*].

(b) In order to determine whether a particular item of expenditure is of revenue or capital nature, the substance and not merely the form should be looked into. [*Assam Bengal Cement Co. Ltd. v. CIT (1955) 27 ITR 34 (SC)*].

4. As regards setting off of losses, the provisions relating to merger and amalgamation already contain specific anti-avoidance safeguards. Therefore, GAAR need not be invoked when SAAR is applicable, though as per *CBDT Circular No. 7/2017 dated 27.01.2017,* GAAR and SAAR can co-exist. Further, since merger and amalgamation would be carried out under the order of the National Company Law Tribunal (NCLT), GAAR need not be invoked if the NCLT has explicitly and adequately considered the tax implication while sanctioning the merger scheme.

5. GAAR provisions would not apply in this case as the taxpayer merely makes a selection out of the options available to him under the provisions of the Act for which he is eligible and satisfies the stipulated conditions, if any. Even if choice of such option results in lower tax liability, the same is a result of tax planning.

6. It is obvious that there was no commercial necessity to create a separate firm except to obtain the tax benefit. The firm was only on paper as the manpower was drawn from the company. The firm did not have any commercial substance. Moreover, it is a case of treaty abuse. Hence, GAAR may be invoked to disregard the firm and tax payment for architectural services as fee for technical services. However, the rate of tax on such payment shall be as applicable under the treaty, if more beneficial.

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CHAPTER 12

TAXATION OF DIGITAL TRANSACTIONS

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** the meaning of e-commerce and how business is transacted through E-commerce;
- **identify** the issues and problems in taxing e-commerce transactions;
- **comprehend** the OECD recommendations for taxing e-commerce transactions under Action Plan 1 of Base Erosion and Profit Shifting (BEPS) project;
- **determine** the income arising on transfer of virtual digital asset and taxability thereof;
- **examine** the applicability of the provisions of tax deducted at source on transfer of virtual digital asset by a resident assessee.

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CHAPTER OVERVIEW

E-commerce
- Meaning
- How e-commerce transactions takes place

Taxation of Virtual Digital Assets

12.1 INTRODUCTION

The rapid growth of information and communication technology has resulted in substantial expansion of the supply and procurement of digital goods and services globally, including India. The digital economy is growing at a faster pace than the global economy as a whole.

At present, in the digital domain, business may be conducted without regard to national boundaries and may dissolve the link between an income-producing activity and a specific location. Hence, business in digital domain doesn't actually occur in any physical location but instead takes place in "cyberspace." Persons carrying business in digital domain could be located anywhere in the world. Entrepreneurs across the world have been quick to evolve their business to take advantage of these changes. It has also made it possible for the businesses to conduct themselves in ways that did not exist earlier, and given rise to new business models that rely more on digital and telecommunication network, do not require physical presence, and derives substantial value from data collected and transmitted from such networks.

The growth of e-commerce economy has revolutionised the concept of *brick and mortar* to *click and order.* The need for physical presence in a jurisdiction is consequently getting diminished. Therefore, due to transformed business models, communication with suppliers and customers take place virtually and digitally. Emergence of new age technologies such as 3D printing, sharing economy, internet of things etc. has revolutionised new business models in line with the digital epoch making it difficult to identify the location of source or origin point of a business transaction.

The expansion of business in digital form, give rise to certain tax challenges in relation to nexus, data and characterization of digital transactions. Over the years, to address these tax challenges certain developments are taking place to tax digital transactions which are carried out either by a non-resident non-corporate/ a foreign company or by a resident assessee. This chapter

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encompasses these developments introduced in the form of taxation of gains arising on transfer of virtual digital assets by a resident assessee.

12.2 WHAT IS E-COMMERCE?

Clause (a) of *Explanation* to Section 194O defines "electronic commerce" to mean the supply of goods or services or both, including digital products over digital or electronic network.

E-commerce or electronic commerce is one of the main components of the Digital Economy. In its widest sense, it encompasses consumer and business transactions conducted over a network, with the help of computers and telecommunications. In other words, e-commerce refers to the exchange of goods or services for value on the internet. E-commerce, *inter-alia,* includes, online shopping, online trading of goods and services, electronic fund transfers, electronic data exchanges and online trading of financial instruments.

[1]OECD defines e-commerce as the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing orders. Accordingly, whether a commercial transaction qualifies as e-commerce is determined by the ordering method rather than the characteristics of the product purchased, the parties involved, the mode of payment or the delivery channel. The ordering process is considered as a crucial determinant of an e-commerce transaction in the OECD definition.

E-commerce facilitates trade across borders, increases convenience for consumers, and enables firms to reach new markets. E-commerce reforms have rapidly evolved through the development of new business models, which often integrate new and emerging digital technologies as well as new online payment mechanisms. Many e-commerce business models use online platforms, facilitating purchases between often unknown and dispersed buyers and sellers. Another emerging trend is the growth of subscription e-commerce business models, whereby users access goods and services in a continuous, recurring stream. E-commerce business models integrate digital ordering mechanisms alongside physical infrastructures, including within brick-and-mortar stores.

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[1] *OECD (2019), Unpacking E-commerce: Business Models, Trends and Policies, OECD Publishing, Paris, https://doi.org/10.1787/23561431-en.*

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12.3 CONDUCT OF BUSINESS IN DIGITAL ECONOMY

E-commerce is a method of conducting business transactions and not a business transaction by itself. Therefore, the contents of a business transaction done through e-commerce means is no different from that of a business transaction carried out through traditional means.

New business models expand the e-commerce frontier in two ways. First, new business models can enable more transactions to move online in a given market or for a given set of participants. Second, new business models can enable whole new markets to emerge for goods and services that previously could not have been bought or sold online, or allow new participants to enter the market.

Digital technologies enable e-commerce innovations and often serve as the backbone of business model developments. Some of these technologies, like smart assistants enabled by artificial intelligence (AI), constitute new channels for selling or purchasing products over electronic networks. Similarly, online payment innovations can help to unlock e-commerce potential by promoting trusted online transactions between unknown parties.

Classification of E-commerce based on parties involved in transactions. Major types are mentioned below:

(i) **Business to Customers (B2C):** In this type of e-commerce, transactions take place between businesses and consumers. In B2C e-commerce, products or services are sold to end-users (i.e. consumers).

Examples: *Amazon.in, Flipkart.com, Myntra.com, Snapdeal.com etc. are the examples of B2C e-commerce businesses, where consumers can find almost anything be it books, electronic products like washing machines, USB storage devices, clothes, shoes or personal care etc.*

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(ii) **Business to Business (B2B):** In B2B e-commerce, transactions take place between two businesses.

Example: *IndiaMART, TradeIndia, Alibaba, go4WorldBusiness.com (an online B2B marketplace for global exporters and importers), Amazon, the US-based ecommerce giant etc. are the example of B2B online platforms.*

(iii) **Government to Customers (G2C):** The online platform between a government and its citizens or consumers for paying taxes, registering vehicles, and providing information and services such as filing of income-tax return etc.

(iv) **Government to Business (G2B)/ Business to Government (B2G):** In G2B/ B2G e-commerce, an electronic exchange of any information between businesses and the government, usually using internet so the cooperation or communication takes place on the internet. In G2B, government agencies and business use websites, procurement marketplaces, applications, web services.

Example: *Government e-Marketplace (GeM), a one stop portal to facilitate online procurement of common use Goods & Services required by various Government Departments/Organizations / PSUs.*

INAM-Pro is a web based application, designed by National Highways and Infrastructure Development Corporation Ltd (NHIDCL) and launched by the Ministry as a common platform to bring cement buyers and sellers together.

(v) **Customer to Customer (C2C):** When goods or services are bought and sold between two consumers, C2C e-commerce business takes place.

Example: Olx, a C2C e-commerce online platform where customer sells his used goods to other customer; eBay, an online marketplace in which an individual sells a product or service to another.

E-Commerce Business Models

With the advancement of digitalization and emergence of new technologies, new forms of e-commerce business models have evolved. Some of such ways of transacting e-commerce business are discussed here below:

Online platform e-commerce business model:

In the context of e-commerce, online platforms act as intermediaries between buyers and sellers to facilitate the exchange of goods and services over the Internet. Buyers benefit due to the presence

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of variety of products available with diverse sellers. Likewise, sellers discover many buyers to whom they can sell their products. As compared to the physical stores, digital marketplace deliver variety of goods and service.

Meaning of Marketplace based model and Inventory based model of e-commerce[2]:

Marketplace based model *of e-commerce means providing an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller.*

Inventory based model of e-commerce *means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.*

Subscription e-commerce business model: Subscription business model is characterised by regular and recurring payments for the repeated provision of a good or a service. The subscription business model can relate to recurring purchases of digital goods and services, or a combination of both digital and tangible products (such as a newspaper subscription that includes access to digital content). Some current e-commerce subscription business models, such as Spotify or Netflix etc.

Digital identity and its potential for e-commerce: Digital identity refers to the set of information used by a computer to authenticate an identity. For example, India's Aadhaar programme issues a unique number to every Indian citizen which is a valid means of identification *vis-à-vis* the government as well as private Internet sites including Airbnb, Uber and digital wallet services.

Subscription access to tangible and bundled goods and services: A recent e-commerce trend has been the growth of subscription business models for tangible goods, including in categories like beauty supplies (Birchbox), minerals (Celestial Minerals), groceries (Blue Apron, Hello Fresh), snack foods (Nature Box), cosmetics and self-care products (Dollar Shave Club, Harry's), and many more.

Online-offline e-commerce business models: These business models serve as extensions of e-commerce, pushing the edges of online purchases into physical stores. Some business models combine online ordering with offline distribution, which may be useful to enable the online purchase of products whose quality may not be assessed from a distance, such as perishable goods like groceries. Many businesses have taken advantage of the ubiquity of digital technologies to grow business models based on a combination of both online and offline features. Other online businesses are moving offline by adding brick-and-mortar elements to enable the online sale of other goods, like clothing, where fit may be difficult to assess from a distance.

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[2] *Consolidated FDI Policy Circular of 2017, dated 28.8.2017 read with Press Note dated 26.12.2018*

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Mobile technologies - Helping e-commerce to flourish in brick-and-mortar stores: Mobile technologies empower consumers to perform a range of digital activities, including online shopping. Consumers use digital technologies throughout the commercial process, but smartphones enable buyers to compare prices, to do research and finally make transactions from any networked location.

Online groceries – e-commerce frontier: Many businesses are successfully selling perishable food and groceries online. Some online business models offer direct shipping of purchased groceries alongside guarantees related to quality and customer satisfaction to give consumers confidence in the purchase of perishable goods and services.

Innovative payment mechanisms: Safely and remotely exchanging money online, including across borders, is fundamental to e-commerce. Safe and effective online payment mechanisms facilitate trusted online transactions, boosting the growth of e-commerce between unknown buyers and sellers. Many online payment mechanisms are closely associated with the rise of e-commerce. In fact, one of the earliest online payment models is "Paypal", which is emerged in combination with the pioneering online auction house and e-commerce platform eBay, to enable safe online payments between the parties involved.

Digital wallets: An online payment can be broadly considered to be a "purchase order placed using devices connected to the Internet", a definition that is relevant to many forms of e-commerce. One mechanism of enabling online payments includes the use of digital wallets, also known as "e-wallets" or "electronic wallets".

Digital wallets allow e-commerce by enabling trusted transactions online, without which most e-commerce purchases would not be possible. Consumers may be more willing to do a transaction online using a digital wallet as opposed to directly sharing financial information with online retailers.

Mobile money - Extending e-commerce to the unbanked: Another form of payment innovation that enables e-commerce is the rise of a specific form of mobile payment, also known as "mobile money", particularly for unbanked people (i.e. those without access to financial services). Mobile money differs from digital wallets insofar that the mechanism for payment is conducted via mobile communication networks, and does not necessarily require an existing relationship with a financial services provider.

Mobile money is facilitated by mobile network operators who use a system of agents to accept regular currency in the form of cash and store an equivalent value in a digital wallet, which can then be transferred to other users or can be withdrawn later. Mobile money is connected with a mobile phone number and often uses two-factor authentication through a personal identification number issued at the point of registration. Mobile money can be transferred to others who are also registered

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with the same mobile money system, exchanged with merchants for goods and services, or can be withdrawn as cash from a mobile money agent. Mobile money can therefore act as a means of storing and transferring value in a secure and convenient way for unbanked people.

Resources: *The discussion on E-commerce Business Models in this chapter is essentially based on the text published in "Unpacking E-commerce: Business Models, Trends and Policies, OECD Publishing, Paris" available at https://doi.org/10.1787/23561431-en.*

12.4 TAXATION ISSUES RELATING TO DIGITAL ECONOMY

These new business models have created new tax challenges. The typical taxation issues relating to digital economy are:

(i) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,

(ii) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

The digital business, thus, challenges physical presence-based permanent establishment rules. If permanent establishment principles are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e. place of business, location, and permanency must be reconciled with the new digital reality. Further, characterizing the income as technical services becomes difficult since the technical services rendered digitally does not involve human intervention, as the digital platforms operate on sophisticated artificial intelligence mechanism. Hence the new digital business models gives rise to 'stateless income' and thereby going completely tax free.

12.5 OECD RECOMMENDATIONS UNDER ACTION PLAN 1 OF THE BEPS PROJECT

Due to the tax challenges arising from digitalization, the G20-OECD BEPS Action Plan Committee as part of its 2015 Action 1 Report identified a number of broader tax challenges raised by digitalisation, notably in relation to nexus, data and characterisation.

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The Action Report 1 analysed the following three options, namely -

(i) a new nexus rule in the form of a "***significant economic presence***" test,

(ii) ***a withholding tax*** which could be applied to certain types of digital transactions, and

(iii) ***an equalisation levy***, intended to address a disparity in tax treatment between foreign and domestic businesses where the foreign business had a sufficient economic presence in the jurisdiction

The OECD has recommended several options to tackle the direct tax challenges which include:

(1) Modifying the existing definition of permanent establishment to provide for whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

(2) Introducing the concept of a virtual fixed place of business in the concept of permanent establishments i.e., creation of a permanent establishments when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.

(3) Imposition of a final withholding tax on gross basis in case of certain payments made for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

It was concluded that countries could introduce any of these options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties. The above options can be resorted to as an interim measure until a clear solution emerges on taxing digital economy.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions. In order to arrive at a long term solution, the OECD along with the BEPS Inclusive Framework is working on arriving at a consensus based solution to tackle the tax challenges arising out of the digital economy as part of a 'Unified Approach' under Pillar One.

Consequent to the BEPS Action Report 1, a committee was constituted by the CBDT to evaluate the alternatives suggested in the BEPS Action Report 1 for addressing the challenges arising on taxing the digital economy. Pursuant to the recommendations of the Committee, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy" was introduced. It provides for an equalisation levy @6% of the amount of consideration for specified services received or receivable by a non-resident

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not having PE in India, from a resident in India who carries out business or profession, or from a non-resident having PE in India.

In order to widen and deepen the equalisation levy net beyond online advertisement, its scope had been extended by the Finance Act, 2020 to consideration received or receivable for e-commerce supply or services made or provided or facilitated on or after 1.4.2020.

However, some stakeholders have raised concerns that the scope of equalisation levy on e-commerce supply or services made or provided or facilitated is ambiguous and as a result it leads to compliance burden. In view of this it is proposed that this equalisation levy shall not be applicable to consideration received or receivable for e-commerce supply or services, on or after the 1st day of August 2024. Further, vide Finance Act, 2025 the equalisation levy on specified services also abolished.

12.6 TAXATION OF VIRTUAL DIGITAL ASSETS

There has been a phenomenal increase in transactions in virtual digital assets. Further, a market is emerging where payment for the transfer of a virtual digital asset can be made through another such asset. Accordingly, for the taxation of virtual digital assets, a scheme has been introduced by the Finance Act, 2022.

Meaning of virtual digital asset [Section 2(47A)]

It means -

(a) any information or code or number or token (not being Indian currency or foreign currency),

- generated through cryptographic means or otherwise, by whatever name called,
- providing a digital representation of value exchanged with or without consideration,
- with the promise or representation of having inherent value, or
- functions as a store of value or a unit of account including its use in any financial transaction or investment, but not limited to investment scheme; and
- can be transferred, stored or traded electronically;

(b) a non-fungible token or any other token of similar nature, by whatever name called;

The non-fungible token means such digital asset as may be notified by the Central Government.

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Accordingly, the Central Government has, vide notification no. 75/2022 dated 30.6.2022, specified a token which qualifies to be a virtual digital asset as non-fungible token. However, it shall not include a non-fungible token whose transfer results in transfer of ownership of underlying tangible asset and the transfer of ownership of such underlying tangible asset is legally enforceable.

(c) any other digital asset, as may be notified by the Central Government.

(d) any crypto-asset being a digital representation of value that relies on a cryptographically secured distributed ledger or a similar technology to validate and secure transactions, whether or not such asset is included in point (a) or (b) or (c) above.

However, the Central Government may, by notification, exclude any digital asset from the definition of virtual digital asset subject to specified conditions.

Accordingly, the Central Government has, vide notification no. 74/2022 dated 30.6.2022, notified that the following virtual digital assets would be excluded from the definition of virtual digital asset–

(i) Gift card or vouchers, being a record that may be used to obtain goods or services or a discount on goods or services;

(ii) Mileage points, reward points or loyalty card, being a record given without direct monetary consideration under an award, reward, benefit, loyalty, incentive, rebate or promotional program that may be used or redeemed only to obtain goods or services or a discount on goods or services;

(iii) Subscription to websites or platforms or application

Taxability of income from transfer of virtual digital assets [Section 115BBH]

(1) Tax rate on transfer of virtual digital asset – Where the total income of an assessee includes any income from the transfer of any virtual digital asset, such income would be taxed @30% under section 115BBH.

(2) No deduction allowed – In computing the income from transfer of virtual digital asset, no deduction would be allowed under any provisions of the Act in respect of any expenditure or allowance except cost of acquisition, if any. Further, no set off of any loss is allowed to the assessee from such income.

(3) Set off or carry forward of loss from transfer of virtual digital asset not allowed – Loss from transfer of virtual digital asset would **not** be allowed to be set off against income computed under any provision of this Act to the assessee and such loss would not be allowed to be carried forward to succeeding assessment years.

(4) Virtual digital asset need not to be a capital asset - The definition of "transfer" under section 2(47) would apply to any virtual digital asset, whether it is a capital asset or not.

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Taxability of receipt of virtual digital asset as gift or for inadequate consideration [Section 56(2)(x)]

In order to tax gift of virtual digital asset in the hands of the recipient, section 56 has been amended to include virtual digital asset within the definition of "property".

Accordingly, if virtual digital asset is received by any person from any person

(i) **Without consideration:** The aggregate fair market value of such virtual digital asset on the date of receipt would be taxed as the income of the recipient, if it exceeds ₹ 50,000.

(ii) **For inadequate consideration:** If the difference between the aggregate fair market value and such consideration exceeds ₹ 50,000, such difference would be taxed as the income of the recipient.

However, the exclusions from the applicability of section 56(2)(x) will apply to gift virtual digital asset also. For example, if virtual digital asset is received as a gift by an individual from his relative, the value of the same would not be treated as income.

TDS on payment on transfer of virtual digital asset [Section 194S]

(1) **Applicability and rate of TDS –** Section 194S requires any person who is responsible for paying to any resident any sum by way of consideration for transfer of a virtual digital asset to deduct tax @1% of such sum.

(2) **Time of deduction –** The deduction is to be made at the time of credit of consideration to the account of the resident or at the time of payment of such sum by any mode, whichever is earlier.

Where consideration is credited to any account in the books of account of the person liable to pay such sum, such credit of the sum is deemed to be the credit of such sum to the account of the payee and tax has to be deducted at source. The account to which such sum is credited may be called "Suspense Account" or by any other name.

(3) **Cases where the consideration for transfer of virtual digital asset is wholly in kind or partly in kind and partly in cash** – In a case where the consideration for transfer of virtual digital asset is

- wholly in kind or in exchange of another virtual digital asset, where there is no part in cash; or
- partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of such transfer,

the person responsible for paying such consideration has to, before releasing the consideration, ensure that tax required to be deducted has been paid in respect of such consideration for the transfer of virtual digital asset.

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(4) Non applicability of TDS under section 194S – No tax is required to be deducted under section 194S, where the consideration is payable by the person referred to in column (2) of the table below and aggregate value of such consideration during the financial year does not exceed the threshold limit in the corresponding row of column (3) of the table below:

(1)	Consideration is payable by (2)	Threshold limit (3)
(i)	Specified person, being an individual or a Hindu undivided family - whose total sales, gross receipts or turnover from his business or profession does not exceed ₹ 1 crore in case of business or ₹ 50 lakhs in case of profession, during the financial year immediately preceding the financial year in which such virtual digital asset is transferred; or - not having any income under the head "Profits and gains of business or profession".	≤ ₹ 50,000
(ii)	Other than specified person mentioned in (i) above	≤ ₹ 10,000

(5) Due date of remittance to Government Account [Rule 30] and Furnishing statement and certificate of TDS u/s 194S [Rules 31A and 31]

Sl. No.	(1) Particulars	(2) Specified Person	(3) Exchange	(4) Any other person
(i)	**Rule 30** – Time of payment to Government Account	30 days from the end of the month of deduction	In case of tax deducted in March, on or before 30th April. In any other case, on or before 7 days from the end of the month of deduction.	
(ii)	**Rule 31A** – Furnishing of Statement of TDS u/s 200(3)			
	Form	Form 26QE	Form 26QF	Form 26Q
	Time	Within 30 days from the end of the month of deduction	Common for Exchange and any other person	

Qtr ending	Due date
30th June	31st July
30th Sep	31st Oct
31st Dec	31st Jan
31st March	31st May

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(iii)	**Rule 31** – TDS Certificate	Form 16E to be furnished within 15 days from the due date of furnishing TDS statement in Form 26QE.	Form 16A to be furnished within 15 days from the due date of furnishing TDS statement in Form 26QF/Form 26Q.

ILLUSTRATION 1

Compute the net income-tax payable by Mr. Abhinav, aged 32 years, who has the following income for the A.Y.2026-27:

(i) Interest on fixed deposits with SBI (Gross) ₹ 1,10,000

(ii) Interest on savings bank account with SBI ₹ 35,000

(iii) Consideration for transfer of VDA ₹ 4,62,000

(iv) Cost of acquisition ₹ 21,000

(v) Expenses on transfer of VDA ₹ 1,000

Mr. Abhinav has exercised option to shift out of section 115BAC.

SOLUTION

Total income (excluding Income from transfer of VDA) is below the basic exemption limit of ₹ 2,50,000. Therefore, tax on income, other than income from VDA, is Nil. Income of ₹ 4,41,000 (₹ 4,62,000 – ₹ 21,000) from transfer of VDA would be taxable@30% (plus cess of 4%). The tax on income from transfer of VDA would be ₹ 1,37,592, being 31.2% of ₹ 4,41,000. The expenses on transfer of VDA is not allowable as deduction.

Section 194S provides for deduction of tax on payment on transfer of virtual digital asset to a resident at the rate of 1% of consideration. Hence, the transferee would have deducted tax of ₹ 4,620, being 1% of ₹ 4,62,000.

Tax@10% under section 194A would have been deducted by SBI from ₹ 1,10,000. TDS u/s 194A = ₹ 11,000

Net tax payable by Mr. Abhinav would be ₹ 1,21,972 [₹ 1,37,592 – ₹ 11,000 (TDS u/s 194A) – ₹ 4,620 (TDS u/s 194S)].

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ILLUSTRATION 2

Compute the net income-tax payable by Mr. Siddhanth, aged 24 years, who has the following income for the A.Y.2026-27

(i)	*Income from Salaries (computed)*	*₹ 8,40,000*
(ii)	*Interest on savings bank account with Axis Bank*	*₹ 12,000*
(iii)	*Consideration on transfer of VDA to Mr. Harsh*	*₹ 50,000*
(iv)	*Cost of acquisition of VDA transferred*	*₹ 5,000*

Mr. Harsh is employed with ABC Ltd. on a monthly salary of ₹ 50,000. In addition, he has interest on savings bank account with Bank of India.

Mr. Siddhanth has not exercised option to shift out of section 115BAC. Ignore TDS on income other than VDA.

SOLUTION

Tax payable by Mr. Siddhanth for A.Y. 2026-27

Particulars		Amount in ₹
Total income (excluding income from transfer of VDA) [₹ 8,40,000 + ₹ 12,000]		8,52,000
Income from VDA (₹ 50,000 – ₹ 5,000)		45,000
Total Income		**8,97,000**
Tax on income other than VDA		
Upto ₹ 4,00,000	Nil	
₹ 4,00,001 to ₹ 8,00,000 @5%	₹ 20,000	
₹ 8,00,001 to ₹ 8,52,000 @10%	₹ 5,200	25,200
Tax on income from VDA @30%		13,500
		38,700
Add: Health and education cess @ 4%		1,548
		40,248
Less: TDS under section 194S [Mr. Harsh is a specified person since he does not have income under the head "Profits and gains of business and profession" and the consideration payable by him does not exceed ₹ 50,000. Accordingly, Mr. Harsh need not deduct tax u/s 194S on consideration payable to Siddhanth]		Nil
Net tax payable		**40,248**
Net tax payable (rounded off)		**40,250**

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ILLUSTRATION 3

Compute the net income-tax payable by Mr. Raj, aged 32 years, who has the following income for the A.Y.2026-27

(i)	*Business loss*	*(₹ 3,18,000)*
(ii)	*Interest on fixed deposits with HDFC Bank*	*₹ 18,000*
(iii)	*Consideration on transfer of VDA*	*₹ 6,20,000*
(iv)	*Cost of acquisition of VDA transferred*	*₹ 20,000*

SOLUTION

As per section 71, business loss of the current year can be set off against income from other sources of that year. Therefore, business loss of ₹ 3,18,000 can be set off against interest of ₹ 18,000 from fixed deposits.

As per section 115BBH, business loss cannot be set off against income from transfer of VDA. Therefore, balance business loss of ₹ 3,00,000 cannot be set off against Income from VDA of ₹ 6,00,000 (₹ 6,20,000 – ₹ 20,000). The same has to be carried forward to A.Y.2027-28 for set-off against business income of that year.

Tax on Income from VDA would be ₹ 1,87,200 (i.e., 31.2% of ₹ 6 lakh).

Section 194S provides for deduction of tax on payment on transfer of virtual digital asset to a resident at the rate of 1% of consideration. Hence, the transferee would have deducted tax of ₹ 6,200, being 1% of ₹ 6,20,000.

Net tax payable by Mr. Raj = ₹ 1,87,200 – ₹ 6,200 = ₹ 1,81,000.

(6) **Non-applicability of section 203A -** The provisions of section 203A containing the requirement of obtaining TAN would **not** be applicable in case of specified person referred in 4(1).

(7) **Cross application of section 194-O and section 194S -** In case of a transaction where tax is deductible under section 194-O along with the section 194S, then, the tax shall be deducted under section 194S and not section 194-O.

(8) **Power of the CBDT to issue guidelines –** In case any difficulty arises in giving effect to the provisions of this section, the CBDT is empowered to issue guidelines, with the prior approval of the Central Government, for the purposes of removing the difficulty.

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Every guideline issued by the CBDT shall be laid before each House of Parliament and shall be binding on the income-tax authorities and on the person responsible for paying the consideration on transfer of such virtual digital asset.

Accordingly, the CBDT has, with the prior approval of the Central Government, vide Circular no. 13/2022 dated 22.6.2022, issued the following guidelines. These guidelines would apply only in cases where transfer of virtual digital asset is taking place on or through an Exchange. In other cases (like peer to peer and others) provisions of section 194S would apply.

Question 1: Who is required to deduct tax when the transfer of virtual digital asset is taking place on or through an Exchange and payment is made by the purchaser to the Exchange (directly or through broker) and then from the Exchange it goes to seller directly or through the broker?

Answer: According to section 194S, any person who is responsible for paying to any resident any sum by way of consideration for transfer of virtual digital asset is required to deduct tax.

Thus, in a peer to peer (i.e., direct buyer to seller) transaction, the buyer (i.e., person paying the consideration) is required to deduct tax under section 194S. The tax so deducted is required to be deposited with Government in accordance with the time and procedure prescribed in the Act read with the relevant provisions of the Income-tax Rules, 1962.

After deduction, the deductor is required to furnish a quarterly statement (in Form No. 26Q) for all such transactions of the quarter on or before the due date prescribed in the Income-tax Rules, 1962. For specified person Form 26QE has been introduced.

It may be clarified that the TDS shall be on consideration for transfer of virtual digital asset less GST. **[Clarified by the CBDT vide circular no. 14/2022 dated 28.6.2022 for all other transactions not conducted on or through Exchange]**

However, if the transaction is taking place on or through an Exchange, there is a possibility of tax deduction requirement under section 194S at multiple stages. Hence, in order to remove difficulties for transactions taking place on or through an Exchange, the following clarifications have been issued by CBDT:-

(i) **In a case where the transfer of virtual digital asset takes place on or through an Exchange and the virtual digital asset being transferred is owned by a person other than the Exchange:** In this case, buyer would be crediting or making payment to the Exchange (directly or through a broker). The Exchange, then, would

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be required to credit or make payment to the owner of virtual digital asset being transferred, either directly or through a broker. Since there are multiple players, to remove difficulty it has been clarified that:

1. Tax may be deducted under section 194S only by the Exchange which is crediting or making payment to the seller (owner of the virtual digital asset being transferred). In a case where broker owns the virtual digital asset, it is the broker who is the seller. Hence, the amount of consideration being credited or paid to the broker by the Exchange is also subject to tax deduction under section 194S.

2. In a case where the credit/ payment between Exchange and the seller is through a broker (and the broker is not seller), the responsibility to deduct tax under section 194S shall be on both the Exchange and the broker. However, if there is a written agreement between the Exchange and the broker that broker shall be deducting tax on such credit/ payment, then broker alone may deduct the tax under section 194S. The Exchange would be required to furnish a quarterly statement (in Form 26QF) for all such transactions of the quarter on or before the due date prescribed in the Income-tax Rules, 1962.

(ii) **In a case where the transfer of virtual digital asset takes place on or through an Exchange and the virtual digital asset being transferred is owned by such Exchange:** In this case, there are no multiple players. The buyer is required to deduct tax under section 194S. However, there may be a practical issue as the buyer may not know whether the virtual digital asset being transferred is owned by the Exchange or not. Hence, there may be genuine doubt in the mind of buyer with regard to its responsibility to deduct tax under section 194S. This difficulty would also be there if the buyer is buying virtual digital asset from an Exchange through a broker.

To remove this difficulty, it has been clarified that while the primary responsibility to deduct tax under section 194S, in this case, remains with the buyer or his broker, as an alternative the Exchange may enter into a written agreement with the buyer or his broker that in regard to all such transactions, the Exchange would be paying the tax on or before the due date for that quarter. The Exchange would be required to furnish a quarterly statement (in Form 26QF) for all such transactions of the quarter on or before the due date prescribed in the Income-tax Rules, 1962. The Exchange would also be required to furnish its income tax return and all these transactions must be included in such return. If these conditions are complied with, the buyer or his broker would not be held as assessee in default under section 201 for these transactions.

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Meaning of certain terms:

(i) The term "Exchange" means any person that operates an application or platform for transferring of virtual digital assets, which matches buy and sell trades and executes the same on its application or platform.

(ii) The term "Broker" means any person that operates an application or platform for transferring of virtual digital assets and holds brokerage account/accounts with an Exchange for execution of such trades.

Question 2: Question no 1 was with respect to transactions where the consideration for transfer of virtual digital asset is not in kind. How will this operate in a situation where it is in kind or in exchange of another virtual digital asset?

Answer: In the above situation, the buyer will release the consideration in kind after seller provides proof of payment of such tax (e.g., Challan details etc.). In a situation where virtual digital asset "A" is being exchanged with another virtual digital asset "B", both the persons are buyer as well as seller. One is buyer for "A" and seller for "B" and another is buyer for "B" and seller for "A". Thus, both need to pay tax with respect to transfer of virtual digital asset and show the evidence to other so that virtual digital assets can then be exchanged. This would then be required to be reported in TDS statement along with challan number. Form 26Q has included provisions for reporting such transactions. For specified persons, Form 26QE has been introduced. **[Also clarified by the CBDT vide circular no. 14/2022 dated 28.6.2022 for all other transactions not conducted on or through Exchange]**

However, if the transaction is through an Exchange there is practical issue in implementing this provision. In order to address this practical issue and to remove difficulty, it is clarified that in such a situation, as an alternative, tax may be deducted by the Exchange. Such an alternative mechanism can be exercised by the Exchange based on written contractual agreement with the buyers/sellers.

If such an alternative mechanism is exercised,

(i) the Exchange would be required to deduct tax for both legs of the transactions and pay to the Government. In the Form 26Q it will need to report it as tax deducted on both legs of the transaction.

(ii) the buyer and seller would not be independently required to follow the procedure prescribed under proviso to section 194S(1) i.e., to ensure that the tax required to be deducted has been paid by the other person, before releasing the consideration.

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(iii) The tax withheld in kind under section 194S and converted into INR shall be deposited in the Government Account as per the time line and process given in the Income-tax Rules 1962.

It has been clarified that there would not be any further TDS for converting the tax withheld in kind in the form of virtual digital asset into INR or from one virtual digital asset to another virtual digital asset and then into INR.

Question 3: Whether the provision of section 194Q is also applicable on transfer of virtual digital asset?

Answer: Without going into the merit whether virtual digital asset is goods or not, it is clarified that once tax is deducted under section 194S, tax would not be required to be deducted under section 194Q. **[Also clarified by the CBDT vide circular no. 14/2022 dated 28.6.2022 for all other transactions also not conducted on or through Exchange]**

Question 4: Whether the consideration for transfer of virtual digital asset shall be on Gross basis after including GST/commission or it shall be on "net basis" after exclusion of these items.

Answer: In order to remove difficulty, it is clarified that the tax required to be withheld under section 194S shall be on the "net" consideration after excluding GST/charges levied by the deductor for rendering service.

Question 5: In transactions where payment is being carried out through payment gateways, there may be tax deduction twice. To illustrate that a person "XYZ" is required to make payment to the seller for transfer of virtual digital asset. He makes payment of ₹ 1,00,000 through digital platform of "ABC". On these facts liability to deduct tax under section 194S may fall on both "XYZ" and "ABC". Is tax required to be deducted by both?

Answer: In order to remove this difficulty, it is provided that in the above example, the payment gateway will not be required to deduct tax under section 194S on a transaction, if the tax has been deducted by the person ("XYZ") required to make deduction under section 194S. Hence, in the above example, if "XYZ" has deducted tax under section 194S on ₹ 1,00,000, "ABC" will not be required to deduct tax under section 194S on the same transaction. To facilitate proper implementation, "ABC" may take an undertaking from "XYZ" regarding deduction of tax.

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TEST YOUR KNOWLEDGE

Questions

1. *Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions.*

2. *E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the taxation issues involving such transactions.*

3. From the following details compute the taxable income of Mr. Mohan for the sale and purchase of Bitcoins and NFT made during the year:

Date	Particulars	Units	Amount (₹)
June 15, 2025	Purchase (Bitcoin)	5000	50,000
July 15, 2025	Sale (Bitcoin)	2500	25,500
July 20, 2025	Sale (Bitcoin)	2500	28,750
	Expenses Incurred on Sale of Bitcoin		15,000
August 1, 2025	Purchase (NFT)	10000	1,50,000
August 16, 2025	Sale (NFT)	6000	89,000
August 31, 2025	Sale (NFT)	4000	56,000
	Expenses Incurred on Sale of NFT		18,000

Answers

1. The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the Income-tax Act, 1961 are absence of national boundaries, no requirement of physical presence of goods and no requirement of physical delivery (in certain cases). Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.

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2. The typical taxation issues relating to e-commerce are:

(1) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,

(2) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

3. **Computation of Taxable Income of Mr. Mohan**

	₹
Sale of 2500 Bitcoin 15.07.2025	
Sale Consideration	25,500
Less: Cost of Acquisition (2500 x 50000/5000)	25,000
Gain	**500**
Sale of 2500 Bitcoin 20.07.2025	
Sale Consideration	28,750
Less: Cost of Acquisition (2500 x 50000/5000)	25,000
Gain	**3,750**
Sale of 6000 NFT 16.08.2025	
Sale Consideration	89,000
Less: Cost of Acquisition (6000 x 150000/10000)	90,000
Loss on Sale of NFT [Neither setoff of loss nor carry forward of loss allowed]	**1,000**
Sale of 4000 NFT 31.08.2025	
Sale Consideration	56,000
Less: Cost of Acquisition (4000 x 150000/10000)	60,000
Loss on Sale of NFT [Neither setoff of loss nor carry forward of loss allowed]	**4,000**
Taxable income	**4250**

Note: VDA income would be taxed @30% under section 115BBH without any deduction of expenses.

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Final Course
Study Material
(Modules 1 to 4)

Paper 4

Direct Tax Laws & International Taxation

[Direct Tax Laws as amended by the Finance Act, 2025]
Assessment Year 2026-27

Module – 3

(Relevant for May 2026, September 2026 and January 2027 examinations)

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CHAPTER 13

DEDUCTION, COLLECTION AND RECOVERY OF TAX

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **examine** the provisions relating to deduction and collection of tax at source to determine whether tax needs to be deducted/collected at source;
- **compute** the amount of tax to be deducted/collected at source;
- **analyse and apply** the provisions relating to deduction and collection of tax at source to address related issues;
- **examine** the provisions relating to advance tax obligations, the instalments and due dates, and interest and penal consequences of non-payment or delayed payment of advance tax; **analyse and apply** such provisions to determine the quantum of advance tax payment and interest liability, if any, and address related issues;
- **examine** the provisions relating to chargeability of interest for defaults in furnishing return of income, for non-payment of advance tax and deferral of advance tax; **analyse and apply** such provisions to compute interest and address related issues;
- **analyse and apply** the provisions relating to refunds to compute the refund due and address related issues.

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CHAPTER OVERVIEW

Note – *Provisions which are specifically related to non-residents and REITs and Invits are discussed in Chapter 21: Non-resident Taxation and Chapter 10: Assessment of Trusts and Institutions, Political Parties and Other Special Entities, respectively.*

13.1 DEDUCTION AT SOURCE AND ADVANCE PAYMENT [SECTION 190]

The total income of an assessee for the previous year is taxable in the relevant assessment year. For example, the total income for the P.Y. 2025-26 is taxable in the A.Y. 2026-27. However, income-tax is recovered from the assessee in the previous year itself through –

(1) Tax deduction at source (TDS)

(2) Tax collection at source (TCS)

(3) Payment of advance tax

TDS, TCS and Advance Tax

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Another mode of recovery of tax is from the employer through tax paid by him under section 192(1A) on the non-monetary perquisites provided to the employee.

These taxes are deductible from the total tax due from the assessee. The assessee, while filing his return of income, has to pay self-assessment tax under section 140A, if tax is due on the total income as per his return of income after adjusting, TDS, TCS, relief of tax claimed under section 89, relief of tax claimed under section 90, 90A or 91 on account of tax paid in a country outside India or specified territory outside India, tax credit claimed to be set off in accordance with the provisions of section 115JAA or section 115JD, any tax or interest payable according to the provisions of section 191(2) and advance tax.

13.2 DIRECT PAYMENT [SECTION 191]

(1) Direct payment of tax [Section 191(1)]- Section 191 provides that in the following cases, tax is payable by the assessee directly –

(i) in the case of income in respect of which tax is not required to be deducted at source; and

(ii) income in respect of which tax is liable to be deducted but is not actually deducted.

In view of this provision, the proceedings for recovery of tax necessarily had to be taken against the assessee whose tax was liable to be deducted, but not deducted.

Direct payment of Tax

In order to overcome this difficulty, *Explanation* to this section provides that if any person, including the principal officer of a company

(i) who is required to deduct tax at source; or

(ii) an employer paying tax on non-monetary perquisites under section 192(1A),

does not deduct or after deducting fails to pay such tax, or does not pay, the whole or part of the tax, then, such person shall be deemed to be an assessee-in-default.

However, if the assessee himself has paid the tax, this provision will not apply.

(2) Direct payment of tax, where income of the assessee includes value of specified security or sweat equity shares allotted or transferred free of cost or at a concessional rate to the assessee by an employer being an eligible start-up [Section 191(2)] – In a case where the income of the assessee includes the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the current employer, being an

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eligible start-up referred to in section 80-IAC, free of cost or at concessional rate to the assessee, the income-tax on such income has to be paid by the assessee within 14 days from the earliest of the following dates -

- after the expiry of 48 months from the end of the relevant assessment year; or
- from the date of the sale of such specified security or sweat equity share by the assessee; or
- from the date of the assessee ceasing to be the employee of the employer who allotted or transferred him such specified security or sweat equity shares.

13.3 DEDUCTION OF TAX AT SOURCE

13.3.1 Salary [Section 192]

(1) Applicability of TDS under section 192

This section casts an obligation on every person responsible for paying any income chargeable to tax under the head 'Salaries' to deduct income-tax at the time of payment on the amount payable.

(2) Manner of deduction of tax

(i) Such income-tax has to be calculated at the average rate of income-tax computed on the basis of the rates in force for the relevant financial year in which the payment is made, on the estimated total income of the assessee where the employee intimates to the employer his intent to exercise the option of shifting out of the default tax regime under section 115BAC.

Note *- The liability to deduct tax at source in the case of salaries arises only at the time of payment.*

(ii) Average rate of income-tax means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

(iii) The income-tax in respect of the total income of an employee would be computed at the rates provided in section 115BAC, subject to certain conditions, including the

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condition that the employee does not avail of specified exemptions and deductions. The tax regime provided in section 115BAC is the default tax regime applicable, *inter alia*, to an individual.

However, under section 115BAC(6), an employee may exercise an option to opt out of this tax regime.

(iv) A deductor, being an employer, has to seek information from each of its employees having income under section 192 regarding their intended tax regime and each such employee shall intimate the same to the deductor, being his employer, regarding his intended tax regime for each year and upon intimation, the deductor shall compute his total income, and deduct tax at source thereon according to the option exercised.

If intimation is not made by the employee, it shall be presumed that the employee continues to be in the default tax regime and has not exercised the option to opt out of the new tax regime. Accordingly, in such a case, the employer shall deduct tax at source, on income under section 192, in accordance with the rates provided under section 115BAC(1A).

It is also clarified that the intimation would not amount to exercising option under section 115BAC(6) and the person shall be required to do so separately in accordance with the provisions of that section [Circular No. 4/2023 dated 5.4.2023].

(v) The concept of payment of tax on non-monetary perquisites has been provided in sections 192(1A) and (1B). These sections provide that the employer may pay this tax, at his option, in lieu of deduction of tax at source from salary payable to the employee. Such tax will have to be worked out at the average rate applicable to aggregate salary income of the employee and payment of tax will have to be made every month along with tax deducted at source on monetary payment of salary, allowances, etc.

(vi) An employer, being an eligible start-up referred to in section 80-IAC, responsible for paying any income to the assessee by way of perquisite being any specified security or sweat equity shares allotted or transferred, directly or indirectly, free of cost or at concessional rate to the assessee, has to deduct or pay, as the case may be, tax on the value of such perquisite provided to its employee within 14 days from the earliest of the following dates -

- after the expiry of 48 months from the end of the relevant assessment year; or
- from the date of the sale of such specified security or sweat equity share by the assessee; or

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- from the date of the assessee ceasing to be the employee of the employer who allotted such shares

Such tax has to deducted or paid on the basis of rates in force for the financial year in which the said specified security or sweat equity share is allotted or transferred.

(vii) In cases where an assessee is simultaneously employed under more than one employer or the assessee takes up a job with another employer during the financial year after his resignation or retirement from the services of the former employer, he may furnish the details of the income under the head "Salaries" due or received by him from the other employer, the tax deducted therefrom and such other particulars to his current employer. Thereupon, the subsequent employer should take such information into consideration and then deduct the tax remaining payable in respect of the employee's remuneration from both the employers put together for the relevant financial year.

(viii) For purposes of deduction of tax out of salaries payable in a foreign currency, the value of salaries in terms of rupees should be calculated at the prescribed rate of exchange as specified in Rule 26 of the Income-tax Rules, 1962.

(ix) In respect of salary payments to employees of Government or to employees of companies, co-operative societies, local authorities, universities, institutions, associations or bodies, deduction of tax at source should be made after allowing relief under section 89, where eligible.

(x) A tax payer having salary income in addition to other income chargeable to tax for that financial year, may send to the employer, the following particulars of:

(a) such other income and particulars of any tax deducted under any other provision;

(b) loss, if any, under the head 'Income from house property', if the assessee intimated to the employer his intent to exercise the option of shifting out of the default tax regime provided under section 115BAC(1A).

The employer shall take the above particulars into account while calculating tax deductible at source.

(xi) An employee can inform his employer for a financial year, the details of the following:

(a) such other income chargeable to tax (not being a loss under any such head);

(b) any tax deducted or collected under any other provision of the Act; and

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(c) loss, if any, under the head "Income from house property" if the assessee intimated to the employer his intent to exercise the option of shifting out of the default tax regime provided under section 115BAC(1A),

in prescribed form and manner and thereupon the person responsible to deduct tax shall take into account the above particulars while calculating tax deductible at source.

However, it has to be noted that on account of submission of the above details, the tax deducted at source on salaries should not be reduced except with respect to loss from house property (allowable to the extent of ₹ 2,00,000) and tax deducted at source and tax collected at source.

(3) Furnishing of statement of particulars of perquisites or profits in lieu of salary by employer to employee

Section 192(2C) provides that the employer shall furnish to the employee, a statement in Form No. 12BA giving correct and complete particulars of perquisites or profits in lieu of salary provided to him and the value thereof. The statement shall be in the prescribed form and manner. This requirement is applicable only where the salary paid/payable to an employee exceeds ₹ 1,50,000. For other employees, the particulars of perquisites/profits in lieu of salary shall be given in Form 16 itself.

(4) Circular issued by CBDT

Every year, the CBDT issues a circular giving details and direction to all employers for the purpose of deduction of tax from salaries payable to the employees during the relevant financial year. These instructions should be followed.

(5) Requirement to obtain evidence/ proof/ particulars of claims from the employee by the employer

Section 192(2D) casts responsibility on the person responsible for paying any income chargeable under the head "Salaries" to obtain from the assessee, the evidence or proof or particulars of prescribed claims (including claim for set-off of loss) under the provisions of the Act in the prescribed form and manner, for the purposes of –

(1) estimating income of the assessee; or

(2) computing tax deductible under section 192(1).

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In case an employee has intimated his employer of his intent to exercise the option of shifting out of the default tax regime provided under section 115BAC(1A), Rule 26C requires furnishing of evidence of the following claims by him to the person responsible for making payment under section 192(1) in Form No.12BB for the purpose of estimating his income or computing the amount of tax to be deducted at source:

S. No.	Nature of Claim	Evidence or particulars
1.	House Rent Allowance	Name, address and PAN of the landlord(s) where the aggregate rent paid during the previous year exceeds ₹ 1 lakh.
2.	Leave Travel Concession or Assistance	Evidence of expenditure
3.	Deduction of interest under the head "Income from house property"	Name, address and PAN of the lender
4.	Deduction under Chapter VI-A	Evidence of investment or expenditure.

ILLUSTRATION 1

LL Limited paid leave travel facility to its employees and considered exemption under section 10(5), based on the self-declaration furnished by the employees, who have exercised option to opt out of new tax regime under section 115BAC. The Assessing Officer held that the company as an employer ought to have verified the genuineness of the claim of exemption by obtaining from them, the proof of actual expenditure incurred by availing leave travel facility. Accordingly, the Assessing Officer treated the assessee company as assessee in default. Decide the correctness of action.

SOLUTION

Section 192 casts liability on the employer to deduct tax at source from the salary paid to its employees.

In this case, the employer has paid leave travel concession/facility to its employees and the said concession/ facility would be eligible for exemption subject to the conditions laid down in section 10(5) read with Rule 2B of the Income-tax Rules, 1962.

Section 192(2D) casts responsibility on the person responsible for paying any income chargeable under the head 'Salaries' to obtain from the assessee, the evidence or proof or particulars of prescribed claims under the provisions of the Act in the prescribed form and manner for the purposes of –

(1) estimating income of the assesses; or

(2) computing tax deductible under section 192(1).

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Rule 26C of the Income-tax Rules, 1962 mandates a salaried assessee claiming, *inter alia*, leave travel concession or assistance to furnish evidence of expenditure incurred in relation thereto to the person responsible for making such for payment under section 192(1), for the purpose of estimating his income for computing the tax deductible under section 192.

In the given case, LL Limited paid leave travel concession to its employees and considered for exemption on the basis of mere self-declaration, instead of verifying and obtaining the evidence/ proof of actual expenditure. Thus, the action of the Assessing Officer is correct in law.

13.3.2 Premature withdrawal from Employees Provident Fund [Section 192A]

(1) Compliance with Rule 9 of Part A of the Fourth Schedule: Certain Concerns

WITHDRAWAL OF EPF

(i) Under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 (EPF & MP Act, 1952), certain specified employers are required to comply with the Employees' Provident Fund Scheme, 1952 (EPFS). However, these employers are also permitted to establish and manage their own private provident fund (PF) scheme subject to the fulfillment of certain conditions.

(ii) The provident funds established under a scheme framed under EPF & MP Act, 1952 or Provident Fund exempted under section 17 of the said Act and recognised under the Income-tax Act, 1961 are termed as Recognised Provident fund (RPF) under the Act.

(iii) Part A of the Fourth Schedule to the Income-tax Act, 1961 contains the provisions relating to RPFs. Under the existing provisions of Rule 8 of Part A of the Fourth Schedule, the withdrawal of accumulated balance by an employee from the RPF is exempt from taxation.

(iv) For the purpose of discouraging pre-mature withdrawal and promoting long term savings, if the employee makes withdrawal before continuous service of five years (other than the cases of termination due to ill health, contraction or discontinuance of business, cessation of employment etc.) and does not opt for transfer of accumulated balance to the new employer, the withdrawal would be subject to tax.

(v) Rule 9 of Part A of the Fourth Schedule provides the manner of computing the tax liability of the employee in respect of such pre-mature withdrawal. In order to ensure collection of tax in respect of such pre-mature withdrawals, Rule 10 of Part A of the

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Fourth Schedule casts responsibility on the trustees of the RPF to deduct tax as computed in Rule 9 at the time of payment.

(vi) Rule 9 provides that the tax on the withdrawn amount is required to be calculated by re-computing the tax liability of the years for which the contribution to RPF has been made by treating the same as contribution to unrecognized provident fund. The trustees of private provident fund schemes, are generally a part of the employer group and hence, have access to or can easily obtain the information regarding taxability of the employee making pre-mature withdrawal for the purposes of computation of the amount of tax liability under Rule 9. However, it may not always be possible for the trustees of EPFS to get the information regarding the taxability of the employee such as year-wise amount of taxable income and tax payable for the purposes of computation of the amount of tax liability under Rule 9.

(2) Applicability and Rate of TDS

Section 192A provides for deduction of tax @10% on premature taxable withdrawal from employees' provident fund scheme. Accordingly, in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income owing to the provisions of Rule 8 of Part A of the Fourth Schedule not being applicable, the trustees of the Employees Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax @10%.

TDS@ 10%

(3) Time of tax deduction at source

Tax should be deducted **at the time of payment** of accumulated balance due to the employee.

(4) Non-applicability of TDS under section 192A

No tax deduction is to be made under this section, if the amount of such payment or aggregate amount of such payment to the payee is less than **₹ 50,000**.

ILLUSTRATION 2

Mr. Sharma, an employee of M/s. ABC Ltd. since 10-04-2021, resigned on 31-03-2026 and withdrew ₹ 60,000 being the balance in his EPF account. Discuss with reasons whether the provisions of Chapter XVII-B are attracted, and if so, what is the net amount receivable by the payee, Mr. Sharma?

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SOLUTION

As per section 192A, in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income owing to the provisions of Rule 8 of Part A of the Fourth Schedule not being applicable, the trustees of the Employees' Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax@10% at the time of payment of accumulated balance due to the employee. Tax deduction at source has to be made only if the amount of such payment or aggregate amount of such payment of the payee is ₹ 50,000 or more.

Rule 8 of Part A of the Fourth Schedule, *inter alia*, provides that only if an employee has rendered continuous service of five years or more with the employer, then accumulated balance in a recognized provident fund payable to an employee would be excluded from the total income of that employee.

In the present case, Mr. Sharma has withdrawn an amount exceeding ₹ 50,000 on his resignation after rendering a continuous service of four years with M/s. ABC Ltd. Therefore, tax has to be deducted at source@10% under section 192A on ₹ 60,000, being the amount withdrawn on his resignation without rendering continuous service of a period of five years with M/s. ABC Ltd.

The net amount receivable by Mr. Sharma is ₹ 54,000 [i.e., ₹ 60,000 – ₹ 6,000, being tax deducted at source].

13.3.3 Interest on securities [Section 193]

INTEREST ON SECURITIES - TDS @10%

(1) Person responsible for deduction of tax at source

This section casts responsibility on every person responsible for paying to a resident any income by way of interest on securities, ***being the amount or the aggregate of amounts exceeding ₹ 10,000 during the financial year.***

(2) Meaning of interest on securities [Section 2(28B)]

Interest on securities means -

(i) interest on any security of the Central Government or a State Government

(ii) interest on debentures or other securities for money issued by or on behalf of a local authority or a company or a corporation established by a Central, State or Provincial Act.

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(3) Rate of TDS

Such person is vested with the responsibility to deduct income-tax at the rates in force from the amount of interest payable.

The rate at which tax is deductible under section 193 is **10%**, both in the case of domestic companies and resident non-corporate assessees.

(4) Time of tax deduction at source

Tax should be deducted at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

Where any income by way of interest on securities is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and tax has to be deducted at source. The account to which such interest is credited may be called "Interest Payable account" or "Suspense account" or by any other name.

(5) Threshold Limit

No tax is required to be deducted if the amount or aggregate of amount of interest is less than ₹ 10,000 in a financial year. Prior to F.Y. 2025-26, there was no such threshold limit.

(6) Non-applicability of TDS under section 193

No tax deduction is to be made from any interest payable:

Non-applicability

(i) on 4¼% National Defence Bonds 1972, where the bonds are held by an individual not being a non-resident;

(ii) on 4¼% National Defence Loan, 1968 or 4¾% National Defence Loan, 1972, where the interest is payable to an individual;

(iii) on National Development Bonds;

(iv) on 7-year National Savings Certificates (IV Issue);

(v) on debentures issued by any institution or authority or any public sector company or any co-operative society (including a co-operative land mortgage bank or a co-operative land development bank), as notified by the Central Government;

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Accordingly, the Central Government has, vide Notification No. 27 & 28/2018, dated 18-06-2018, notified-

(i) "Power Finance Corporation Limited 54EC Capital Gains Bond" issued by Power Finance Corporation Limited {PFCL} and

(ii) "Indian Railway Finance Corporation Limited 54EC Capital Gains Bond" issued by Indian Railway Finance Corporation Limited {IRFCL}

Thus, no tax is required to be deducted at source on interest payable on "Power Finance Corporation Limited 54EC Capital Gains Bond" and "Indian Railway Finance Corporation Limited 54EC Capital Gains Bond".

The benefit of this exemption would, however, be admissible in the case of transfer of such bonds by endorsement or delivery, only if the transferee informs PFCL/IRFCL by registered post within a period of sixty days of such transfer.

(vi) on 6½% Gold Bonds, 1977 or 7% Gold Bonds, 1980, where the bonds are held by an individual (other than a non-resident), provided that the holders of the bonds make a written declaration that the total nominal value of the bonds held by him or on his behalf did not in either case exceed ₹ 10,000 at any time during the period to which the interest relates;

(vii) on any security of the Central Government or a State Government;

Note – It may be noted that tax has to be deducted at source in respect of interest payable on 8% Savings (Taxable) Bonds, 2003, or 7.75% Savings (Taxable) Bonds, 2018 or Floating Rate Savings Bonds, 2020 (Taxable), or any other notified security of the Central Government or State Government if such interest payable exceeds ₹ 10,000 during the financial year;

(viii) on securities to LIC, GIC, subsidiaries of GIC or any other insurer, provided –

(a) the securities are owned by them or

(b) they have full beneficial interest in such securities.

(ix) to a business trust by a special purpose vehicle on any security.

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13.3.4 Dividend [Section 194]

(1) Applicability of TDS under section 194

The principal officer of a domestic company is required to deduct tax on dividend distributed or paid by it to its resident shareholders.

DIVIDEND - TDS @10%

The provisions of tax deduction at source under section 194, therefore, applies only to dividend distributed or paid to resident shareholders.

(2) Rate of TDS

The rate of deduction of tax in respect of such dividend is **10%**.

(3) Time of tax deduction at source

The deduction of tax has to be made before making any payment by any mode in respect of any dividend or before making any distribution or payment to a resident shareholder of any amount deemed as dividend under section 2(22)(a)/(b)/(c)/(d)/(e)/(f).

(4) Non-applicability of TDS under section194

(i) No tax is to be deducted in case of a shareholder, being an individual, where -

Non-applicability

(a) the dividend is paid by any mode other than cash; and

(b) the amount of such dividend or aggregate of dividend distributed or paid or likely to be distributed or paid during the financial year by the company to such shareholder does not exceed ***₹ 10,000***.

(ii) The TDS provisions will **not** apply to such dividend credited or paid to

- LIC, GIC, subsidiaries of GIC or any other insurer provided the shares are owned by them, or they have full beneficial interest in such shares
- a business trust by a special purpose vehicle
- any other person as may be notified by the Central Government.

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Notification

No deduction of tax at source under section 194 on dividend paid by any unit of an IFSC, primarily engaged in the business of leasing of an aircraft to a company, being a Unit of an IFSC primarily engaged in the business of leasing of an aircraft [Notification No. 52/2023 dated 20.07.2023]

In exercise of the power provided under section 197A(1F), the Central Government has, vide this notification, notified that, no tax is required to be deducted under section 194 from dividend paid by any unit of an IFSC, primarily engaged in the business of leasing of an aircraft (payer) to a company, being a Unit of an IFSC primarily engaged in the business of leasing of an aircraft (payee) subject to the following:

(i) The payee has to furnish and verified a statement-cum-declaration to the payer giving details of previous year relevant to the assessment year in which the dividend income eligible for exemption under section 10(34B) is payable.

(ii) The payer would not deduct tax on payment made or credited to the recipient of such dividend (payee) after the date of receipt of copy of statement-cum-declaration from payee and furnish the particulars of all the payments made to the recipient of such dividend on which tax has not been deducted in the statement of deduction of tax under section 200(3) read with the Rule 31A.

13.3.5 Interest other than interest on securities [Section 194A]

(1) Applicability of TDS under section 194A

Interest - TDS @10%

This section applies only to interest, other than "interest on securities", credited or paid by assessees other than individuals or Hindu undivided family. However, an individual or Hindu undivided family whose total sales, gross receipts or turnover from the business or profession carried on by him exceed ₹ 1 crore in case of business and ₹ 50 lakhs in case of profession during the immediately preceding financial year is liable to deduct tax at source under this section.

These provisions apply only to interest paid or credited to residents.

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(2) *Time of tax deduction at source*

The deduction of tax must be made at the time of crediting such interest to the payee or at the time of its payment in cash or by any other mode, whichever is earlier.

Where any such interest is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and the tax has to be deducted at source. The account to which such interest is credited may be called "Interest Payable account" or "Suspense account" or by any other name.

Circular

Clarification regarding deduction of tax at source on payment of interest on time deposits under section 194A by banks following Core-branch Banking Solutions (CBS) software

The CBDT has, *vide Circular No.3/2010 dated 2.3.2010* clarified that *Explanation* to section 194A is not meant to apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software. It has been further clarified that since no constructive credit to the depositor's/ payee's account takes place while calculating interest on time deposits on daily or monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only. In such cases, tax shall be deducted at source on accrual of interest at the end of financial year or at periodic intervals as per practice of the bank or as per the depositor's/ payee's requirement or on maturity or on encashment of time deposits, whichever event takes place earlier, whenever the aggregate of amounts of interest income credited or paid or likely to be credited or paid during the financial year by the banks exceeds the limits specified in section 194A.

Note - The time for making the payment of tax deducted at source would reckon from the date of credit of interest made constructively to the account of the payee.

(3) *Rate of TDS*

The rate at which the deduction is to be made is given in Part II of the First Schedule to the Annual Finance Act. The rate at which tax is to be deducted is 10% both in the case of resident non-corporate assessees and domestic companies.

TDS@ 10%

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(4) Non-applicability of TDS under section 194A

No deduction of tax shall be made in the following cases:

(a) If the aggregate amount of interest paid or credited during the financial year does not exceed ***₹ 10,000***.

This limit is ***₹ 50,000*** where the payer is a –

(i) banking company;

(ii) a co-operative society engaged in banking business; and

(iii) post office and interest is credited or paid in respect of any deposit under notified schemes ("Senior Citizens Saving Scheme, 2019" and "Mahila Samman Savings Certificate, 2023" have been notified by the Central Government for this purpose).

Non-applicability

"Mahila Samman Savings Certificate, 2023" is a one-time scheme available for two years, i.e., from 1st April, 2023 to 31st March, 2025. It offers a maximum deposit facility of upto ₹ 2 lakh in the name of a women or a girl for 2 years at a fixed interest rate of 7.5% p.a., compounded quarterly.

Consequently, no tax under section 194A would be deductible by the post office on interest paid or credited under this scheme since the amount of interest would not exceed ***₹ 50,000***.

In respect of (i), (ii) and (iii) above, the limit is ***₹ 1,00,000, in case of payee, being a senior citizen***.

The limit will be calculated with respect to income credited or paid by a branch of a banking company or a co-operative society or a public company in case of:

(i) time deposits with a banking company

(ii) time deposits with a co-operative society carrying on the business of banking; and

(iii) deposits with housing finance companies, provided:

- they are public companies formed and registered in India
- their main object is to carry on the business of providing long-term finance for construction or purchase of houses in India for residential purposes
- they are eligible for deduction under section 36(1)(viii).

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The threshold limit will be reckoned with reference to the total interest credited or paid by the banking company or the co-operative society or the public company, as the case may be, (and not with reference to each branch), where such banking company or co-operative society or public company has adopted core banking solutions.

(b) Interest paid or credited by a firm to any of its partners;

(c) Interest paid or credited in respect of deposits under any scheme framed by the Central Government and notified by it in this behalf;

(d) Interest income credited or paid in respect of deposits (other than time deposits made on or after 1.7.1995) with a banking company to which the Banking Regulation Act, 1949 applies; or

(e) Income paid or credited by a co-operative society (other than a co-operative bank) to a member thereof or to such income credited or paid by a co-operative society to any other co-operative society;

(f) Interest income credited or paid in respect of -

(i) deposits with primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank;

(ii) deposit (other than time deposits made on or after 1.7.1995) with a co-operative society [other than cooperative society or bank referred to in (i)] engaged in carrying on the business of banking.

From a combined reading of (e) and (f), it can be inferred that a co-operative bank other than mentioned in (i) above is required to deduct tax at source on payment of interest on time deposit. However, it is not required to deduct tax from the payment of interest on time deposit, to a depositor, being a co-operative society.

However, a cooperative society referred to in (e) or (f) is liable to deduct tax if –

(i) the total sales, gross receipts or turnover of the co-operative society exceeds ₹ 50 crore during the financial year immediately preceding the financial year in which interest is credited or paid; **and**

(ii) the amount of interest or the aggregate amount of interest credited or paid, or is likely to be credited or paid, during the financial year is more than ***₹ 1,00,000*** in case of the payee being a senior citizen and ***₹ 50,000***, in any other case.

Thus, such co-operative society is required to deduct tax under section 194A on interest credited or paid by it –

(a) to its member or to any other co-operative society; or

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(b) in respect of deposits with a primary agricultural credit society or a primary credit society or a co-operative land mortgage bank or a co-operative land development bank or

(c) in respect of deposits with a co-operative bank other than a co-operative society or bank, engaged in carrying on the business of banking

(g) Interest income credited or paid by the Central Government under any provisions of the Income-tax Act, 1961.

(h) Interest paid or credited to the following entities:

(i) banking companies, or co-operative societies engaged in the business of banking, including co-operative land mortgage banks;

(ii) financial corporations established under any Central, State or Provincial Act.

(iii) the Life Insurance Corporation of India.

(iv) companies and co-operative societies carrying on the business of insurance.

(v) the Unit Trust of India; and

(vi) notified institution, association, body or class of institutions, associations or bodies (National Skill Development Fund and Housing and Urban Development Corporation Ltd. (HUDCO), New Delhi have been notified by the Central Government for this purpose)

(i) income credited by way of interest on the compensation amount awarded by the Motor Accidents Claims Tribunal;

(j) income 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 paid during the financial year does not exceed ₹ 50,000.

(k) income paid or payable by an infrastructure capital company or infrastructure capital fund or infrastructure debt fund or public sector company or scheduled bank in relation to a zero coupon bond issued on or after 1.6.2005.

(l) income by way of interest paid by special purpose vehicle to business trust under section 10(23FC)

Notes

(1) The expression "time deposits" [for the purpose of (4)(a), (d) and (f) above] means the deposits, **including** recurring deposits, repayable on the expiry of fixed periods.

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(2) Senior citizen means an individual resident in India who is of the age of 60 years or more at any time during the relevant previous year.

(5) Power to the Central Government to issue notification

The Central Government is empowered to issue notification for non-deduction of tax at source or deduction of tax at a lower rate, from such payment to such person or class of persons, specified in that notification.

S. No.	Circulars & Notifications
1.	**Applicability of provisions for deduction of tax at source under section 194A on interest on fixed deposit made in the name of the Registrar General of Court or the depositor of the Fund on directions of Courts [*Circular No.23/2015, dated 28-12-2015*]** Section 194A stipulates deduction of tax at source (TDS) on interest other than interest on securities if the aggregate of amount of such interest credited or paid to the account of the payee during the financial year exceeds the specified amount. In the case of UCO Bank in *Writ Petition No. 3563 of 2012 and CM No. 7517/2012 vide judgment dated 11/11/2014*, the Hon'ble Delhi High Court has held that the provisions of section 194A do not apply to fixed deposits made in the name of Registrar General of the Court on the directions of the Court during the pendency of proceedings before the Court. In such cases, till the Court passes the appropriate orders in the matter, it is not known who the beneficiary of the fixed deposits will be. Amount and year of receipt is also unascertainable. The Delhi High Court, thus, held that the person who is ultimately granted the funds would be determined by orders that are passed subsequently. At that stage, undisputedly, tax would be required to be deducted at source to the credit of the recipient. The High Court has also quashed Circular No.8/2011. The CBDT has accepted the aforesaid judgment. Accordingly, it is clarified that interest on FDRs made in the name of Registrar General of the Court or the depositor of the fund on the directions of the Court, will not be subject to TDS till the matter is decided by the Court. However, once the Court decides the ownership of the money lying in the fixed deposit, the provisions of section 194A will apply to the recipient of the income.
2.	**No deduction of tax at source 194A on payment made to a member of Schedule Tribe referred u/s 10(26) by a Scheduled Bank *[Notification No. 110/2021, dated 17.09.2021]*** In exercise of the power provided under section 197A(1F), the Central Government notified that no tax is required to be deducted on the following payment under section 194A, namely payment in the nature of interest, other than interest on securities, made by a Scheduled Bank located in a specified area to a member of Scheduled Tribe residing in any specified area as referred to in section 10(26)

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	[Refer Chapter 3 in Module 1 for detail regarding specified area], subject to the following conditions: (i) the payer satisfies itself that the receiver is a member of Scheduled Tribe residing in any specified area, and the payment as referred above is accruing or arising to the receiver as referred to in section 10(26), during the previous year relevant for the assessment year in which the payment is made, by obtaining necessary documentary evidences in support of the same; (ii) the payer reports the above payment in the statements of deduction of tax as referred to in section 200(3) (iii) the payment made or aggregate of payments made during the previous year does not exceed ₹ 20 lakh.
3.	**Deduction of tax at source on interest income accrued to minor child, where both the parents have deceased *[Notification No. 05/2017, dated 29.05.2017]*** Under Rule 31A(5) of the Income-tax Rules, 1962, the Director General of Income-tax (Systems) is authorized to specify the procedures, formats and standards for the purposes of furnishing and verification of, *inter alia*, the statements and shall be responsible for the day-to-day administration in relation to furnishing and verification of the statements in the manner so specified. The Principal Director General of Income-tax (Systems) has, in exercise of the powers delegated by the CBDT under Rule 31A(5), specified that in case of minors where both the parents have deceased, TDS on the interest income accrued to the minor is required to be deducted and reported against PAN of the minor child unless a declaration is filed under Rule 37BA(2) that credit for tax deducted has to be given to another person.
4.	**Deduction of tax at source on interest on deposits made under Capital Gains Accounts Scheme, 1988 where depositor has deceased *[Notification No. 08/2017, dated 13.09.2017]*** The Principal Director General of Income-tax (Systems) has, in exercise of the powers delegated by the CBDT under Rule 31A(5), vide this notification, specified that in case of deposits under the Capital Gains Accounts Scheme, 1988 where the depositor has deceased: (i) TDS on the interest income accrued for and upto the period of death of the depositor is required to be deducted and reported against PAN of the depositor, and (ii) TDS on the interest income accrued for the period after the death of the depositor is required to be deducted and reported against PAN of the legal heir, unless a declaration is filed under Rule 37BA(2) that credit for tax deducted has to be given to another person.

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ILLUSTRATION 3

Examine the TDS implications under section 194A in the cases mentioned hereunder –

(i) On 1.10.2025, Mr. Harish, aged 45 years, made a six-month fixed deposit of ₹ 12 lakh@9% p.a. with ABC Co-operative Bank. The fixed deposit matures on 31.3.2026.

(ii) On 1.6.2025, Mr. Ganesh, aged 35 years, made three nine months fixed deposits of ₹ 3 lakh each, carrying interest @9% p.a. with Dwarka Branch, Janakpuri Branch and Rohini Branch of XYZ Bank, a bank which has adopted CBS. The fixed deposits mature on 28.2.2026.

(iii) On 1.10.2025, Mr. Rajesh, aged 40 years, started a six months recurring deposit of ₹ 2,00,000 per month @8% p.a. with PQR Bank. The recurring deposit matures on 31.3.2026.

SOLUTION

(i) ABC Co-operative Bank has to deduct tax at source@10% on the interest of ₹ 54,000 (9% × ₹ 12 lakh × ½) under section 194A. The tax deductible at source under section 194A from such interest is, therefore, ₹ 5,400.

(ii) XYZ Bank has to deduct tax at source@10% u/s 194A, since the aggregate interest on fixed deposit with the three branches of the bank is ₹ 60,750 [3,00,000 × 3 × 9% × 9/12], which exceeds the threshold limit of ₹ 50,000. Since XYZ Bank has adopted CBS, the aggregate interest credited/paid by all branches has to be considered. Since the aggregate interest of ₹ 60,750 exceeds the threshold limit of ₹ 50,000, tax has to be deducted @10% u/s 194A.

(iii) No tax has to be deducted under section 194A by PQR Bank on the interest of ₹ 28,000 falling due on recurring deposit on 31.3.2026 to Mr. Rajesh, since such interest does not exceed the threshold limit of ₹ 50,000.

ILLUSTRATION 4

Maya Bank credited ₹ 73,50,000 towards interest on the deposits in a separate account for macro-monitoring purposes by using Core-branch Banking Solutions (CBS) software. No tax was deducted at source in respect of interest on deposits so credited even where the interest in respect of some depositors exceeded the limit of ₹ 50,000.

The Assessing Officer disallowed 30% of interest expenditure, where the interest on time deposits credited exceeded the limit of ₹ 50,000 and levied a penalty under section 271C.

Decide the correctness of action of the Assessing Officer.

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SOLUTION

The *Explanation* to section 194A provides that where any income by way of interest other than interest on securities is credited to any account, whether called 'interest payable account' or 'suspense account' or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and provisions of section 194A, shall, thus, apply.

However, the CBDT has, vide *Circular No.3/2010 dated 2.3.2010*, clarified that *Explanation* to section 194A will not apply in cases of banks where credit is made to provisioning account on daily/monthly basis for the purpose of macro monitoring only by the use of CBS software.

Since no constructive credit to the depositor's/ payee's account takes place while calculating interest on daily/monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purposes of macro monitoring only.

In such cases, tax shall be deducted at source on accrual of interest at the end of the financial year or at periodic intervals as per practice of the bank or as per the depositor's or payee's requirement or on maturity or on encashment of time deposit, whichever event takes place earlier and wherever the aggregate amount of interest income credited or paid or likely to be credited or paid during the financial year by the bank exceeds the limits specified in section 194A i.e., ₹ 50,000.

In view of the above, the action of the Assessing Officer in disallowing the interest expenditure credited in a separate account for macro monitoring purpose is not valid and consequent initiation of penalty proceedings under section 271C is not tenable in law.

13.3.6 Winnings from lotteries, crossword puzzles, etc. and horse races [Sections 194B and 194BB]

(1) Rate of tax

Winnings from lotteries - TDS @30%

Any income by way of winnings from lotteries, crossword puzzles, card game and other game of any sort, or from gambling or betting of any form or nature whatsoever, races including horse races, etc., will be charged to income-tax at a flat rate of **30%** [Section 115BB].

(2) TDS on winning from lotteries, crossword puzzles, etc.

According to the provisions of section 194B, every person responsible for paying to any person, whether resident or non-resident, any income by way of winnings from lottery or crossword puzzle or card game and other game of any sort, or from gambling or betting of any form or nature whatsoever, is required to deduct income-tax therefrom at the rate of **30%**

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if the amount of payment ***in respect of a single transaction*** exceeds **₹ 10,000**. Winnings by way of jackpot would also fall within the scope of section 194B.

(3) Cases where winnings are partly in kind and partly in cash

In a case where the winnings are wholly in kind or partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of the winnings, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings.

The provisions of section 194B are not applicable in respect of winnings from any online game.

(4) Person responsible for deduction of tax under section 194BB

Section 194BB casts responsibility on the following persons to deduct tax at source -

(i) a bookmaker; or

(ii) a person to whom a license has been granted by the Government under any law for the time being in force -

(a) for horse racing in any race course; or

(b) for arranging for wagering or betting in any race course.

(5) Threshold limit and rate of TDS under section 194BB

The obligation to deduct tax at source under section 194BB arises when the above mentioned persons make payment to any person of any income by way of winnings from any horse race in excess of the amount of **₹ 10,000** ***in a single transaction***. The rate applicable for deduction of tax at source is **30%**.

Threshold limit > ₹10,000 in a single transaction

Similarly, in cases where the book-maker or other person responsible for paying the winnings, credits such winnings and debits the losses to the individual account of the punter, tax has to be deducted **@30%** on winnings before set-off of losses. Thereafter, the net amount, after deduction of tax and losses, has to be paid to the winner.

(6) Meaning of the expression "horse race"

In the context of the provisions of section 194BB, the expression 'any horse race' used therein must be taken to include, wherever the circumstances so necessitate, more than one horse race.

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ILLUSTRATION 5

Mr. Govind won the first prize in a lottery ticket, and the prize was a Maruti car worth ₹ 5 lakhs. What is the procedure to be adopted before handing over the Maruti Car to Mr. Govind?

SOLUTION

Section 194B provides that the person responsible for paying to any person, any income by way of winnings from any lottery or crossword puzzle, card game or any other game of any sort and the amount of winning exceeds ₹ 10,000 in a single transaction, tax shall be deducted at source @30%.

However, in case where the winning is wholly in kind, the person responsible for paying the prize shall before releasing the winning, ensure that the tax has been paid in respect of such winning.

The Karnataka High Court, in the case of *CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1,* has held that where the winnings are wholly in kind, the responsibility cast under section 194B is to ensure that the tax is paid by the winner of the prize before the prize is released in his favour. In this regard, the *CBDT Circular No.763 dated 18/2/1998* clarifies that the person responsible for paying the winnings shall, before releasing such winnings, ensure that the tax is paid by the winner. He can do so, for example, by collecting from the winner a sum equal to the tax deductible at source on the winnings in kind, before releasing the winnings. For this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind.

Therefore, in this case, since the entire winning is in kind, it must be ensured that the sum equal to the tax deductible at source (i.e., ₹ 1,50,000, being @ 30% of ₹ 5 lakhs) is paid by Mr. Govind, before the car is released in his favour. This can be done by collecting ₹ 1,50,000 from Mr. Govind before releasing the Maruti car to him and remitting the said sum to the Government account or verifying the tax payment by the winner and thereafter releasing the prize.

13.3.7 Winnings from online games [Section 194BA]

(1) Applicability of TDS on winnings from online games

Winnings from online games - TDS @30%

Any person responsible for paying to any person (whether resident or non-resident) any income by way of winnings from any online game during the financial year shall deduct income-tax on the net winnings in his user account, computed in the manner as may be prescribed, **at the end of the financial year at the rates in force, i.e., 30%** [Section 194BA(1)]

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(2) TDS on withdrawal during the financial year

However, in a case where **there is a withdrawal from user account** during the financial year, the income-tax shall be **deducted at the time of such withdrawal** on the net winnings comprised in such withdrawal, **as well as on the remaining amount** of net winnings in the user account, computed in the manner as may be prescribed**, at the end of the financial year** [Proviso to section 194BA(1)].

(3) Net winnings wholly in kind or partly in cash or partly in kind

Where the net winnings are wholly in kind or partly in cash, and partly in kind, but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of the net winnings, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the net winnings.

(4) Meaning of certain terms:

Term	Meaning
Computer resource	Computer, computer system, computer network, data, computer data base or software [Section 2(1)(e) of Information Technology Act, 2000]
Internet	The combination of computer facilities and electromagnetic transmission media, and related equipment and software, comprising the interconnected worldwide network of computer networks that transmits information based on a protocol for controlling such transmission.
Online game	A game that is offered on the internet and is accessible by a user through a computer resource including any telecommunication device.
Online gaming intermediary	An intermediary that offers one or more online games.
User	Any person who accesses or avails any computer resource of an online gaming intermediary.
User Account	Account of a user registered with an online gaming intermediary.

(5) Manner for computation of net winnings

Rule 133

In exercise of powers conferred by section 115BBJ read with section 194BA, the CBDT has, vide *Notification No. 28/2023 dated 22.5.2023* inserted Rule 133 to prescribe the manner for computation of net winnings:

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Section 115BBJ provides that any income by way of winnings from online games, would be chargeable to tax @30%. The tax would be calculated on net winnings from such online games computed in the prescribed manner.

Accordingly, Rule 133 prescribes the following manner for the computation of net innings:

Sub-rule	Provision
(1)	**Computation of net winnings for the previous year:** Net winnings from online games during the previous year, for the purposes of section 115BBJ, shall be calculated using the following formula, namely - **Net winnings = (A + D) - (B + C)** A = Aggregate amount withdrawn from the user account during the financial year. B = Aggregate amount of non-taxable deposit made in the user account by the assessee during the financial year. C = Opening balance of the user account at the beginning of the financial year. D = Closing balance of the user account at the end of the financial year.
(2)	**Computation of net winnings at the time of first withdrawal during the F.Y.** Net winnings comprised in the first withdrawal during the financial year, for the purposes of section 194BA, shall be calculated using the following formula - **Net winnings = A - (B + C)** A = Amount withdrawn from the user account. B = Aggregate amount of non-taxable deposit made in the user account by the owner of such account during the financial year, till the time of such withdrawal. C = Opening balance of the user account at the beginning of the financial year. ***Note -*** *If the sum of amounts B and C is equal to or greater than the amount A, net winnings would be considered as zero [Sub-rule (3)].*
(3)	**Computation of net winnings at the time of each subsequent withdrawal** Net winnings comprised in each subsequent withdrawal during the financial year, for the purposes of section 194BA, shall be calculated using the following formula - **Net winnings = A - (B + C + E)** A = Aggregate amount withdrawn from the user account during the financial year till the time of subsequent withdrawal including the amount of such subsequent withdrawal.

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	B = Aggregate amount of non-taxable deposit made in the user account by the owner of such account during the financial year, till the time of such subsequent withdrawal. C = Opening balance of the user account at the beginning of the financial year. E = Net winnings comprised in the earlier withdrawal or withdrawals computed under sub-rule (2), or under this sub-rule, during the financial year till the time of subsequent withdrawal if tax has been deducted in accordance with the provision of section 194BA on winnings comprised in such withdrawal or withdrawals. ***Note -*** *Net winnings would be zero, if the sum of amounts B, C and E is equal to or greater than the amount A [Sub-rule (5)]*
(4)	**Computation of net winnings at the end of the financial year:** Net winnings comprised in the user account at the end of the financial year, for the purposes of section 194BA, shall be calculated using the following formula, namely - **Net winnings = (A + D) - (B + C + E)** A = Aggregate amount withdrawn from the user account during the financial year. B = Aggregate amount of non-taxable deposit made in the user account by the owner of such account during the financial year. C = Opening balance of the user account at the beginning of the financial year. D = Closing balance of the user account at the end of the financial year. E = Net winnings comprised in the earlier withdrawal or withdrawals computed under sub-rule (2), or sub-rule (4), during the financial year if tax has been deducted in accordance with the provision of section 194BA on winnings comprised in such withdrawal or withdrawals. ***Note -*** *Net winnings would be zero, if the sum of amounts B, C and E is equal to or greater than the sum of amount A and D [Sub-rule (7)].*

Meaning of certain terms:

Term	Meaning
Non-taxable deposit	The amount deposited by the user in his user account and which is not taxable.
Taxable deposit	Any amount deposited in the user account which is not a non-taxable deposit and includes any amount paid directly to the user not through the user account.
Withdrawal	Any amount withdrawn by the user from any user account.

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Important points for consideration

User Account: User account shall include every account of user, by whatever name called, which is registered with the online gaming intermediary and where any taxable deposit, non-taxable deposit or the winnings made by the user is credited and withdrawal by the user is debited.

(a) **Multiple user accounts:** Whenever there are multiple user accounts of the same user, **each user account shall be considered** for the purposes of calculating net winnings and the deposit, withdrawal or balance in the user account shall mean aggregate of deposit, withdrawal or balance in all user accounts.

(b) **Transfer from one user account to another user account:** Whenever there are multiple user accounts of the same user, transfer from one user account to another user account, maintained with the same online gaming intermediary, of the same user shall not be considered as withdrawal or deposit, as the case may be, for the purposes of deducting tax under section 194BA.

Payment in cash or kind

Whenever there is payment to the user in kind or in cash, or partly in kind and partly in cash, which is not from the user account, the provisions of this rule shall apply to calculate net winnings by deeming that the money equivalent to such payment has been deposited as taxable deposit in the user account and the equivalent amount has been withdrawn from the user account at the same time and shall accordingly be included in amount A;

Taxable deposit in the form of bonus

- Whenever there is a taxable deposit in the form of bonus, referral bonus, incentives, promotional money, discount by whatever name called; and such deposit can only be used for playing the online games and not for withdrawal or any other purposes, such deposit shall be ignored for the purposes of calculation of net winnings and shall not be included in amount B or amount C or amount D; and
- Whenever any bonus, referral bonus, incentives, promotional money, discount, by whatever name called, is not considered as part of amount B or amount C or amount D under clause (e) and subsequently, they are recharacterized and allowed to be withdrawn, they shall be deemed as taxable deposit at the time of such recharacterization and it shall be deemed that the equivalent amount has been deposited in the user account at that time.

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(6) Power of CBDT to issue Guidelines [Section 194BA(3)]

If any difficulty arises in giving effect to the provisions of this section, the CBDT may, with the previous approval of the Central Government, issue guidelines for the purposes of removing the difficulty.

Every guideline issued by the CBDT shall, as soon as may be after it is issued, be laid before each House of Parliament, and shall be binding on the income-tax authorities and on the person liable to deduct income-tax.

Accordingly, the CBDT has, vide *Circular No. 5/2023 dated 22.5.2023*, issued the following guidelines:

Question 1: There are multiple wallets under one user. How "net winnings" is to be computed with respect to multiple wallets of one use.

Answer: It has been clarified in the Rule 133 that user account shall include every account of user, by whatever name called, which is registered with online gaming intermediary and where any taxable deposit, non-taxable deposit or the winning of the user is credited and withdrawal by the user is debited. Thus, each wallet which qualifies as a user account shall be considered as user account for the purposes of computing net winnings. It has further been clarified in the Rule 133 that whenever there are multiple user accounts of the same user, each user account shall be considered for the purposes of calculating net winnings. The deposit, withdrawal or balance in the user account shall mean the aggregate of deposits, withdrawals or balances in all user accounts.

For illustration, a user has multiple user accounts under one deductor (one TAN). For the purposes of calculating tax required to be deducted under section 194BA, each of these user accounts is to be considered. Deposit in any of these user accounts would be considered as deposit (non-taxable or taxable as per the definition in Rule 133) and withdrawal from any user accounts would be considered as withdrawal.

Let us suppose that there is a first withdrawal from any of these user accounts. Net winnings for the purposes of calculating tax required to be deducted under section 194BA shall be calculated as under

Net winnings = A - (B + C)

A = Amount withdrawn from the user account.

B = Aggregate amount of non-taxable deposit made in the user account by the owner of such account during the financial year, till the time of such withdrawal.

C = Opening balance of the user account at the beginning of the financial year.

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Here for the purposes of calculating amount B, the non-taxable deposits in all of the user accounts under that deductor (one TAN) is to be aggregated. Same would apply to calculating all other amount for calculation under Rule 133.

However, if the one deductor (one TAN) is having multiple platforms and it is not technologically feasible for him to integrate multiple user accounts across platforms, then he may, at his option, calculate tax required to be deducted for the purposes of section 194BA for each platform separately. But even in that case all the user accounts under one user in one platform need to be considered for the purposes of calculating net winnings in the formulas provided in Rule 133.

It may also be noted that Rule 133 has also clarified that transfer from one user account to another user account, maintained with the same online gaming intermediary, of the same user shall not be considered as withdrawal or deposit, as the case may be. However, if the deductor is deducting tax under section 194BA for each platform separately, as discussed in the immediately preceding paragraph, transfer from one user account to another user account under same online gaming intermediary **across platforms** shall be considered as withdrawal or deposit for the purposes of calculation of net winnings under Rule 133.

Question 2: If a user borrows some money and deposits in his user account, will it be considered taxable deposit or non-taxable deposit?

Answer: For non-taxable deposit it is necessary that the amount deposited by the user is not taxable, i.e., it is from already taxed income or it is not chargeable to tax. In a case where user borrows the money and deposit in his user account, it shall be considered as non-taxable deposit.

Question 3: How will bonus, referral bonus, incentives etc., be treated?

Answer: Bonus, referral bonus, incentives etc, are given by the online game intermediary to the user. They are to be considered as taxable deposit under Rule 133. The taxable deposit will increase the balance in user account and is not allowed to be deducted in the calculation of net winnings, as only non-taxable deposits are allowed to be deducted. Thus, any deposit in the form of bonus, referral bonus, incentives etc, would form part of net winnings and tax under section 194BA is liable to be deducted at the time of withdrawal as well as at the end of the financial year.

Some deposit could be money equivalent too like coins, coupons, vouchers, counters etc. In such a situation the equivalence in money of such deposit shall be considered as taxable deposit and would accordingly form part of balance in user account.

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However, it is seen that there is some incentives/bonus which is credited in user account only for the purposes of playing and they cannot be withdrawn or used for any other purposes. Rule 133 has provided that such deposit shall be ignored for calculation of net winnings. Thus they shall not be included in non-taxable deposit and they shall also not be included in opening balance or closing balance of user account. Thus, to the extent they will not be part of net winnings. However, person liable to deduct tax under section 194BA must keep separate accounts of such deposits.

Further, if and when these incentive/bonus are recharacterized and they are allowed to be withdrawn, they would be treated as taxable deposit at the time when they are recharacterized. Thus, they will become part of net winnings in the year of recharacterization.

Question 4: At what point we consider that amount has been withdrawn?

Answer: As stated earlier, it has also been clarified in the Rule 133 that transfer from one user account to another user account, maintained with the same online gaming intermediary, of the same user shall not be considered as withdrawal or deposit, as the case may be. However, when the amount is withdrawn from the user account to any other account, it shall be considered as withdrawal. With respect to deductor, any account of user which is not registered with the online game intermediary (for which he is a deductor) is an account which is not a user account and any transfer from user account to such account is a withdrawal. When in consideration of amount in user account, some coupons etc are issued for purchase of goods or services, or some item in kind is issued, that will also be considered as withdrawal. It is the duty of the person who is required to deduct tax at source under section 194BA to ensure that the tax, as required to be deducted, is deducted at source under section 194BA, before issuing such coupons or items in kind.

The clarification provided in answer to Question no 1 is also needed to be kept in mind. It has been clarified that if the deductor is deducting tax under section 194BA for each platform separately, transfer from one user account to another user account under same online gaming intermediary across platform shall be considered as withdrawal or deposit for the purposes of calculation of net winnings under Rule 133.

Question 5: There are a large number of gamers who play with very insignificant amount and withdraw also very small amount. Deducting tax at source under section 194BA for each insignificant withdrawal would increase compliance for tax deductor. Can there be relaxation to ease compliance?

Answer: In order to remove difficulty in deducting tax at source under section 194BA for insignificant withdrawal, it is clarified that tax may not be deducted on withdrawal on satisfaction of all of the following conditions, namely:-

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(i) net winnings comprised in the amount withdrawn does not exceed ₹ 100 in a month;

(ii) tax not deducted on account of this concession is deducted at a time when the net winnings comprised in withdrawal exceeds ₹ 100 in the same month or subsequent month or if there is no such withdrawal, at the end of the financial year; and

(iii) the deductor undertakes responsibility of paying the difference if the balance in the user account at the time of tax deduction under section 194BA is not sufficient to discharge the tax deduction liability calculated in accordance with Rule 133.

Question 6: When the net winnings is in kind how will tax deduction under section 194BA operate?

Answer: At the outset, it may be clarified that where money in user account is used to buy an item in kind and given to user then it is net winnings in cash only and the deductor is required to deduct tax at source under section 194BA accordingly.

However, there could be a situation where the winning of the game is a prize in kind. In that situation provision of section 194BA(2) will operate.

According to this where the net winnings are wholly in kind or partly in cash, and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of the net winnings. In these situations, the person responsible for paying, shall, before releasing the winnings, ensure that tax has been paid in respect of the net winnings. In the above situation, the deductor will release the net winnings in kind after the deductee provides proof of payment of such tax (e.g., Challan details, etc.).

In the alternative, as an option to remove difficulty if any, the deductor may deduct the tax under section 194BA and pay to the Government.

Question 7: How will the valuation of winnings in kind required to be carried out?

Answer: The valuation would be based on fair market value of the winnings in kind except in following cases:-

(i) The online game intermediary has purchased the winnings before providing it to the user. In that case the purchase price shall be the value for winnings.

(ii) The online game intermediary manufactures such items given as winnings. In that case, the price that it charges to its customers for such items shall be the value for such winnings.

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It is further clarified that **GST will not be included for the purposes of valuation** of winnings for TDS under section 194BA.

13.3.8 Payments to contractors and sub-contractors [Section 194C]

(1) Applicability of TDS under section 194C

Section 194C provides for deduction of tax at source from the payment made to resident contractors and sub-contractors.

Contract payments

Tax has to be deducted at source under section 194C by any person responsible for paying any sum to a resident contractor for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and the –

(i) the Central Government or any State Government; or

(ii) any local authority; or

(iii) any statutory corporation; or

(iv) any company; or

(v) any co-operative society; or

(vi) any statutory authority dealing with housing accommodation; or

(vii) any society registered under the Societies Registration Act, 1860; or

(viii) any trust; or

(ix) any university established under a Central, State or Provincial Act and an institution declared to be a university under the UGC Act, 1956; or

(x) any firm; or

(xi) any Government of a foreign State or foreign enterprise or any association or body established outside India; or

(xii) any person, being an individual, HUF, AOP or BOI, who has total sales, gross receipts or turnover from the business or profession carried on by him **exceeding ₹ 1 crore in case of business** and **₹ 50 lakhs in case of profession** during the financial year immediately preceding the financial year in which such sum is credited or paid to the account of the contractor.

Turnover

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(2) Time of deduction

Tax has to be deducted at the time of payment of such sum or at the time of credit of such sum to the account of the contractor, whichever is earlier.

Where any such sum is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and the tax has to be deducted at source. The account to which such sum is credited may be called "Suspense account" or by any other name.

However, no tax has to be deducted at source in respect of payments made by individuals/ HUF to a contractor exclusively for personal purposes.

(3) Rate of TDS

The rate of TDS under section 194C on payments to contractors would be **1%**, where the payee is an individual or HUF and **2%** in respect of other payees. The same rates of TDS would apply for both contractors and sub-contractors.

The applicable rates of TDS under section 194C are as follows –

Payee	TDS rate
Individual/HUF contractor/sub-contractor	1%
Other than individual / HUF contractor/sub-contractor	2%
Contractor in transport business (if PAN is furnished)	Nil
Sub-contractor in transport business (if PAN is furnished)	Nil

(4) Threshold limit for deduction of tax at source under section 194C

No deduction will be required to be made if the consideration for the contract does not exceed **₹ 30,000**. However, to prevent the practice of composite contracts being split up into contracts valued at less than **₹ 30,000** to avoid tax deduction, it has been provided that tax will be required to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds **₹ 30,000** in a single payment or **₹ 1,00,000** in the aggregate during a financial year.

Therefore, even if a single payment to a contractor does not exceed **₹ 30,000**, TDS provisions under section 194C would be attracted where the aggregate of the amounts of such sums credited or paid or likely to be credited or paid to the contractor during the financial year exceeds **₹ 1,00,000**.

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ILLUSTRATION 6

ABC Ltd. makes the following payments to Mr. X, a contractor, for contract work during the P.Y.2025-26 –

₹ 20,000 on 1.5.2025

₹ 25,000 on 1.8.2025

₹ 28,000 on 1.12.2025

On 1.3.2026, a payment of ₹ 30,000 is due to Mr. X on account of a contract work.

Discuss whether ABC Ltd. is liable to deduct tax at source under section 194C from payments made to Mr. X.

SOLUTION

In this case, the individual contract payments made to Mr. X does not exceed ₹ 30,000. However, since the aggregate amount paid to Mr. X during the P.Y. 2025-26 exceeds ₹ 1,00,000 (on account of the last payment of ₹ 30,000, due on 1.3.2026, taking the total from ₹ 73,000 to ₹ 1,03,000), the TDS provisions under section 194C would get attracted. Tax has to be deducted @1% on the entire amount of ₹ 1,03,000 from the last payment of ₹ 30,000 and the balance of ₹ 28,970 (i.e., ₹ 30,000 – ₹ 1030) has to be paid to Mr. X.

(5) Definition of work

Work includes –

(a) advertising;

(b) broadcasting and telecasting including production of programmes for such broadcasting or telecasting;

(c) carriage of goods or passengers by any mode of transport other than by railways;

(d) catering

Definition of work

(e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer or its associate, being a person related to the customer in such manner as defined u/s 40A(2)(b) (i.e., the customer would be in the place of assessee; and the associate would be the related person(s) mentioned in that section).

However, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person,

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other than such customer or associate of such customer, as such a contract is a contract for 'sale'. However, this will not be applicable to a contract which does not entail manufacture or supply of an article or thing (e.g., a construction contract).

It may be noted that the term "work" would include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer or its associate. In such a case, tax shall be deducted on the invoice value excluding the value of material purchased from such customer or its associate, if such value is mentioned separately in the invoice. Where the material component has not been separately mentioned in the invoice, tax shall be deducted on the whole of the invoice value.

Further, it is clarified that work shall not include any sum referred to in section 194J(1).

(6) Non-applicability of TDS under section194C

No deduction is required to be made from the sum credited or paid or likely to be credited or paid during the previous year to the account of a contractor, during the course of the business of plying, hiring or leasing goods carriages, if he furnishes his PAN to the deductor.

Non-applicability

In order to convey the true intent of law, it has been clarified that this relaxation from the requirement to deduct tax at source shall only be applicable to the payment in the nature of transport charges (whether paid by a person engaged in the business of transport or otherwise) made to a contractor fulfils the following three conditions cumulatively-

Meaning of "Goods carriage":

"Goods carriage" means -

(i) any motor vehicle constructed or adapted for use solely for the carriage of goods; or

(ii) any motor vehicle not so constructed or adapted, when used for the carriage of goods.

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The term "motor vehicle" does not include vehicles having less than four wheels and with engine capacity not exceeding 25cc as well as vehicles running on rails or vehicles adapted for use in a factory or in enclosed premises.

(7) Important points

(i) The deduction of income-tax at source from payments made to non-resident contractors will be governed by the provisions of section 195.

(ii) The deduction of income-tax will be made from sums paid for carrying out any work or for supplying labour for carrying out any work. In other words, the section will apply only in relation to 'works contracts' and 'labour contracts' and will not cover contracts for the sale of goods.

(iii) Contracts for rendering professional services by lawyers, physicians, surgeons, engineers, accountants, architects, consultants, etc., cannot be regarded as contracts for carrying out any "work" and, accordingly, no deduction of income-tax is to be made from payments relating to such contracts under this section. Separate provisions for fees for professional services have been made under section 194J.

S. No.	Circulars & Notifications
1.	**Deduction of tax at source on payment of gas transportation charges by the purchaser of natural gas to the seller of gas *[Circular No. 9/2012 dated 17.10.2012]*** In case the Owner/Seller of the natural gas sells as well as transports the gas to the purchaser till the point of delivery, where the ownership of gas to the purchaser is simultaneously transferred, the manner of raising the sale bill (whether the transportation charges are embedded in the cost of gas or shown separately) does not alter the basic nature of such contract which remains essentially a 'contract for sale' and not a 'works contract' as envisaged in section 194C. Therefore, in such circumstances, the provisions of Chapter XVII-B are not applicable to the component of Gas Transportation Charges paid by the purchaser to the Owner/Seller of the gas. Further, the use of different modes of transportation of gas by Owner/Seller will not alter the position. However, transportation charges paid to a third-party transporter of gas, either by the Owner/Seller of the gas or purchaser of the gas or any other person, shall continue to be governed by the appropriate provisions of the Act and tax shall be deductible at source on such payment to the third party at the applicable rates.

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2.	**Applicability of TDS provisions on payments by broadcasters or Television Channels to production houses for production of content or programme for telecasting *[Circular No. 04/2016, dated 29-2-2016]*** The issue under consideration is whether payments made by the broadcaster/telecaster to production houses for production of content/programme are payments under a 'work contract' liable for tax deduction at source under section 194C or a contract for 'professional or technical services' liable for tax deduction at source under section 194J. In this regard, the CBDT has clarified that while applying the relevant provisions of TDS on a contract for content production, a distinction is required to be made between: (i) a payment for production of content/programme as per the specifications of the broadcaster/telecaster; and (ii) a payment for acquisition of broadcasting/ telecasting rights of the content already produced by the production house. In the first situation where the content is produced as per the specifications provided by the broadcaster/ telecaster and the copyright of the content/programme also gets transferred to the telecaster/ broadcaster, such contract is covered by the definition of the term 'work' in section 194C and, therefore, subject to TDS under that section. However, in a case where the telecaster/broadcaster acquires only the telecasting/ broadcasting rights of the content already produced by the production house, there is no contract for ''carrying out any work", as required in section 194C(1). Therefore, such payments are not liable for TDS under section 194C. However, payments of this nature may be liable for TDS under other sections of Chapter XVII-B of the Act.
3.	**TDS on Goods and Services Tax (GST) component comprised in payments made to residents *[Circular No. 23/2017 dated 19.07.2017]*** The CBDT had, vide Circular No. 1/2014 dated 13.01.2014, clarified that wherever in terms of the agreement or contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid or payable without including such service tax component. In order to harmonize the same treatment with the new system for taxation of services under the GST regime w.e.f. 01.07.2017, the CBDT has, vide this circular, clarified that wherever in terms of the agreement or contract between the payer and the payee, the component of 'GST on services' comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid or payable without including such 'GST on services' component.

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	GST shall include Integrated Goods and Services Tax, Central Goods and Services Tax, State Goods and Services Tax and Union Territory Goods and Services Tax. Further, for the purposes of this Circular, any reference to "service tax" in an existing agreement or contract which was entered into prior to 01.07.2017 shall be treated as "GST on services" with respect to the period from 01.07.2017 onward till the expiry of such agreement or contract. ***Note –*** *The clarification given in the above circular applies to any amount paid or payable to a resident on which tax is deductible at source as per the provisions of Chapter XVII-B.*
4.	***Applicability of TDS provisions on payments by the transporter to truck operators or owners for hiring the vehicles [Shree Choudhary Transport Co. v ITO [2020] 426 ITR 0289(SC)]*** The assessee-firm entered into contract with a cement company for transporting cement to various places in India. As the assessee did not have transport vehicles of its own, it engaged the services of other transporters for the said purpose. The cement company effected payments to the assessee towards transportation charges after due deduction of tax at source. In its return of income, the assessee showed the income arising out of the business of transport contracts. While making payment to the truck operators or owners, the assessee had not deducted tax at source. The Supreme Court observed that the nature of the contract entered into by the assessee with the consignor company (cement company) makes it clear that it was the responsibility of the assessee to transport the goods (cement) of the company; and how to accomplish this task of transportation was a matter exclusively within the domain of the assessee. There is no privity of contract between the transporters and the consignor company (cement company). Hiring the services of the transporters for this purpose could have only been under a contract between the assessee and the transporters, irrespective of whether such a contract was reduced into writing or not. If a particular truck was not engaged, there existed no contract, but when any truck got engaged for the purpose of execution of the work undertaken by the assessee and freight charges were payable to its operator or owner upon execution of the work, i. e., transportation of the goods, all the essentials of a contract existed; and the truck operator or owner became a sub-contractor. The Supreme Court opined that the assessee was not acting as a facilitator or intermediary between the consignor company and the truck operators or owners because those two parties had no privity of contract

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	between them. The contract of the company for transportation of its goods was only with the assessee and it was the assessee who hired the services of the trucks. The payment made by the assessee to such transporter was clearly a payment made to a sub-contractor. The Supreme Court, thus, held that section 194C was applicable and the assessee was under obligation to deduct tax at source in relation to the payments made by it to the truck operators or owners for hiring the vehicles for the purpose of its business of transportation of goods.

ILLUSTRATION 7

Bharathi Cements Ltd. purchased jute bags from Raj Kumar & Co. The latter has to supply the jute bags with the logo and address of the assessee, printed on it. From 01.09.2025 to 20.03.2026, the value of jute bags supplied is ₹ 8,00,000, for which the invoice has been raised on 20.03.2026. While effecting the payment for the same, is the assessee bound to deduct tax at source, assuming that the value of the printing component involved is ₹ 1,10,000. You are informed that the assessee has not sold any material to Raj Kumar & Co. and that the latter has to manufacture the jute bags in its plant using raw materials purchased by it from outsiders.

SOLUTION

As per the definition under section 194C, "work" shall not include manufacturing or supplying a product according to the requirement or specification of a customer by using raw material purchased from a person, other than such customer or associate of such customer. This is regardless of the quantum of expenditure incurred towards printing or processing comprised in the bill amount.

The problem clearly states that Raj Kumar & Co. has to manufacture the jute bags using raw materials purchased from outsiders and that the assessee Bharathi Cements Ltd has not sold any material to them. Therefore, in this case, it is a contract of sale. Hence, the provisions of section 194C are **not** attracted and no liability to deduct tax at source would arise.

ILLUSTRATION 8

Alap Ltd. has made following payments on various dates in financial year 2025-26 to Vilambit Ltd. towards work done under different contracts:

Contract Number	Date of payment	Amount (₹)
1.	5.5.2025	20,000
2.	6.6.2025	15,000
3.	8.8.2025	25,000
4.	10.12.2025	25,000
5.	29.01.2026	17,000

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Alap Ltd. claims that it is not liable for deduction of tax at source under section 194C. Examine the correctness of the claim made by the company. What would be the position if the value of contract no. 5 is ₹ 14,000 only and there was no further contract during the year?

SOLUTION

As per section 194C(5), tax has to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds ₹ 30,000 in a single payment or ₹ 1,00,000 in aggregate during the financial year.

Therefore, in the given case, even though the value of each individual contract does not exceed ₹ 30,000, the aggregate amount exceeds ₹ 1,00,000. Hence, Alap Ltd's contention is not correct and tax is required to be deducted at source on the whole amount of ₹ 1,02,000 from the last payment of ₹ 17,000 towards Contract No.5 on account of which the aggregate amount exceeded ₹ 1,00,000.

However, no tax deduction is to be made if the value of the last contract is ₹ 14,000 as the aggregate amount in such case would only be ₹ 99,000, which is below the aggregate monetary limit of ₹ 1,00,000.

13.3.9 Insurance Commission [Section 194D]

(1) Applicability of TDS under section 194D

Section 194D casts responsibility on any person responsible for paying to a resident any income by way of remuneration or reward, whether by way of commission or otherwise, for soliciting or procuring insurance business (including the business relating to the continuance, renewal or revival of policies of insurance) to deduct tax at source.

Insurance Commission - TDS @ 2% or 10%

(2) Rate of TDS

Such person is required to deduct income-tax at the rate of **2%** in case of resident other than a domestic company and **10%** in case of a domestic company.

(3) Time of deduction

The deduction is to be made at the time of the credit of the income to the account of the payee or at the time of making the payment (by whatever mode) to the payee, whichever is earlier.

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(4) Threshold limit

Threshold limit

The tax under this section has to be deducted at source only if the amount of such income or the aggregate of the amounts of such income credited or paid during the financial year to the account of the payee exceeds ***₹ 20,000***.

13.3.10 Payment in respect of life insurance policy [Section 194DA]

(1) Taxability of sum received under a life insurance policy

LIP – TDS @2%

Under section 10(10D), any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy is exempt subject to fulfilment of conditions specified under the said section.

Consequently, the sum received under a life insurance policy which does not fulfill the conditions specified under section 10(10D) is taxable.

(2) Rate of TDS

For ensuring a proper mechanism for reporting of transactions and collection of tax in respect of sum paid under life insurance policies which are not exempt under section 10(10D), section 194DA provides for deduction of tax at the rate of ***2%*** on the amount of income comprised therein i.e., after deducting the amount of insurance premium paid by the resident assessee from the total sum received.

(3) Threshold limit

Threshold limit

Tax deduction is required only if the payment or aggregate payment under a life insurance policy, including the sum allocated by way of bonus in a financial year to an assessee, is **₹ 1,00,000 or more**. This is for alleviating the compliance burden on the small tax payers.

ILLUSTRATION 9

Examine the applicability of the provisions for tax deduction at source under section 194DA in the following cases -

(i) Mr. X, a resident, is due to receive ₹ 4.50 lakhs on 30.6.2025, towards maturity proceeds of LIC policy taken on 1.7.2022, for which the sum assured is ₹ 4 lakhs and the annual premium is ₹ 1,25,000.

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(ii) Mr. Y, a resident, is due to receive ₹ 3.95 lakhs on 31.12.2025 on LIC policy taken on 1.1.2012, for which the sum assured is ₹ 3.50 lakhs and the annual premium is ₹ 26,100.

(iii) Mr. Z, a resident, is due to receive ₹ 95,000 on 1.8.2025 towards maturity proceeds of LIC policy taken on 31.7.2017 for which the sum assured is ₹ 90,000 and the annual premium is *₹ 10,000.*

SOLUTION

(i) Since the annual premium exceeds 10% of sum assured in respect of a policy taken after 31.3.2012, the maturity proceeds of ₹ 4.50 lakhs due on 30.6.2025 are not exempt under section 10(10D) in the hands of Mr. X. Therefore, tax is required to be deducted @2% under section 194DA on the amount of income comprised therein i.e., on ₹ 75,000 (₹ 4,50,000, being maturity proceeds - ₹ 3,75,000, being the aggregate amount of insurance premium paid).

(ii) Since the annual premium is less than 20% of sum assured in respect of a policy taken before 1.4.2012, the sum of ₹ 3.95 lakhs due to Mr. Y would be exempt under section 10(10D) in his hands. Hence, no tax is required to be deducted at source under section 194DA on such sum payable to Mr. Y.

(iii) Even though the annual premium exceeds 10% of sum assured in respect of a policy taken after 31.3.2012, and consequently, the maturity proceeds of ₹ 95,000 due on 1.8.2025 would not be exempt under section 10(10D) in the hands of Mr. Z. However, tax deduction at source provisions under section 194DA are not attracted since the maturity proceeds are less than ₹ 1 lakh.

13.3.11 Payments in respect of deposits under National Savings Scheme, etc. [Section 194EE]

(1) Rate of TDS

Deposits under NSS TDS @10%

The person responsible for paying to any person any amount from National Savings Scheme Account shall deduct income-tax thereon at the rate of **10%** at the time of payment.

(2) Threshold limit

No such deduction shall be made where the amount of payment or the aggregate amount of payments in a financial year is less than **₹ 2,500**.

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(3) Non-applicability of TDS under section 194EE

The provisions of this section shall not apply to the payments made to the heirs of the assessee.

Notification

No deduction of tax at source under section 194EE on amount withdrawn under NSS [Notification No. 27/2025 dated 04.04.2025]

In exercise of the power provided under section 197A(1F), the Central Government has, vide this notification, notified that, no tax is required to be deducted under section 194EE on amount (including interest accrued) withdrawn by the individual assessee under NSS (in respect of which deduction was allowed under section 80CCA), on or after 4th April, 2025.

13.3.12 Commission etc. on the sale of lottery tickets [Section 194G]

(1) Applicability and Rate of TDS

Under section 194G, the person responsible for paying to any person, who is or has been stocking, distributing, purchasing or selling lottery tickets, any income by way of commission, remuneration or prize (by whatever name called) on lottery tickets in an amount exceeding ***₹ 20,000*** shall deduct income-tax thereon at the rate of **2%**.

(2) Time of deduction of tax

Such deduction should be made at the time of credit of such income to the account of the payee or at the time of payment of such income by cash, cheque, draft or any other mode, whichever is earlier.

Where any such income is credited to any account, whether called "Suspense Account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

Commission on sale of lottery tickets - TDS @2%

13.3.13 Commission or brokerage [Section 194H]

(1) Applicability and Rate of TDS

Any person other than an individual or HUF, who is responsible for paying any income by way of commission (other than insurance commission) or brokerage to a resident shall deduct income tax at the rate of **2%**.

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Commission or brokerage – TDS @2%

However, an individual or HUF whose total sales, gross receipts or turnover from the business or profession carried on by him exceed **₹ 1 crore in case of business and ₹ 50 lakhs in case of profession** during the financial year immediately preceding the financial year in which such commission or brokerage is credited or paid, is liable to deduct tax at source.

(2) Time of deduction

The deduction shall be made at the time such income is credited to the account of the payee or at the time of payment in cash or by issue of cheque or draft or by any other mode, whichever is earlier.

Even where income is credited to some other account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit to the account of the payee for the purposes of this section.

(3) Threshold limit

No deduction is required if the amount of such income or the aggregate of such amount does not exceed ***₹ 20,000*** during the financial year.

(4) Meaning of "Commission or brokerage"

"Commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person

- for services rendered, or
- for any services in the course of buying or selling of goods, or
- in relation to any transaction relating to any asset, valuable article or thing, **other than securities**.

(5) Non-applicability of TDS under section 194H

Non-applicability

(i) This section is not applicable to professional services. "Professional Services" means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or such other profession as notified by the CBDT for the purpose of compulsory maintenance of books of account under section 44AA.

(ii) Further, there would be no requirement to deduct tax at source on commission or brokerage payments by BSNL or MTNL to their public call office (PCO) franchisees.

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Circular

Applicability of TDS provisions on payments by television channels and publishing houses to advertisement companies for procuring or canvassing for advertisements *[Circular No. 05/2016, dated 29-2-2016]*

There are two types of payments involved in the advertising business:

(i) Payment by client to the advertising agency, and

(ii) Payment by advertising agency to the television channel/newspaper company

The applicability of TDS on these payments has already been dealt with in Circular No. 715 dated 8-8-1995, where it has been clarified in Question Nos. 1 & 2 that while TDS under section 194C (as work contract) will be applicable on the first type of payment, there will be no TDS under section 194C on the second type of payment, e.g. payment by advertising agency to the media company.

However, another issue has been raised in various cases as to whether the fees/charges taken or retained by advertising companies from media companies for canvasing/booking advertisements (typically 15% of the billing) are 'commission' or 'discount' for attracting the provisions of section 194H.

The CBDT has clarified that no TDS is attracted on payments made by television channels/newspaper companies to the advertising agency for booking or procuring of or canvassing for advertisements. It is also further clarified that 'commission' referred to in Question No.27 of the *CBDT's Circular No. 715 dated 8-8-1995* does not refer to payments by media companies to advertising companies for booking of advertisements but to payments for engagement of models, artists, photographers, sportspersons, etc. and, therefore, is not relevant to the issue of TDS referred to in this Circular.

ILLUSTRATION 10

Moon TV, a television channel, made payment of ₹ 50 lakhs to a production house for the production of programme for telecasting as per the specifications given by the channel. The copyright of the programme is also transferred to Moon TV. Would such payment be liable for tax deduction at source under section 194C? Discuss.

Also, examine whether the provisions of tax deduction at source under section 194C would be attracted if the payment was made by Moon TV for the acquisition of telecasting rights of the content already produced by the production house.

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SOLUTION

In this case, since the programme is produced by the production house as per the specifications given by Moon TV, a television channel, and the copyright is also transferred to the television channel, the same falls within the scope of definition of the term 'work' under section 194C. Therefore, the payment of ₹ 50 lakhs made by Moon TV to the production house would be subject to tax deduction at source under section 194C.

If, however, the payment was made by Moon TV for the acquisition of telecasting rights of the content already produced by the production house, there is no contract for ''carrying out any work", as required in section 194C(1). Therefore, such payment would not be liable for tax deduction at source under section 194C.

13.3.14 Rent [Section 194-I]

(1) Applicability and Rate of TDS

Any person other than individual or HUF, who is responsible for paying to a resident any income by way of rent, shall deduct income tax at the rate of:

(i) **2%** in respect of rent for plant, machinery or equipment;

(ii) **10%** in respect of other rental payments (i.e., rent for use of any land or building, including factory building or land appurtenant to a building, including factory building, or furniture or fittings).

However, an individual or HUF whose total sales, gross receipts or turnover from the business or profession carried on by him exceed ₹ 1 crore in case of business and ₹ 50 lakhs in case of profession during the F.Y. immediately preceding the F.Y. in which such rent was credited or paid, is liable to deduct tax at source.

Further, no deduction shall be made under this section from rent credited or paid to a business trust, being a REIT, in respect of any real estate asset owned directly by it.

(2) Time of deduction

This deduction is to be made at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, whichever is earlier.

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Where any such income is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section will apply accordingly.

(3) Threshold limit

No deduction needs to be made where the amount of rent credited or paid for a month or part of a month by such person to the account of, or to, the payee, does not exceed ***₹ 50,000.***

Threshold limit
₹ 50,000 per month or part of month

(4) Meaning of Rent

"Rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any –

(a) land; or

(b) building (including factory building); or

(c) land appurtenant to a building (including factory building); or

(d) machinery; or

(e) plant; or

(f) equipment; or

(g) furniture; or

(h) fittings,

whether or not any or all of the above are owned by the payee.

Circulars & Notifications

Applicability/non-applicability of TDS under section 194-I on certain payments

Nature of Payment	Analysis	Conclusion
Payments made by the customers on account of ***cooling charges to the cold storage owners****.* ***[Circular No.1/2008 dated 10.1.2008]***	The main function of cold storage is to preserve perishable goods by means of a mechanical process, and storage of such goods is only incidental in nature. **The customer is also not given any right to use any demarcated space/place or the machinery of the**	No tax is to be deducted under section 194-I. However, tax to be deducted under section 194C.

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	cold store and thus does not become a tenant. Therefore, the provisions of 194-I are not applicable to the cooling charges paid by the customers of the cold storage. However, **since the arrangement between the customers and cold storage owners is basically contractual in nature**, the provision of section 194C will be applicable to the amounts paid as cooling charges by the customers of the cold storage.	
Lumpsum lease premium paid for acquisition of long-term lease [Circular No.35/2016, dated 13-10-2016]	The CBDT has, clarified that lump sum lease premium or one-time upfront lease charges, which are not adjustable against periodic rent, paid or payable for the acquisition of long-term leasehold rights over land or any other property are not payments in the nature of rent within the meaning of section 194-I.	Not liable for TDS under section 194-I.
Remittance of Passenger Service Fees (PSF) by an Airline to an Airport Operator ***[Circular No. 21/2017, dated 12.06.2017]***	Section 194-I requires deduction of tax at source at specified percentage on any income payable to a resident by way of rent. Explanation to this section defines the term "rent" as any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any (a) land; or (b) building; or (c) land appurtenant to a building; or (d) machinery; (e) plant; (f) equipment (g) furniture; or (h) fitting, whether or not any or all of them are owned by the payee. On the issue of whether payment of PSF by an airline to an Airport Operator qualifies as rent to attract TDS under section 194-I, the Bombay High Court relied on the Apex Court ruling in Japan Airlines and Singapore Airlines case, wherein it was observed that the primary requirement for any payment to qualify as rent is that the payment must	The provisions of section 194-I shall not be applicable.

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	be for the use of land and building and mere incidental/minor/insignificant use of the same while providing other facilities and service would not make it a payment for use of land and buildings so as to attract section 194-I. Accordingly, the Bombay High Court declined to admit the ground relating to the applicability of the provisions of section 194-I on PSF charges holding that no substantial question of law arises.	
Payment of lease rent or supplemental lease rent, made by a 'lessee' to a lessor, being a Unit located in International Financial Services Center for lease of an aircraft [Notification No. 65/2022, dated 16.06.2022]	The Central Government has, vide this Notification, specified that no tax is required to be deducted under section 194-I on payment in the nature of lease rent or supplemental lease rent, as the case may be, made by a lessee to a lessor, being a Unit located in IFSC, for lease of an aircraft subject to the following conditions- (a) The lessor has to, - (i) furnish a statement-cum-declaration to the lessee giving details of previous years relevant to the ten consecutive assessment years for which the lessor opts for claiming deduction under section 80LA(1A) read with section 80LA(2); and (ii) such statement-cum-declaration has to be furnished for each previous year relevant to the ten consecutive assessment years for which the lessor opts for claiming deduction. (b) The lessee would – (i) not deduct tax on payment made or credited to lessor after the date of receipt of	No tax is required to be deducted under section 194-I The **above relaxation is available to the lessor during the said previous years relevant to the ten consecutive assessment years** as declared by the lessor for which deduction under section 80LA is being opted. The lessee shall be liable to deduct tax on payment of lease rent for any other year.

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	copy of statement cum-declaration from the lessor; and (ii) furnish the particulars of all the payments made to lessor on which tax has not been deducted in view of this notification in the statement of deduction of tax.	
Payment of lease rent or supplemental lease rent, made by a 'lessee' to a lessor, being a Unit located in International Financial Services Center for lease of a ship [Notification No. 57/2023 dated 01.08.2023]	The Central Government has, vide Notification No. 57/2023, dated 01.08.2023 specified that no tax is required to be deducted under section 194-I on payment in the nature of lease rent or supplemental lease rent, as the case may be, made by a lessee to a lessor, being a Unit located in IFSC, for lease of a ship subject to the following conditions- (a) The lessor has to furnish and verify a statement-cum-declaration to the lessee giving details of previous years relevant to the ten consecutive assessment years for which the lessor opts for claiming deduction under section 80LA(1A) read with section 80LA(2); and (b) The lessee would – (i) not deduct tax on payment made or credited to lessor after the date of receipt of copy of statement cum-declaration from the lessor; and (ii) furnish the particulars of all the payments made to lessor on which tax has not been deducted in view of this notification in the statement of deduction of tax.	No tax is required to be deducted under section 194-I The **above relaxation is available to the lessor during the said previous years relevant to the ten consecutive assessment years** as declared by the lessor for which deduction under section 80LA is being opted. The lessee shall be liable to deduct tax on payment of lease rent for any other year.

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TDS on GST component of rental income ***[Circular No.4/2008 dated 15.4.2008]***	Service tax paid by the tenant doesn't partake the nature of income of the landlord. The landlord only acts as a collecting agency for the Government for collection of service tax. Therefore, tax deduction at source under section 194-I would be required to be made on the amount of rent paid/payable without including the service tax. **Note -** It is possible to take a view that the clarification given in Circular No. 4/2008 would apply in the GST regime also.	TDS to be deducted only on the amount of rent excluding rent

13.3.15 Payment on transfer of certain immovable property other than agricultural land [Section 194-IA]

(1) Applicability and Rate

Every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to a resident transferer shall deduct tax, at the rate of **1%** of **such sum or the stamp duty value of such property, whichever is higher.**

"Agricultural land", for the purpose of this section, means rural agricultural land. In other words, transfer of urban agricultural land, will attract the provision of section 194-IA, if the consideration or the stamp duty value of such land is **₹ 50 lakhs or more**.

It is clarified that in case there is more than one transferor or transferee in respect of immovable property, consideration for the purpose of TDS shall be the aggregate of the amounts paid or payable by all the transferees to the transferor or all the transferors for transfer of such immovable property.

(2) Time of deduction

The deduction is to be made at the time of credit of such sum to the account of the resident transferor or at the time of payment of such sum to a resident transferor, whichever is earlier.

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(3) Threshold limit

Tax is not required to be deducted at source where the total amount of consideration for the transfer of immovable property and the stamp duty value of such property, are both less than **₹ 50 lakhs**.

Threshold limit

(4) Non-applicability of TDS under section 194-IA

Since tax deduction at source for compulsory acquisition of immovable property is covered under section 194LA, the provisions of section 194-IA do not get attracted into the hands of the transferee in such cases.

(5) No requirement to obtain TAN

The provisions of section 203A containing the requirement of obtaining Tax Deduction Account Number (TAN) shall not apply to the person required to deduct tax in accordance with the provisions of section 194-IA.

(6) Meaning of consideration for transfer of any immovable property

Consideration for transfer of any immovable property includes all charges of the nature of club membership fee, car parking fee, electricity or water facility fee, maintenance fee, advance fee or any other charges of a similar nature, which are incidental to the transfer of the immovable property.

ILLUSTRATION 11

Mr. X sold his house property in Bangalore as well as his rural agricultural land for a consideration of ₹ 60 lakh and ₹ 15 lakh, respectively, to Mr. Y on 1.8.2025. He has purchased the house property and the land in the year 2024 for ₹ 40 lakh and ₹ 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 1.8.2025, is ₹ 85 lakh and ₹ 20 lakh for the house property and rural agricultural land, respectively. Examine the tax implications in the hands of Mr. X and Mr. Y and the TDS implications, if any, in the hands of Mr. Y, assuming that both Mr. X and Mr. Y are resident Indians.

SOLUTION

(i)	**Tax implications in the hands of Mr. X**
	As per section 50C, the stamp duty value of house property (i.e., ₹ 85 lakh) would be deemed to be the full value of consideration arising on transfer of property since the stamp duty value exceeds 110% of the consideration received. Therefore, ₹ 45 lakh (i.e., ₹ 85 lakh – ₹ 40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2026-27.

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	Since rural agricultural land is not a capital asset, the gains arising on the sale of such land is not taxable in the hands of Mr. X.
(ii)	**Tax implications in the hands of Mr. Y**
	In case the immovable property is received for inadequate consideration, the difference between the stamp value and actual consideration would be taxable under section 56(2)(x), if such difference exceeds the higher of ₹ 50,000 and 10% of the consideration. Therefore, in this case, ₹ 25 lakh (₹ 85 lakh – ₹ 60 lakh) would be taxable in the hands of Mr. Y under section 56(2)(x). Since agricultural land is not a capital asset, the provisions of section 56(2)(x) are not attracted in respect of receipt of agricultural land for inadequate consideration, since the definition of "property" under section 56(2)(x) includes only capital assets specified thereunder.
(iii)	**TDS implications in the hands of Mr. Y**
	Since the sale consideration and stamp duty value of house property, both are not less than ₹ 50 lakhs, Mr. Y is required to deduct tax at source under section 194-IA. The tax to be deducted under section 194-IA would be ₹ 85,000, being 1% of ₹ 85 lakh (higher of ₹ 60 lakhs and ₹ 85 lakhs). TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

13.3.16 Payment of rent by certain individuals or Hindu undivided family [Section194-IB]

(1) Applicability and Rate of TDS

Section 194-IB requires any person, being individual or HUF, other than those individual or HUF whose total sales, gross receipts or turnover from the business or profession exceeds ₹ 1 crore in case of business and ₹ 50 lakhs in case of profession in the financial year immediately preceding the financial year in which such rent was credited or paid, responsible for paying to a resident any income by way of rent, to deduct income tax at the rate of **2%**.

Rent by an Individual or HUF- TDS @2%

(2) Threshold limit

Under this section, tax has to be deducted at source only if the amount of such rent exceeds **₹ 50,000** for a month or part of a month during the previous year.

Threshold limit

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(3) Time of deduction

This deduction is to be made at the time of credit of such rent, for the last month of the previous year or the last month of tenancy, if the property is vacated during the year, as the case may be, to the account of the payee or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, whichever is earlier.

(4) No requirement to obtain TAN

The provisions of section 203A containing the requirement of obtaining a Tax Deduction Account Number (TAN) shall not apply to the person required to deduct tax in accordance with the provisions of section 194-IB.

(5) Meaning of "Rent"

"Rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any land or building or both.

(6) Deduction not to exceed rent for last month

Where the tax is required to be deducted as per the provisions of section 206AA, such deduction shall not exceed the amount of rent payable for the last month of the previous year or the last month of the tenancy, as the case may be. [Section 206AA provides for deduction of tax at source at a higher rate, which is discussed at length later in this chapter]

ILLUSTRATION 12

Mr. X, a salaried individual, pays rent of ₹ 55,000 per month to Mr. Y from June, 2025. Is he required to deduct tax at source? If so, when is he required to deduct tax? Also, compute the amount of tax to be deducted at source.

Would your answer change if Mr. X vacated the premises on 31st August, 2025?

Also, what would be your answer if Mr. Y does not provide his PAN to Mr. X?

SOLUTION

Since Mr. X pays rent exceeding ₹ 50,000 per month in the F.Y. 2025-26, he is liable to deduct tax at source @2%. The tax is to be deducted in the last month of the P.Y. 2025-26 i.e., March 2026 or in the last month of tenancy, if the property is vacated during the year. Since property is not vacated during the year, ₹ 11,000 [(₹ 55,000 x 2% x 10)] has to be deducted from rent payable for March, 2026.

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If Mr. X vacated the premises in August, 2025, then tax of ₹ 3,300 [₹ 55,000 x 2% x 3] has to be deducted from rent payable for August, 2025.

In case Mr. Y does not provide his PAN to Mr. X, tax would be deductible @20%, instead of 2%.

In case 1 above, this would amount to ₹ 1,10,000 [₹ 55,000 x 20% x 10] but the same has to be restricted to ₹ 55,000, being rent for March, 2026.

In case 2 above, this would amount to ₹ 33,000 [₹ 55,000 x 20% x 3].

13.3.17 Payment under specified agreement [Section 194-IC]

(1) Applicability and Rate

This section casts responsibility on any person responsible for paying to a resident any sum by way of consideration, not being consideration in kind, under a specified agreement under section 45(5A), to deduct income-tax at the rate of **10%**.

(2) Time of deduction

This deduction is to be made at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, whichever is earlier.

Specified Agreements - TDS @10%

(3) Non-applicability of section 194-IA

Since tax deduction at source for specified agreement under section 45(5A) is covered under section 194-IC, the provisions of section 194-IA do not get attracted in the hands of the transferee in such cases.

(4) Meaning of specified agreement

Specified agreement under section 45(5A):

- It means a registered agreement in which a person owning land or building or both, agrees to allow another person to develop a real estate project on such land or building or both.
- The consideration, in this case, is a share, being land or building or both in such project; part of the consideration may also be in cash.

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13.3.18 Fees for professional or technical services [Section 194J]

(1) Applicability and Rate of TDS

FTS or royalty for cinematographic films - TDS @2%
Others - TDS @10%
[Payee is in operation of call centre – TDS @2%]

Every person other than an individual or a HUF, who is responsible for paying to a resident any sum by way of–

(i) fees for professional services; or

(ii) fees for technical services; or

(iii) any remuneration or fees or commission, by whatever name called, other than those on which tax is deductible under section 192, to a director of a company; or

(iv) royalty, or

(v) non-compete fees referred to in section 28(va)

shall deduct tax at source at the rate of

(a) **2%** in case of fees for technical services (not being professional services) or royalty where such royalty is in the nature of consideration for sale, distribution or exhibition of cinematographic films; and

(b) **10%** in other cases.

However, in case of a payee, engaged only in the business of operation of a call centre, the tax shall be deducted at source @**2%**

(2) Time of deduction

The deduction is to be made at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

Where any sum is credited to any account, whether called suspense account or by any other name, in the books of accounts of the person liable to pay such sum, such crediting shall be deemed to be credit of such sum to the account of the payee and tax has to be deducted accordingly.

(3) Threshold limit

Threshold limit

No tax deduction is required if the amount of fees or the aggregate of the amounts of fees credited or paid or likely to be credited or paid during a financial year does not

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exceed **₹ 50,000** in the case of fees for professional services, **₹ 50,000** in the case of fees for technical services, **₹ 50,000** in the case of royalty and **₹ 50,000** in the case of non-compete fees.

The limit of ₹ 50,000 under section 194J is applicable separately for fees for professional services, fees for technical services, royalty and non-compete fees referred to in section 28(va). It implies that if the payment to a person towards each of the above is less than ₹ 50,000, no tax is required to be deducted at source, even though the aggregate payment or credit exceeds ₹ 50,000 to such person. However, there is no such exemption limit for deduction of tax on any remuneration or fees or commission payable to director of a company.

Summary of rates and threshold limit u/s 194J for deduction of tax at source

Nature of payment	TDS rate	Separate Limit
Fees for technical services (not being professional services)	2%	*₹ 50,000*
Fees for professional services	10%	*₹ 50,000*
Royalty in the nature of consideration for sale, distribution or exhibition of cinematographic films	2%	*₹ 50,000*
Other royalty	10%	
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	10%	*Nil*
Non-compete fees	10%	*₹ 50,000*
Note - In case of a payee, engaged only in the business of operation of call centre, the tax shall be deducted at source **@2%**		

ILLUSTRATION 13

XYZ Ltd. makes a payment of ₹ 28,000 to Mr. Ganesh on 2.8.2025 towards fees for professional services and another payment of ₹ 25,000 to him on the same date towards fees for technical services. Discuss whether TDS provisions under section 194J are attracted.

SOLUTION

TDS provisions under section 194J would not get attracted, since the limit of ₹ 50,000 is applicable for fees for professional services and fees for technical services, separately. It is assumed that there is no other payment to Mr. Ganesh towards fees for professional services and fees for technical services during the P.Y.2025-26.

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(4) Non-applicability of TDS under section 194J

Non-applicability

(i) An individual or a Hindu undivided family is not liable to deduct tax at source.

However, an individual or HUF, whose total sales, gross receipts or turnover from business or profession carried by him exceeds ₹ 1 crore in case of business or ₹ 50 lakhs in case of profession in the financial year immediately preceding the financial year in which the **fees for professional services or fees for technical services** is credited or paid is required to deduct tax on such fees.

> ***Note*** *- It may be noted that since this provision requires such individuals/HUFs to deduct tax at source only in respect of fees for professional services or fees for technical services, it can be inferred that individuals and HUFs are not required to deduct tax at source under section 194J on royalty and non-compete fees.*

(ii) Further, an individual or Hindu Undivided Family, shall not be liable to deduct income-tax on the sum payable by way of fees for professional services, in case such sum is credited or paid exclusively for personal purposes.

(5) Meaning of "Professional services"

"Professional services" means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or advertising or such other profession as is notified by the CBDT for the purposes of section 44AA or of this section.

Professional services

Other professions notified for the purposes of section 44AA are as follows:

(a) Profession of "authorised representatives";

(b) Profession of "film artist";

(c) Profession of "company secretary".

(d) Profession of "Information technology"

The CBDT has notified the services rendered by following persons in relation to the sports activities as Professional Services for the purpose of the section 194J:

(i) Sports Persons,

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(ii) Umpires and Referees,

(iii) Coaches and Trainers,

(iv) Team Physicians and Physiotherapists,

(v) Event Managers,

(vi) Commentators,

(vii) Anchors and

(viii) Sports Columnists.

Accordingly, the requirement of TDS as per section 194J would apply to all the aforesaid professions. The term "profession", as such, is of a very wide import. However, the term has been defined exhaustively in this section. For the purposes of TDS, therefore, all other professions would be outside the scope of section 194J. For example, this section will not apply to professions of teaching, sculpture, painting, etc., unless they are notified.

(6) Meaning of "Fees for technical services"

Explanation (b) to section 194J provides that the term 'fees for technical services' shall have the same meaning as in *Explanation 2* to section 9(1)(vii). The term 'fees for technical services' as defined in *Explanation 2* to section 9(i)(vii) means any consideration (including any lump sum consideration) for rendering of any of the following services:

(i) Managerial services;

(ii) Technical services;

(iii) Consultancy services;

(iv) Provision of services of technical or other personnel.

It is expressly provided that the term 'fees for technical services' will not include the following types of consideration:

(i) Consideration for any construction, assembly, mining or like project, or

(ii) Consideration which is chargeable under the head 'Salaries'.

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(7) TPAs liable to deduct tax under section 194J on payment to hospitals on behalf of insurance companies

The CBDT has, through *Circular No.8/2009 dated 24.11.2009*, clarified that TPAs (Third Party Administrator's) who are making payment on behalf of insurance companies to hospitals for settlement of medical/insurance claims etc. under various schemes, including cashless schemes are liable to deduct tax at source under section 194J on all such payments to hospitals etc. This is because the services rendered by hospitals to various patients are primarily medical services and, therefore, the provisions of section 194J are applicable to payments made by TPAs to hospitals, etc.

Whether transaction charges paid by the members of the stock exchange for availing fully automated online trading facility, being a facility provided by the stock exchange to all its members, constitute fees for technical services to attract the provisions of tax deduction at source under section 194J [CIT v. Kotak Securities Ltd (2016) 383 ITR 1 (SC)]

The Supreme Court observed that technical services like managerial and consultancy service are in the nature of specialised services made available by the service provider to cater to the special needs of the customer-user as may be felt necessary. It is the above feature that would distinguish or identify a service provider from a facility offered.

The Apex Court, accordingly, held that the service provided by the BSE for which transaction charges are paid failed to satisfy the test of specialized, exclusive and individual requirement of the user or the consumer who may approach the service provider for such assistance or service.

Therefore, the transaction charges paid to BSE by its members are not for technical services but are in the nature of payments made for facilities provided by the stock exchange. Such payments would, therefore, not attract the provisions of tax deduction at source under section 194J.

(8) Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)

As per section 9(1)(vi), any income payable by way of royalty in respect of any right, property or information is deemed to accrue or arise in India. The term "royalty" means consideration for transfer of all or any right in respect of certain rights, property or information.

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Royalty

As per *Explanation 4* to section 9(1)(vi), the consideration for use or right to use of computer software would be royalty. This *Explanation* clarifies that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right to use computer software since the same falls within the definition of royalty as per the provisions of the Income-tax Act, 1961.

Note - The Central Government has, vide *Notification No.21/2012 dated 13.6.2012*, effective from 1st July, 2012, exempted certain software payments from the applicability of tax deduction under section 194J. Accordingly, where payment is made by the transferee for acquisition of software from a resident-transferor, the provisions of section 194J would **not** be attracted if -

(1) the software is acquired in a subsequent transfer without any modification by the transferor;

(2) tax has been deducted either under section 194J or under section 195 on payment for any previous transfer of such software; and

(3) the transferee obtains a declaration from the transferor that tax has been so deducted along with the PAN of the transferor.

ILLUSTRATION 14

East Bengal Club, a renowned football club, has engaged Raghu, a resident in India, as its coach at a remuneration of ₹ 6 lakhs per annum. The club wants to know from you whether it is liable to deduct tax at source from such remuneration.

SOLUTION

Section 194J requires deduction of tax at source @10% from the amount credited or paid by way of fees for professional services, where such amount or aggregate of such amounts credited or paid to a person exceeds ₹ 50,000 in the F.Y. 2025-26. As per *Explanation (a)* to section 194J, professional services include services rendered by a person in the course of carrying on such other profession as is notified by the CBDT for the purposes of section 194J.

Accordingly, the CBDT has, vide *Notification No.88 dated 21.8.2008*, notified the services rendered by coaches and trainers in relation to the sports activities as professional services for the purposes of section 194J.

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Therefore, the club is liable to deduct tax at source under section 194J from the remuneration payable to the Coach, Raghu.

13.3.19 Income in respect of units [Section 194K]

(1) Applicability and rate of tax

Payment in respect of Units TDS @10%

Section 194K provides for deduction of tax at source **@10%** by any person responsible for paying to a resident any income in respect of –

(i) units of a Mutual fund specified under section 10(23D)

(ii) units from Administrator of the specified undertaking

(iii) units from the specified company, being a company whose entire capital is subscribed by financial institutions or banks as notified by the Central Government

(2) Time of deduction

The deduction is to be made at the time of credit of such sum to the account of the payee or at the time of payment by any mode, whichever is earlier.

Where any income in respect of units of a mutual fund, Administrator of the specified undertaking or the specified company is credited to any account in the books of account of the person liable to pay such income, such crediting is deemed to be credit of such income to the account of the payee and tax has to be deducted at source. The account to which such income is credited may be called "Suspense account" or by any other name.

(3) Non-applicability of section 194K

Non-applicability

No tax is required to be deducted if -

(i) the amount of such income or the aggregate of the amounts of such income credited or paid or likely to be credited or paid during a financial year does not exceed ***₹10,000***; or

(ii) the income is of the nature of capital gains.

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13.3.20 Payment of compensation on acquisition of certain immovable property [Section 194LA]

(1) Applicability

Section 194LA provides for deduction of tax at source by a person responsible for paying to a resident any sum in the nature of –

(i) compensation or the enhanced compensation or

(ii) the consideration or the enhanced consideration

on account of compulsory acquisition, under any law for the time being in force, of any immovable property (other than agricultural land).

Compensation on compulsory acquistion -TDS @10%

Immovable property means any land (other than agricultural land) or any building or part of a building.

"Agricultural land" for the purpose of this section means any land situated in India including urban agricultural land.

(2) Rate of TDS

The amount of tax to be deducted is ***10%*** of such sum mentioned in (1) above.

(3) Time of deduction

The tax should be deducted at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(4) Threshold limit

No tax is required to be deducted where the amount of such payment or, as the case may be, the aggregate amount of such payments to a resident during the financial year does not exceed ***₹ 5,00,000***.

Threshold limit

(5) Non-applicability of TDS under section 194LA

No tax is required to be deducted where payment is made in respect of any award or agreement which has been exempted from levy of income tax under section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013.

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13.3.21 Payment made by an individual or a HUF for contract work or by way of commission or brokerage or fees for professional services [Section 194M]

(1) Applicability and rate of TDS

Contract payment, Commission/brokerage and fee for prof. services made by an indl. or HUF - TDS @2%

Section 194M provides for deduction of tax at source **@2%** by an individual or a HUF responsible for paying any sum during the financial year to any resident –

(i) for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract; or

(ii) by way of commission (not being insurance commission referred to in section 194D) or brokerage; or

(iii) by way of fees for professional services.

It may be noted that only individuals and HUFs (other than those who are required to deduct income-tax as per the provisions of section 194C or 194H or 194J) are required to deduct tax in respect of the above sums payable during the financial year to a resident.

(2) Time of deduction

The tax should be deducted at the time of credit of such sum or at the time of payment of such sum, whichever is earlier.

(3) Threshold limit

Threshold limit

No tax is required to be deducted where such sum or, as the case may be, aggregate amount of such sums credited or paid to a resident during the financial year does not exceed **₹ 50,00,000.**

(4) Non-applicability of TDS under section 194M

An individual or a Hindu undivided family is not liable to deduct tax at source under section 194M, if –

(i) they are required to deduct tax at source u/s 194C for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract, i.e., an individual or a HUF whose total sales, gross receipts or

Non-applicability

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turnover from the business or profession carried on by him exceeds ₹ 1 crore in case of business and ₹ 50 lakhs in case of profession during the immediately preceding financial year and such amount is not exclusively credited or paid for personal purposes of such individual or HUF.

(ii) they are required to deduct tax at source u/s 194H on commission (not being insurance commission referred to in section 194D) or brokerage, i.e., an individual or an HUF whose total sales, gross receipts or turnover from the business or profession carried on by him exceeds ₹ 1 crore in case of business and ₹ 50 lakhs in case of profession during the immediately preceding financial year.

(iii) they are required to deduct tax at source u/s 194J on fees for professional services, i.e., an individual or a HUF whose total sales, gross receipts or turnover from the business or profession carried on by him exceeds ₹ 1 crore in case of business and ₹ 50 lakhs in case of profession during the immediately preceding financial year and such amount is not exclusively credited or paid for personal purposes of such individual or HUF.

(5) No requirement to obtain TAN

The provisions of section 203A containing the requirement of obtaining Tax Deduction Account Number (TAN) shall not apply to the person required to deduct tax in accordance with the provisions of section 194M.

Note - *For the meaning of the terms "Work", "Professional services" and "Commission or brokerage" refer sub-heading "15.3.7 Payments to contractors and sub-contractors [Section 194C]", "15.3.18 Fees for professional or technical services [Section 194J]" and "15.3.13 Commission or brokerage [Section 194H]", respectively.*

ILLUSTRATION 15

Examine whether TDS provisions would be attracted in the following cases, and if so, under which section. Also, specify the rate of TDS applicable in each case. Assume that all payments are made to residents.

	Particulars of the payer	***Nature of payment***	***Aggregate of payments made in the F.Y.2025-26***
1.	*Mr. Ganesh, an individual carrying on retail business*	*Contract Payment for repair of residential house*	*₹ 5 lakhs*

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	with turnover of ₹ 2.5 crores in the P.Y.2024-25	*Payment of commission to Mr. Vallish for business purposes*	*₹ 80,000 in November 2025*
2.	*Mr. Rajesh, a wholesale trader whose turnover was ₹ 95 lakhs in P.Y. 2024-25.*	*Contract Payment for the reconstruction of a residential house (made during the period January-March, 2026)*	*₹ 20 lakhs in January, 2026, ₹ 15 lakhs in February 2026 and ₹ 20 lakhs in March 2026.*
3.	*Mr. Satish, a salaried individual*	*Payment of brokerage for buying a residential house in March, 2026*	*₹ 51 lakhs*
4.	*Mr. Dheeraj, a pensioner*	*Contract payment made during October-November 2025 for reconstruction of residential house*	*₹ 48 lakhs*

SOLUTION

	Particulars of the payer	Nature of payment	Aggregate of payments in the F.Y.2025-26	Whether TDS provisions are attracted?
1.	Mr. Ganesh, an individual carrying on retail business with turnover of ₹ 2.5 crores in the P.Y.2024-25	Contract Payment for repair of residential house	₹ 5 lakhs	No; TDS under section 194C is **not** attracted since the payment is for personal purpose. TDS under section 194M is not attracted as aggregate of contract payment to the payee in the P.Y.2025-26 does not exceed ₹ 50 lakhs.
		Payment of commission to Mr. Vallish for business purposes	₹ 80,000	Yes, u/s 194H @2%, since the payment exceeds ₹ 20,000, and Mr. Ganesh's turnover exceeds from business ₹ 1 crore in the P.Y.2024-25.
2.	Mr. Rajesh, a wholesale trader whose turnover was ₹ 95 lakhs in P.Y.2024-25	Contract Payment for reconstruction of residential house	₹ 55 lakhs	Yes, under section 194M @2%, since the aggregate of payments (i.e., ₹ 55 lakhs) exceed ₹ 50 lakhs. Since, his turnover from business does

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				not exceed ₹ 1 crore in the P.Y.2024-25, TDS provisions under section 194C are not attracted in respect of payments made in the P.Y.2025-26.
3.	Mr. Satish, a salaried individual	Payment of brokerage for buying a residential house	₹ 51 lakhs	Yes, under section 194M@2%, since the payment of ₹ 51 lakhs made in March 2026 exceeds the threshold of ₹ 50 lakhs. Since Mr. Satish is a salaried individual, the provisions of section 194H are not applicable in this case.
4.	Mr. Dheeraj, a pensioner	Contract payment for the reconstruction of residential house	₹ 48 lakhs	TDS provisions under section 194C are **not** attracted since Mr. Dheeraj is a pensioner. TDS provisions under section 194M are also **not** applicable in this case, since the payment of ₹ 48 lakhs does not exceed the threshold of ₹ 50 lakhs.

13.3.22 TDS on cash withdrawal [Section 194N]

(1) Applicability and rate of TDS

Section 194N provides that every person, being

Cash withdrawals -TDS @2%

- a banking company to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred under section 51 of that Act)
- a co-operative society engaged in carrying on the business of banking; or
- a post office

who is responsible for paying **any sum,** being the amount or aggregate of amounts, as the case may be, **in cash exceeding ₹ 1 crore during the previous year**, to any person from one or more accounts maintained by such recipient-person with it, shall deduct tax at source **@2% of such sum**

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Where the recipient is a co-operative society, the higher threshold limit of ₹ 3 crores is applicable for cash withdrawals.

(2) Time of deduction

This deduction is to be made at the time of payment of such sum.

(3) Modification in rate of TDS and threshold limit of withdrawal for recipient who has not furnished return of income for last 3 years

If the recipient has not furnished the returns of income for all the three assessment years relevant to the three previous years, for which the time limit for filing return of income under section 139(1) has expired, immediately preceding the previous year in which the payment of the sum is made, **the sum shall mean the amount or the aggregate of amounts, as the case may be, in cash > ₹ 20 lakhs during the previous year**, and the tax shall be deducted at the rate of -

- **2%** of the sum, where the amount or aggregate of amounts, as the case may be, being paid in cash **> ₹ 20 lakhs but ≤ ₹ 1 crore (₹ 3 crores in case the recipient is a co-operative society**
- **5%** of the sum, where the amount or aggregate of amounts, as the case may be, being paid in cash **> ₹ 1 crore (₹ 3 crores in case the recipient is a co-operative society.**

However, the Central Government is empowered to specify, with the consultation of RBI, by notification, the recipient in whose case this provision shall not apply or apply at reduced rate, subject to the satisfaction of the conditions specified in such notification.

(4) Non-applicability of TDS under section 194N

Liability to deduct tax at source under section 194N shall **not** be applicable to any payment made to –

(i) the Government

(ii) any banking company or co-operative society engaged in carrying on the business of banking or a post-office

(iii) any business correspondent of a banking company or co-operative society engaged in carrying on the business of banking, in accordance with the RBI guidelines

Non-applicability

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(iv) any white label ATM operator of a banking company or co-operative society engaged in carrying on the business of banking, in accordance with the authorisation issued by the RBI under the Payment and Settlement Systems Act, 2007

The Central Government may specify, with the consultation of RBI, by notification, the recipient in whose case section 194N shall not apply or apply at a reduced rate, subject to the satisfaction of the conditions specified in such notification. Accordingly, the Central Government has, after consultation with the Reserve Bank of India (RBI), specified –

(i) **Cash Replenishment Agencies (CRA's) and franchise agents of White Label Automated Teller Machine Operators (WLATMO's) –** For availing exemption from applicability of TDS u/s 194N, CRA's and franchise agents of WLATMO's should maintain a separate bank account from which withdrawal is made only for the purposes of replenishing cash in the Automated Teller Machines (ATM's) operated by such WLATMO's. Further, the WLATMO should furnish a certificate every month to the bank certifying that the bank account of the CRA's and the franchise agents of the WLATMO's have been examined and the amounts being withdrawn from their bank accounts have been reconciled with the amount of cash deposited in the ATM's of the WLATMO's.

(ii) **Commission agent or trader, operating under Agriculture Produce Market Committee (APMC), and registered under any law relating to Agriculture Produce Market of the concerned State** - For availing exemption from the applicability of TDS u/s 194N, the commission agent/trader should intimate to the banking company or co-operative society or post office, his account number through which he wishes to withdraw cash in excess of ₹ 1 crore in the previous year along with his Permanent Account Number (PAN) and the details of the previous year. Also, he should certify to the banking company or co-operative society or post office that the withdrawal of cash from the account in excess of ₹ 1 crore during the previous year is for the purpose of making payments to the farmers on account of purchase of agriculture produce. Further, the banking company or co-operative society or post office has to ensure that the PAN quoted is correct and the commission agent or trader is registered with the APMC, and for this purpose, collect necessary evidences and place the same on record.

(iii) (a) the authorised dealer and its franchise agent and sub-agent; and

(b) Full-Fledged Money Changer (FFMC) licensed by the RBI and its franchise agent;

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Such persons should maintain a separate bank account from which withdrawal is made only for the purposes of -

(i) purchase of foreign currency from foreign tourists or non-residents visiting India or from resident Indians on their return to India, in cash as per the directions or guidelines issued by RBI; or

(ii) disbursement of inward remittances to the recipient beneficiaries in India in cash under Money Transfer Service Scheme (MTSS) of the RBI;

The exemption from the requirement to deduct tax u/s 194N would be available only if a certificate is furnished by the authorised dealers and their franchise agent and sub-agent, and the Full-Fledged Money Changers (FFMC) and their franchise agent to the bank that withdrawal is only for the purposes specified above and the directions or guidelines issued by the RBI have been adhered to.

"Authorised dealer" means any person who is authorised by the RBI as an authorised dealer to deal in foreign exchange [Section 10(1) of the Foreign Exchange Management Act, 1999].

(iv) ***Foreign Representations, Diplomatic Missions, etc.*** - *The provisions of section 194N shall not apply to Foreign Representations duly approved by the Ministry of External Affairs of the Government of India including Diplomatic Missions, agencies of the United Nations, International Organisations, Consulates and Offices of Honorary Consuls which are exempt from paying taxes in India as per the Diplomatic Relations (Vienna Convention) Act, 1972 and the United Nations (Privileges and Immunities) Act, 1947.*

(5) ***Person to whom credit is to be given for tax deducted and paid:*** Rule 37BA provides the manner of giving credit for tax deducted and remitted to the Central Government, i.e., it specifies the person to whom credit for tax deducted is to be given and also the assessment year for which the credit may be given. Accordingly, sub-rule (3A) has been inserted in Rule 37BA, to provide that, for the purposes of section 194N, credit for tax deducted at source shall be given to the person from whose account tax is deducted and paid to the Central Government account for the assessment year relevant to the previous year in which such tax deduction is made.

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(6) Furnishing particulars in case of no deduction of tax in consequence of exemption [Rule 31A]

Every person has to furnish particulars of the amount paid or credited on which tax was not deducted in view of the exemption provided in point (4) above. [Rule 31A].

Example

The persons referred to in (i) to (vi) in Column (2) of the table below have always been filing their returns of income on or before the due date u/s 139(1). The persons mentioned in (vii) to (x) in Column (2) of the table below have not filed their returns of income for the last five years. Determine the liability of deduction of tax at source u/s 194N by the bank/co-operative bank referred to in column (3) of the table below in each of the following individual cases, assuming that this is the only withdrawal in the P.Y.2025-26 by the persons referred to in Column (2).

(1)	(2)	(3)	(4)	(5)	(6)
	Person making the withdrawal	**Bank/Co-operative Bank from which money is withdrawn**	**Date of withdrawal**	**Amount of withdrawal (₹)**	**TDS u/s 194N (₹)**
(i)	Mr. Harshit	SBI	1.7.2025	1,10,00,000	₹10,00,000 x 2% = ₹20,000
(ii)	Mr. Pranav	SBI	1.8.2025	90,00,000	Nil (since withdrawals < ₹1 crore)
(iii)	ABC Co-operative Society	SBI	1.9.2025	2,70,00,000	Nil (since withdrawals < ₹3 crore)
(iv)	XYZ Co-operative Society	MNO Co-operative bank	1.9.2025	3,10,00,000	₹10,00,000 x 2% = ₹20,000
(v)	Mr. Vaibhav	MNO Co-operative bank	1.9.2025	2,10,00,000	₹1,10,00,000 x 2% = ₹2,20,000
(vi)	A Ltd.	MNO Co-operative bank	1.10.2025	1,05,00,000	₹5,00,000 x 2% = ₹10,000
(vii)	M/s. DEF & Co., a firm	MNO Co-operative bank	1.2.2026	90,00,000	₹70,00,000 x 2% = ₹1,40,000
(viii)	Mr. Varun	BOI	1.2.2026	1,20,00,000	₹80,00,000 x 2% (+) ₹20,00,000 x 5% = ₹2,60,000

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(ix)	*Mr. Rakesh*	*BOI*	*1.2.2026*	*45,00,000*	*₹25,00,000 x 2% = ₹50,000*
(x)	*PQR Co-operative Society*	*BOI*	*1.2.2026*	*3,30,00,000*	*₹2,80,00,000 x 2% **(+)** ₹30,00,000 x 5% = ₹7,10,000*

13.3.23 TDS on certain payment by e-commerce operator to e-commerce participant [Section 194-O]

(1) Applicability and rate of TDS

Section 194-O provides that where sale of goods or provision of services of an e-commerce participant is facilitated by an e-commerce operator through its digital or electronic facility or platform, such e-commerce operator is liable to deduct tax at source **@0.1%** of the gross amount of such sales or services or both.

Payment by e-commerce operator- TDS @ 0.1%

(2) Time of deduction

The deduction is to be made at the time of credit of amount of such sale or services or both to the account of an e-commerce participant or at the time of payment thereof to such e-commerce participant by any mode, whichever is earlier.

(3) Deemed credit

Any payment made by a purchaser of goods or recipient of services directly to an e-commerce participant for the sale of goods or provision of services or both, facilitated by an e-commerce operator, would be deemed to be amount credited or paid by the e-commerce operator to the e-commerce participant. Accordingly, such payment would be included in the gross amount of such sales or services for the purpose of deduction of income-tax under this section.

(4) Non-applicability of TDS under section 194-O

No tax is required to be deducted under section 194-O in case of any sum credited or paid to an e-commerce participant, being an individual or HUF, where the gross amount of such sale or services or both during the previous year does not exceed ₹ 5 lakh and such e-commerce participant has furnished his PAN/ Aadhaar number to e-commerce operator.

Non-applicability

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(5) Non-applicability of TDS under any other section

A transaction in respect of which tax has been deducted by the e-commerce operator under this section or which is not liable to tax deduction under this section on account of the exemption discussed in point (4) above, would not be liable to tax deduction at source under any other provision of this Chapter.

However, this exemption from TDS under this would not apply to any amount or aggregate of amounts received or receivable by an e-commerce operator for hosting advertisements or providing any other services which are not in connection with the sale of goods or services referred to in point (1) above.

(6) Power of CBDT to issue guidelines

In case any difficulty arises in giving effect to the provisions of this section, the CBDT may issue guidelines for the purpose of removing the difficulty with the approval of the Central Government.

Every guideline issued by the CBDT shall be laid before each House of Parliament and shall be binding on the income-tax authorities and on the e-commerce operator.

Guidelines

Accordingly, the CBDT has, vide **Circular no. 17/2020 dated 29.9.2020 and Circular no. 20/2021 dated 25.11.2021**, issued the following guidelines for removing certain difficulties-

1. Applicability on transactions carried through various Exchanges:

In order to remove practical difficulties in implementing section 194-O in case of certain exchanges and clearing corporations, it has been provided that section 194-O shall **not be applicable** in relation to-

- transactions in securities and commodities which are traded through recognized stock exchanges or cleared and settled by the recognized clearing corporation, including recognized stock exchanges or recognized clearing corporation located in International Financial Service Centre;
- transactions in electricity, renewable energy certificates and energy saving certificates traded through power exchanges registered in accordance with Regulation 21 of the CERC (Central Electricity Regulatory Commission).

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2. **Applicability on payment gateway:**

In e-commerce transactions, the payments are generally facilitated by payment gateways. Consequently, it is possible that there may be applicability of section 194-O twice i.e., once on the main ecommerce operator who is facilitating sale of goods or provision of services or both and once on payment gateway who also happens to qualify as e-commerce operator for facilitating the service. To illustrate, a buyer buys goods worth ₹ 1 lakh on e-commerce website "XYZ". He makes payment of ₹ 1 lakh through the digital platform of "ABC". On these facts, the liability to deduct tax under section 194-O may fall on both "XYZ" and "ABC".

In order to remove this difficulty, it is provided that the payment gateway will not be required to deduct tax under section 194-O on a transaction, if the tax has been deducted by the e commerce operator under section 194-O, on the same transaction. Hence, in the above example, if "XYZ" has deducted tax under section 194-O on ₹ 1 lakh, "ABC" will not be required to deduct tax under section 194-O on the same transaction. To facilitate proper implementation, "ABC" may take an undertaking from XYZ" regarding deduction of tax.

3. **Applicability on insurance agent or insurance aggregator:**

Insurance agents or insurance aggregators, in many cases, have no involvement in transactions between the insurance company and the buyer for subsequent years. Therefore, in subsequent years, the liability to deduct tax may arise on the insurance agents or insurance aggregators, even if the transactions have been completed directly with the insurance company. This may result in hardship for the insurance agents/aggregators.

In order to remove the difficulty, it is provided that in years subsequent to the first year, if the insurance agent or insurance aggregator has no involvement in transactions between the insurance company and the buyer of insurance policy, he would not be liable to deduct tax under section 194-O for those subsequent years. However, the insurance company shall be required to deduct tax on commission payment, if any, made to the insurance agent or insurance aggregator for those subsequent years under the relevant provision of the Act.

4. **Applicability on E-auction services carried out by e-auctioneers through electronic portal:** The provisions of section 194-O **would not** apply in relation to e-auction activities carried out by e-auctioneers if all the facts listed in (a) to (f) are satisfied:

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(a) The e-auctioneer conducts e-auction services for its clients in its electronic portal and is responsible for the **price discovery only** which is reported to the client.

(b) The price so discovered through the e-auction process is not necessarily the price at which the transaction takes place, and it is up to the discretion of the client to accept the price or to directly negotiate with the counter-party.

(c) The transaction of purchase/sale takes place directly between the buyer and the seller party outside the electronic portal maintained by the e-auctioneer and **price discovery only acts as the starting point** for negotiation and conclusion of purchase/sale.

(d) The e-auctioneer is **not responsible for facilitating the purchase and sale of goods** for which e-auction was conducted on its electronic portal except to the extent of price discovery.

(e) Payments for the transactions are carried out directly between the buyer and the seller outside the electronic portal and the **e-auctioneer does not have any information about the quantum and the schedule of payment** which is decided mutually by the client and the counterparty.

(f) For payment made to the e-auctioneer for providing e-auction services, the client deducts tax under the relevant provisions of the Act other than section 194-O.

If any of these facts are not satisfied, the provisions of section 194-O will apply. Further, the buyer would still be liable to deduct tax as per the provisions of section 194Q.

The CBDT further issued, vide **Circular No. 20/2023 dated 28.12.2023,** guidelines for tax deduction at source under section 194-O encompassing transactions that involve **multiple e-commerce operators** in respect of the following issues:

1. Who should deduct tax at source where there are multiple e-commerce operators (ECO) involved in a transaction?

There may be a platform or network (e.g. the Open Network for Digital Commerce) on which multiple e-commerce operators are participating in a single transaction. For example, there could be a buyer side ECO involved in buyer-side functions and a seller-side ECO involved in seller side functions. In this case, there may be two situations:

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Situation 1: Where multiple ECOs are involved in a single transaction of sale of goods or provision of services through ECO platform or network and **where the seller-side ECO is not the actual seller of the goods or services:**

On the buying side, a buyer-side ECO could be providing an interface to the buyer and on the selling side, a seller-side ECO could be providing an interface to the seller.

In this situation, the compliance under section 194-O is to be done by the seller-side ECO who finally makes the payment or the deemed payment to the seller for goods sold or services provided.

Situation 2: Where multiple ECOs are involved in a single transaction of sale of goods or provision of services through ECO platform or network and **where the seller-side ECO is the actual seller of the goods or services.**

On the buying side, an ECO could be providing an interface to the buyer and on the selling side, the seller itself is an ECO and is directly interacting with an ECO.

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In this situation, since on the selling side, the seller itself is an ECO and is directly interacting with an ECO, the compliance under section 194-O is to be done by the ECO which finally makes the payment or the deemed payment to the seller for goods or services sold.

Note - In both the above situations, the tax shall be deducted on the "gross amount" of such sale of goods or provision of services and shall be deducted by seller-side ECO/ECO-2, as the case may be, at the time of credit to the account of a seller (being e-commerce participant) or at the time of the payment or the deemed payment thereof to such seller by any mode, whichever is earlier.

2. **E-commerce operators may be levying convenience fees or charging commission for each transaction and seller might levy logistics & delivery fees for the transaction. Payments may also be made to the platform or network (e.g. ONDC) provider for facilitating the transaction. Would these form part of the "gross amount" for the purposes of TDS under section 194-O of the Act?**

In e-commerce, it is common for an order to be shipped to the buyer from the seller. It is therefore common for the sellers to charge the buyer additionally for shipping in the form of logistics/delivery/shipping/packaging fees.

Further, the buyer-side ECO and seller-side ECO may charge a commission to the seller to enable the online transaction, and the seller may choose to recoup all or part of that amount from the buyer.

Example 1: A buyer purchases goods worth ₹ 100 from the Seller and opts for home delivery. The Seller charges the Buyer an additional ₹ 5 as packing fees, ₹ 10 as shipping fees, and ₹ 3 as a convenience charge (to recoup the fees charged by the seller-side ECO, which includes ₹ 1 charged by the Buyer-side ECO and ₹ 2 charged by the Seller-side ECO itself). So, the seller will issue an invoice for ₹ 118 (i.e. 100 + 5 + 10 + 2 + 1) to the buyer. The shipping fees, packaging fees and convenience fees are separately charged to the buyer to provide services in relation to the main supply. In such a case, TDS is to be deducted by the seller-side ECO under section 194-O on ₹ 118 since this is the gross amount of sales.

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It is thus clarified that TDS shall be deducted by the seller-side ECO on the gross amount of sales of goods (₹ 118) or provision of services at the time of payment (including deemed payment) or credit.

As per section 194-O(3), a transaction on which tax has been deducted by an ECO under section 194-O(1), such transaction shall not be liable to TDS under any other provision of Chapter XVII-B. Accordingly, this exclusion will also apply to the amount received by ECO for the provision of services which are in connection with the main transaction of sale of goods or provision of service or both referred to in section 194-O(1). However, section 194S(4) overrides section 194-O and states that if tax is deducted under section 194-S, no tax is deductible under section 194-O.

In this example, fees charged by the seller-side ECO (₹ 3 charged to the seller) and buyer-side ECO (₹ 1 charged to the seller-side ECO) for services provided would ordinarily have been subjected to TDS under section 194H and the seller and seller-side ECO respectively would have had to deduct tax and file TDS return with respect to the fees paid.

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However, as tax has been deducted under section 194-O(1) on the gross amount of sales of ₹ 118, this amount (which includes buyer-side ECO fee of ₹ 1 and seller-side ECO fee of ₹ 2 charged to the end customer) will not be subject to TDS under any other provision. However, this is subject to provisions of section 194S(4).

Payments may also be made to the platform or network (e.g., the ONDC) provider to facilitate the transaction. These would form part of the "gross amount" for the purposes of TDS under section 194-O if they are included in the payment for the transaction. If these payments are being paid on a lump-sum basis and are not linked to a specific transaction, then these need not be included in the "gross amount".

Example 2:

Money Flow

Invoicing Flow

The Seller's label-price for a product is ₹ 85, the seller-side ECO's fee (for listing the Seller catalogue and facilitating the transaction) is ₹ 10, and the Buyer- side ECO's fee (to provide an interface to enable the Buyer to discover the seller/product and to enable them to place an order) is ₹ 5. The Seller charges the Buyer a total of ₹ 100 (₹ 85 + ₹ 10 + ₹ 5) and issues an invoice for ₹ 100 (gross amount) as shown in the above diagram.

The TDS under section 194-O has to be calculated on ₹ 100 (gross invoice value) @1% by the seller ECO.

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3. How will GST, various state levies and taxes other than GST such as VAT/ Sales tax/ Excise duty / CST be treated when calculating gross amount of sales of goods or provision of services as per the provisions of section 194-O?

Condition	Amount on which tax is to be deducted u/s 194-O
Where tax is deducted at the time of credit of amount in the account of the seller and the component of GST/various state levies and taxes comprised in the amount payable to the seller is indicated separately	Tax has to be deducted under section 194-O on the amount credited without including such GST/ various state levies and taxes.
Where tax is deducted on payment basis because payment is earlier than the credit	Tax has to be deducted on the whole amount (since it is not possible to identify the payment with GST/various state levies and taxes component to be invoiced in the future)

4. How will the adjustment for purchase returns take place?

Tax is required to be deducted under section 194-O at the time of payment or credit, whichever is earlier. Thus, before purchase-return happens, the tax must have already been deducted under section 194-O on that purchase. In such case -

(i) <u>Where the money is refunded against purchase returns</u>

Tax deducted, if any, may be adjusted against the next transaction by the deductor with the same deductee in the same financial year. Further, the tax deducted and deposited will be allowed as credit to the seller.

(ii) <u>Where goods are replaced by the seller against the purchase return</u>

No adjustment is required as in that case the transaction on which tax was deducted under section 194-O has been completed with goods replaced.

5. How will discounts given by the seller as an e-commerce participant or by any of the multiple e-commerce operators be treated while calculating "gross amount"?

(i) <u>Treatment of discounts offered by the actual seller</u>

Where the discount is given by the seller itself, the seller would reduce the price of the products sold or services provided.

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For example, if the label-price of a product is ₹ 100, and the seller offers a discount of ₹ 10, ₹ 90 will be receivable from the buyer. In this case, the seller will invoice the buyer for ₹ 90, and hence the TDS has to be calculated on ₹ 90.

(ii) Treatment of discounts offered by the buyer ECO or Seller ECO

Where discount is given by the buyer ECO/seller ECO, usually the seller receives full consideration for the product, however part of it is received from the buyer and the balance is discharged to the seller by the buyer ECO/seller ECO, as the case may be.

In the above diagram, if the price quoted by the seller is ₹ 100, and the buyer ECO gives a discount of ₹ 10, ₹ 90 (i.e. 100 - 10) will be collected from the buyer and remitted to the seller, and the buyer ECO will pay the remaining ₹ 10 to the seller via the seller ECO. The invoice on the buyer will be raised for ₹ 100 and tax will therefore be deducted by the seller-side ECO on ₹ 100, which is the gross amount of sales.

(7) Person responsible for paying

For the purpose of this section, the e-commerce operator shall be deemed to be the person responsible for paying to the e-commerce participant.

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(8) Meaning of certain terms

Term	Meaning
Electronic commerce	The supply of goods or service or both, including digital products, over digital or electronic network.
E-commerce operator	A person who owns, operates or manages digital or electronic facility or platform for electronic commerce.
E-commerce participant	A person resident in India selling goods or providing services or both, including digital products, through digital or electronic facility or platform for electronic commerce.
Services	It includes fees for technical services and fees for professional services as defined in section 194J.

13.3.24 Deduction of tax by a specified bank in case of specified senior citizen [Section 194P]

(1) Applicability and rate of TDS

(i) Where the deductee exercises the option to shift out of the default tax regime under section 115BAC: Section 194P requires deduction of tax at source on the basis of **rates in force by a specified bank**, being a notified banking company, on **the total income of specified senior citizen** for the relevant assessment year, computed **after giving effect to** -

Tax to be deducted by specified bank

- deduction allowable under Chapter VI-A; **and**
- rebate allowable under section 87A.

(ii) Where the deductee does not exercise the option to shift out of the default tax regime under section 115BAC: In such case, the specified bank shall deduct tax at source in accordance with the rates provided under section 115BAC(1A) subject to certain conditions, including the condition that the specified senior citizen does not avail of specified exemptions and deductions.

(2) Exemption from filing return of income

The specified senior citizen is exempted from filing his return of income for the assessment year relevant to the previous year in which the tax has been deducted under this section.

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(3) *Meaning of certain terms*

Term	Meaning
Specified bank	A banking company which is a scheduled bank and has been appointed as agents of Reserve Bank of India under section 45 of the Reserve Bank of India Act, 1934.
Specified senior citizen	An individual, being a resident in India, who 1. is of the age of 75 years or more at any time during the previous year; 2. is having pension income [Also, he should have no other income except interest income received or receivable from any account maintained by such individual in the same specified bank in which he is receiving his pension income]; and 3. has furnished a declaration to the specified bank containing such particulars, in the prescribed form and verified in the prescribed manner. Accordingly, CBDT has inserted Rule 26D to prescribe the form and manner for furnishing the declaration discussed below.

(4) *Prescribed form and manner for furnishing declaration with the bank [Rule 26D]*

Sub-rule	Provision
1	**Form No. and manner of furnishing the form:** The declaration required to be furnished by the specified senior citizen to the specified bank shall be in Form no. 12BBA to be furnished in paper form duly verified.
2 & 3	**Specified bank deducts tax at source considering the declaration furnished:** On furnishing of the declaration in Form No. 12BBA, the specified bank would compute the total income of such specified senior citizen for the relevant assessment year, after giving effect to the deduction allowable under Chapter VI-A and rebate allowable under section 87A and deduct income-tax on such total income on the basis of the rates in force. The effect of the deduction allowable under Chapter VI-A has to be given based on the evidence furnished by the specified senior citizen during the previous year.
4	**Specified bank responsible for keeping and maintaining declaration and evidence furnished by the senior citizen:** The declaration referred to in sub-rule (1) and evidence for claiming deduction under Chapter VI-A referred to in sub-rule (3) shall be properly maintained by the Specified Bank and shall be made available to the Principal Chief Commissioner of Income-tax or Chief Commissioner of Income-tax, as and when required

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ILLUSTRATION 16

Mr. Sharma, a resident Indian aged 77 years, gets pension of ₹82,000 per month from the UP State Government. The same is credited to his savings account in SBI, Lucknow Branch. In addition, he gets interest@8% on fixed deposit of ₹40 lakhs with the said bank. Out of the deposit of ₹40 lakhs, ₹ 2 lakh represents a five-year term deposit made by him on 1.4.2025. Interest on savings bank credited to his SBI savings account for the P.Y.2025-26 is ₹9,500.

(I) From the above facts, compute the total income and tax liability of Mr. Sharma for the A.Y. 2026-27, assuming that he has exercised the option of shifting out of the default tax regime under section 115BAC(1A).

(II) What would be the amount of tax deductible at source by SBI, assuming that the same is a specified bank? Is Mr. Sharma required to file his return of income for A.Y.2026-27, if tax deductible at source has been fully deducted? Examine.

(III) Is Mr. Sharma required to file his return of income for A.Y.2026-27, if the fixed deposit of ₹40 lakhs was with Canara Bank instead of SBI, other facts remaining the same?

SOLUTION

(I) Computation of total income of Mr. Sharma for A.Y. 2026-27

	Particulars	₹	₹
I	**Salaries**		
	Pension (₹ 82,000 x 12)	9,84,000	
	Less: Standard deduction u/s 16(ia)	50,000	
			9,34,000
II	**Income from Other Sources**		
	Interest on fixed deposit (₹ 40 lakhs x 8%)	3,20,000	
	Interest on savings account	9,500	3,29,500
Gross total income			**12,63,500**
Less:	**Deductions under Chapter VI-A**		
	Under Section 80C		
	Five years term deposit (₹ 2 lakh, restricted to ₹ 1.5 lakh)	1,50,000	
	Under section 80TTB		
	Interest on fixed deposit and savings account, restricted to ₹ 50,000, since Mr. Sharma is a resident Indian of the age of 77 years.	50,000	2,00,000
Total Income			**10,63,500**

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Computation of tax liability		
Tax payable [₹ 63,500 x 30% + ₹ 1,10,000]		1,29,050
Add: Health and Education Cess@4%		5,162
Tax liability		**1,34,212**
Tax liability (rounded off)		**1,34,210**

(II) SBI, being a specified bank, is required to deduct tax at source u/s 194P and remit the same to the Central Government. In such a case, Mr. Sharma would not be required to file his return of income u/s 139.

(III) If the fixed deposit of ₹ 40 lakh is with a bank other than SBI, which is the bank where his pension is credited, then, Mr. Sharma would not qualify as a "specified senior citizen". In this case, Mr. Sharma would have to file his return of income u/s 139, since his total income (without giving effect to *deduction* under Chapter VI-A) exceeds the basic exemption limit.

13.3.25 Deduction of tax at source on purchase of goods [Section 194Q]

(1) Applicability and rate of TDS

Section 194Q requires any person, being a **buyer who is responsible for paying any sum to any resident-seller for purchase of goods** of the value or aggregate of such value exceeding ₹ 50 lakhs in a previous year, to deduct tax at source **@0.1% of such sum exceeding ₹ 50 lakhs**.

Purchase of goods - TDS @ 0.1% of sum > ₹ 50 lakhs

(2) Time of deduction

The deduction is to be made at the time of credit of such sum to the account of the resident-seller or at the time of payment thereof by any mode, whichever is earlier.

Where such sum is credited to any account in the books of account of the person liable to pay such income, such credit of income is deemed to be credit of such income to the account of the payee and tax has to be deducted at source. The account to which such sum is credited may be called "Suspense account" or by any other name.

(3) Non-applicability of TDS under section 194Q [Section 194Q(5)]

Tax is **not** required to be deducted under this section in respect of a transaction on which -

(a) tax is deductible under any of the provisions of this Act; and

(b) tax is collectible under the provisions of section 206C.

Non-applicability

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Notification

Persons notified by the Central Government, on payment to whom no tax is required to be deducted at source [Notification No. 3/2025 dated 2.1.2025]

Section 197A(1F) empowers the Central Government to notify such person or class of persons, including institution, association or body or class of institutions or associations or bodies, on payment to whom no tax is required to deducted or deducted at lower rate. Accordingly, the CBDT has, vide ***Notification No. 3/2025, dated 02.01.2025,*** *has notified that no deduction of tax shall be made under the provisions of section 194Q by a person, being a buyer, in respect of purchase of goods from a Unit of IFSC, being a seller, subject to the following conditions:*

(a) The seller has to -

(i) furnish a statement-cum-declaration to the buyer giving the details of the previous year relevant to the ten consecutive assessment years for which the seller opts for claiming deduction under section 80LA(1A) and (2) and

(ii) such statement cum declaration has to be furnished and verified for each previous year relevant to the ten consecutive assessment years for which the seller opts for claiming deduction under section 80LA(1A) and (2).

(b) The buyer would -

(i) not deduct tax on payment made or credited to the seller after the date of receipt of copy of statement cum-declaration from the seller; and

(ii) furnish the particulars of all the payments made to the seller on which tax has not been deducted in view of this notification in the statement of deduction of tax.

The above relaxation is available to the seller only during the said previous years relevant to the ten consecutive assessment years as declared by the seller for which deduction under section 80LA is being opted. The buyer shall be liable to deduct tax on payment made or credited for any other year.

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(4) Meaning of buyer

Buyer means a person whose **total sales, gross receipts or turnover** from the business carried on by him **exceeds ₹ 10 crores** during the financial year immediately preceding the financial year in which the purchase of goods is carried out.

Turnover > ₹ 10 crores

However, the buyer does not include a person as notified by the Central Government for this purpose, subject to fulfillment of the stipulated conditions.

(5) Power of the CBDT to issue guidelines

In case of any difficulty arises in giving effect to the provisions of this section, CBDT is empowered to issue guidelines, with the approval of the Central Government, for the purpose of removing the difficulty.

Every guideline issued by the CBDT shall be laid before each House of Parliament, and shall be binding on the income-tax authorities and on the person liable to deduct tax.

Guidelines

Accordingly, the CBDT has, vide ***Circular no. 13/2021 dated 30.6.2021 and Circular No. 20/2021 dated 25.11.2021***, issued the following guidelines for removing certain difficulties-

1. Applicability on transactions carried through various Exchanges

There are practical difficulties in implementing the provisions of TDS contained in section 194-Q in case of certain exchanges and clearing corporations. In these transactions, sometimes, there is no one-to-one contract between the buyers and the sellers.

In order to remove such difficulties, it is provided that the provisions of section 194Q would **not** be applicable in relation to,-

(i) transactions in securities and commodities which are traded through recognized stock exchanges or cleared and settled by the recognized clearing corporation, including recognized stock exchanges or recognized clearing corporation located in International Financial Service Centre (IFSC)

(ii) transactions in electricity, renewable energy certificates and energy saving certificates traded through registered power exchanges.

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2. Adjustment for GST, various state levies and taxes other than GST, purchase returns

It has been clarified in Circular No.23/2017 dated 19th July 2017 as under –

"Wherever in terms of the agreement or contract between the payer and the payee, the component of 'GST on services' comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source under Chapter XVII-B on the amount paid or payable without including such 'GST on services' component. GST for these purposes shall include Integrated Goods and Services Tax, Central Goods and Services Tax, State Goods and Services Tax and Union Territory Goods and Services Tax."

Treatment of tax deduction on GST component included in the invoice and in case of purchase of goods which are not covered within the purview of GST, but which are subject to VAT/Sales tax/Excise duty/CST has been clarified vide CBDT Circular No. 13/2021 dated 30.6.2021 and Circular No. 20/2021 dated 25.11.2021, respectively.

	Condition	***Amount on which tax is to be deducted u/s 194Q***
(i)	*Where tax is deducted at the time of credit of amount in the account of the seller* *and* *In terms of the agreement or contract between the buyer and seller, component of GST is indicated separately in the invoice and where purchase of goods are not covered within the purview of GST, VAT/ Sales tax/ Excise duty/ CST is indicated separately in the invoice*	*Tax has to be deducted on the amount credited (without including such GST/ VAT/ Sales tax/ Excise duty/ CST)*
(ii)	*Where tax is deducted on payment basis (if payment is earlier than the credit)*	*Tax has to be deducted on the whole amount (since it is not possible to identify the payment with the tax component to be invoiced in the future)*
(iii)	*In case of purchase returns, where the money is refunded by the seller*	*Tax deducted earlier u/s 194Q on such purchase (which is now*

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		returned) may be adjusted against the next purchase from the same seller
(iv)	*In case of purchase returns, where goods are replaced by the seller*	*No adjustment is required as in that case the purchase on which tax was deducted under section 194Q has been completed with goods replaced*

3. Can non-resident be a buyer under section 194Q?

The provisions of section 194Q would **not** apply to a non-resident whose purchase of goods from a seller resident in India is not effectively connected with the permanent establishment of such non-resident in India. For this purpose, "permanent establishment" shall mean to include a fixed place of business through which the business of the enterprise is wholly or partly carries on.

4. Should tax be deducted when the seller is a person whose income is exempt?

The provisions of section 194Q would **not** apply on purchase of goods from a person, being a seller, who as a person is exempt from income tax under the Act (like person exempt under section 10) or under any other Act passed by the Parliament (like the RBI Act, ADB Act etc.).

The above clarification would not apply if only part of the income of the person (being a buyer) is exempt.

5. Should tax be deducted on advance payment?

Since the provisions apply on payment or credit whichever is earlier, the provisions of section 194Q shall apply to advance payment made by the buyer to the seller.

6. Would provisions of section 194Q apply to buyer in the year of incorporation?

Under section 194Q, a buyer is required to have total sales or gross receipts or turnover from the business carried on by him exceeding ₹ 10 crore during the financial year immediately preceding the financial year in which the purchase of goods is carried out. Since this condition would not be satisfied in the year of incorporation, the provisions of section 194Q shall **not** apply in the year of incorporation.

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7. **Would provisions of section 194Q apply to buyer if the turnover from business is ₹ 10 crore or less?**

As regards whether the provisions of section 194Q would apply to a buyer who has turnover or gross receipts exceeding ₹ 10 crore but total sales or gross receipts or turnover from business is ₹ 10 crore or less, it is clarified that, for the purposes of section 194Q, a buyer is required to have total sales or gross receipts or turnover **from the business carried on by him** exceeding ₹ 10 crore during the financial year immediately preceding the financial year in which the purchase of goods is carried out. **Hence, the sales or gross receipts or turnover from business carried on by him must exceed ₹ 10 crore.** His turnover or receipts from non-business activity is **not** to be counted for this purpose.

8. **Cross application of section 194-O and section 194Q**

Clarification of how section 194-O and section 194Q apply on the same transaction.

Under section 194-O(3), a transaction in respect of which tax has been deducted by the e-commerce operator under sub-section (1), or which is not liable to deduction under sub-section (2), shall **not** be liable to tax deduction at source under any other provision of Chapter XVII of the Act.

E-commerce operator

Under section 194Q(5), the provisions of this section would **not** apply to a transaction on which -

(i) tax is deductible under any of the provisions of this Act; and

(ii) tax is collectible under the provisions of section 206C

After conjoint reading of these provisions, it is clarified that:

(i) If tax has been deducted by the e-commerce operator on a transaction u/s 194-O [including transactions on which tax is not deducted on account of section 194-O(2)], that transaction shall not be subjected to tax deduction u/s 194Q.

(ii) If a transaction is both within the purview of section 194-O as well as section 194Q, tax is required to be deducted u/s 194-O and not u/s 194Q.

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9. Applicability of section 194Q in cases where exemption has been provided under section 206C(1A)

Section 194Q does not apply in respect of transactions where tax is collectible u/s 206C.

In accordance with section 206C(1A), tax is not required to be collected in the case of a resident buyer who furnishes declaration to the effect that the goods u/s 206C(1) are to be utilised for the purposes of manufacturing, processing or producing articles or things or for the purposes of generation of power and not for trading purposes.

In case of goods which are covered u/s 206C(1) but exempted u/s 206C(1A), tax would not be collectible u/s 206C(1).

It is clarified that the provisions of section 194Q will apply in such cases covered under section 206C(1A) and the buyer is to be liable to deduct tax u/s 194Q, if the conditions specified therein are fulfilled.

10. Applicability of the provisions of section 194Q in case of department of Government not being a public sector undertaking or corporation

As per the provisions of section 194Q, for a person to be considered as a buyer, following conditions are required to be fulfilled:

(a) Such person shall be carrying out a business/ commercial activity;

(b) The total sales, gross receipts or turnover from such business/ commercial activity shall be more than ₹ 10 crore during the financial year immediately preceding the financial year in which goods are being purchased by such person.

	Issue	Would TDS u/s 194Q be attracted?
(i)	Can Department of Government be a "buyer" for the purposes of section 194Q?	
	- If it is carrying on business/ commercial activity	Yes (subject to fulfillment of other conditions)
	- If it is not carrying on any business/ commercial activity	No, since it will not be considered as a buyer

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(ii)	Can Department of Central/State Government be considered as "seller" for the purpose of section 194Q?	No [Hence, no tax can be deducted u/s 194Q by the buyer]

Note - A Public Sector Undertaking or corporation established under Central or State Act or any other such body, authority or entity, would, however, be required to comply with the provisions of section 194Q and tax shall be deducted accordingly.

13.3.26 Deduction of tax at source on benefit or perquisite in respect of business or profession [Section 194R]

(1) Applicability and rate of TDS [Section 194R(1)]

Any person who is responsible for providing, to a resident,

- any benefit or perquisite whether convertible into money or not,
- arising from business or the exercise of a profession, by such resident

Benefit or perquiste - TDS @10%

has to, before providing such benefit or perquisite, as the case may be, to such resident, ensure that tax has been deducted in respect of such benefit or perquisite **@10% of the value or aggregate of value of such benefit or perquisite**.

The provisions of section 194R(1) would apply to any benefit or perquisite whether in cash or in kind or partly in cash and partly in kind.

(2) Meaning of "Person responsible for providing" [Explanation 1 to section 194R]

"Person responsible for providing" means the person providing such benefit or perquisite. In case of a company, it means the company itself, including the principal officer thereof.

(3) Cases where benefit or perquisite is wholly in kind or partly in kind and partly in cash [First Proviso to section 194R(1)]

Where the benefit or perquisite, as the case may be, is wholly in kind or partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of such benefit or perquisite, the person responsible for providing such benefit or perquisite has to, before releasing the benefit or perquisite, ensure that tax required to be deducted has been paid in respect of the benefit or perquisite.

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(4) Cases where no tax is required to be deducted under section 194R [Second and Third Proviso to section 194R(1)]

No tax is required to be deducted under section 194R in the following cases –

- In case of a resident, where the value or aggregate of the value of the benefit or perquisite provided or likely to be provided to such resident during the financial year does not exceed ₹ 20,000; or

Non-applicability

- Where a person responsible for providing such benefit or perquisite is an individual or HUF, whose total sales, gross receipts or turnover from business or profession does not exceed ₹ 1 crore in case of business or ₹ 50 lakhs in case of profession, during the financial year immediately preceding the financial year in which such benefit or perquisite, as the case may be, is provided by such person.

(5) Power of CBDT to issue guidelines [Section 194R(2)/(3)]

In case any difficulty arises in giving effect to the provisions of this section, the CBDT may issue guidelines for the purpose of removing the difficulty with the previous approval of the Central Government.

Every guideline issued by the CBDT would be laid before each House of Parliament, and would be binding on the income-tax authorities and on the person providing such benefit or perquisite.

Guidelines

Accordingly, the CBDT has, with the prior approval of the Central Government, vide **Circular no. 12/2022 dated 16.6.2022 and Circular no. 18/2022 dated 13.9.2022**, issued the following guidelines –

Question 1: Is it necessary that the person providing benefit or perquisite needs to check if the amount is taxable under section 28(iv), before deducting tax under section 194R?

Answer: No. The deductor is not required to check whether the amount of benefit or perquisite that he is providing would be taxable in the hands of the recipient under section 28(iv). The amount could be taxable under any other section, like section 41(1), etc. Section 194R casts an obligation on the person responsible for providing any benefit or perquisite to a resident, to deduct tax at source 10%. There is no further requirement to check whether the amount is taxable in the hands of the recipient or under which section it is taxable.

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In the context of section 195, it is a requirement to know whether the payment made by the deductor is income in the hands of the non-resident recipient, as section 195 requires deduction on any other sum chargeable under the provisions of this Act at the rates in force. Thus, there is a requirement that the deductor needs to verify if the "sum is chargeable under the Income-tax Act". The term "rate in force" is defined under section 2(37A) and it allows benefit of agreement under section 90 or section 90A, if eligible, in determining the rate of tax at which the tax is to be deducted at source. Hence, there is further requirement of checking if the amount is taxable under tax treaty and if yes, at what rate. Such a requirement is not there in section 194R, in the absence of these two terms in this section. Hence, there is no requirement for deductor to verify whether the amount is taxable in the hands of the recipient or section under which it is taxable.

These two terms are also not there in section 194E and the Supreme Court in the case of *PILCOM vs. CIT West Bengal*, held that tax is to be deducted under section 194E at a specific rate indicated there in and there is no need to see the taxability or the rate of taxability in the hands of the non-resident.

Question 2: Is it necessary that the benefit or perquisite must be in kind for section 194R to operate?

Answer: Tax under section 194R is required to be deducted whether the benefit or perquisite is in cash or in kind.

First proviso to section 194R(1) clearly indicates the intent of the legislature that there could also be situations where the benefit or perquisite is in cash or the benefit or perquisite is in kind or partly in cash and partly in kind. Thus, section 194R clearly brings in its scope the situation where the benefit or perquisite is in cash or in kind or partly in cash or partly in kind.

Question 3: Is there any requirement to deduct tax under section 194R, when the benefit or perquisite is in the form of a capital asset?

Answer: As has been stated in answer to question no 1, there is no requirement to check whether the perquisite or benefit is taxable in the hands of the recipient and the section under which it is taxable.

Further, Courts have held many benefits or perquisites to be taxable even though one can argue that they are in the nature of a capital asset. The following judgments illustrate this point:

- Assessee entered into an agreement with "J" for purchase of a plot of land and certain amount was paid as earnest money. However, possession of land was not given to

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assessee, and seller entered into another agreement with a third party to develop the said plot. Assessee filed suit in which a consent decree was passed, and in pursuance of same certain amount as paid to assessee. On appeal, it was held that such sum received in pursuance of the consent decree was liable to tax as business income under section 28(iv) *[Ramesh Babulal Shah v CIT (2015) 53 taxmann.com 277(Bom)]*.

- The amount representing principal loan waived by bank under one time settlement scheme would constitute income falling under section 28(iv) relating to value of any benefit or perquisite, arising from business or exercise of profession [*CIT v Ramaniyam Homes (P) Ltd (2016) 68 taxmann.com 289 (Mad)]*.
- Value of rent free accommodation, furniture and fixtures given to director was held as taxable under section 28(iv). *CIT v Subrata Roy (2016) 385 ITR 547 (All*).
- Where a car was given to an assessee by his disciple, who had been benefited from his preaching, the value of car was held to be taxable in the hands of the assessee being a receipt from the exercise of the vocation carried on by him [*CIT (Addl) v Ram Kripal Tripathi (1980) 125 ITR 408 (All)].*
- The assessee was a director of a company. In terms of an agreement with the promoters, shares were allotted to the director. On these facts, it was held that the shares received by the director were benefit or perquisite received from a company by the director and it was a benefit assessable to tax [*D. M. Neterwala v CIT (1986) 122 ITR 880 (Bom)].*
- Value of gift of land was held as a receipt by the assessee in carrying on of his vocation and was held as taxable [*Amarendra Nath Chakraborty v CIT (1971) 79 ITR 342 (Cal)]*

Thus, the asset given as benefit or perquisite may be a capital asset in general sense of the term, like car, land, etc, but in the hands of the recipient, it is benefit or perquisite and has accordingly been held to be taxable. In any case, as stated earlier, the deductor is not required to check if the benefit or perquisite is taxable in the hands of recipient. Thus, the deductor is required to deduct tax under section 194R in all cases where benefit or perquisite (of whatever nature) is provided.

Question 4: If loan settlement/waiver by a bank is to be treated as benefit/ perquisite, it would lead to hardship as the bank would need to incur the additional cost of tax deduction in addition to the haircut that he has taken. Will section 194R apply in such a situation?

As per the judgment of *CIT v. Ramaniyam Homes (P) Ltd (2016) 68 taxmann.com 289 (Mad)* mentioned above, the amount representing principal loan waived by bank under one time

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settlement scheme would constitute income falling under section 28(iv) relating to value of any benefit or perquisite, arising from business or exercise of profession

However, it has been clarified, vide Circular no. 18/2022 dated 13.9.2022, that one-time loan settlement with borrowers or waiver of loan granted on reaching settlement with the borrowers by the following would not be subjected to tax deduction at source under section 194R:

(i) Public Financial Institution

(ii) Scheduled Bank

(iii) Cooperative bank (other than a primary agricultural credit society)

(iv) Primary Co-operative Agricultural and Rural Development Bank

(v) State Financial Corporation

(vi) State Industrial Investment Corporation, being a Government company, engaged in the business of providing long-term finance for industrial projects;

(vii) Deposit taking Non-Banking Financial Company

(viii) Systemically Important Non-Deposit Taking Non-Banking Financial Company

(ix) Public company engaged in providing long-term finance for construction or purchase of houses in India for residential purpose and which is registered in accordance with the guidelines/ direction issued by the National Housing Bank formed under the National Housing Bank Act 1987;

(x) Registered Asset Reconstruction Companies

This clarification is only for the purposes of section 194R. The treatment of such settlement/ waiver in the hands of the person who had got benefitted from such waiver would not be impacted by this clarification. Taxability of such settlement/ waiver in the hands of the beneficiary will be governed by the relevant provisions of the Act.

Question 5: Whether sales discounts, cash discounts and rebates are benefit or perquisite?

Answer: Sales discounts, cash discounts or rebates allowed to customers from the listed retail price represent a lesser realization of the sale price itself. To that extent, the purchase price of a customer is also reduced.

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Discounts

These are also benefits though related to sales/purchase. Since TDS under section 194R is applicable on all forms of benefit/perquisite, tax is required to be deducted. However, subjecting these to tax deduction would put the seller to difficulty. To remove such difficulty, it has been clarified that no tax is required to be deducted under section 194R on sales discounts, cash discounts and rebates allowed to customers.

Where a seller is selling its items from its stock in trade to a buyer, the seller offers two items free with purchase of 10 items. In substance, the seller is actually selling 12 items at a price of 10 items. Let us assume that the price of each item is ₹ 12. In this case, the selling price for the seller would be ₹ 120 for 12 items. For buyer, he has purchased 12 items at a price of 10. Just like seller, the purchase price for the buyer is ₹ 120 for 12 items and he is expected to record so in his books.

In such a situation, again, there could be difficulty in applying section 194R provision. Hence, to remove difficulty it has been clarified that on the above facts no tax is required to be deducted under section 194R.

It has been clarified that the situation is different when free samples are given and the above relaxation would not apply to a situation of free samples.

Similarly, this relaxation should not be extended to other benefits provided by the seller in connection with its sale. To illustrate, the following are some of the examples of benefits/perquisites on which tax is required to be deducted under section 194R (the list is not exhaustive):

- When a person gives incentives (other than discount, rebate) in the form of cash or kind such as car, TV, computers, gold coin, mobile phone etc.
- When a person sponsors a trip for the recipient and his/her relatives upon achieving certain targets
- When a person provides free ticket for an event
- When a person gives medicine samples free to medical practitioners.

The above examples are only illustrative. The relaxation provided from the non-deduction of tax for sales discounts and rebates is only for those items and should not be extended to others.

It has been further clarified that these benefits/perquisites may be used by owner/ director/ employee of the recipient entity or their relatives who in their individual capacity may not be

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carrying on business or exercising a profession. However, the tax is required to be deducted by the person in the name of recipient entity since the usage by owner/ director/ employee/ relative is by virtue of their relation with the recipient entity and in substance the benefit/perquisite has been provided by the person to the recipient entity.

To illustrate, the free medicine sample may be provided by a company to a doctor who is an employee of a hospital. The TDS under section 194R is required to be deducted by the company in the hands of hospital as the benefit/perquisite is provided to the doctor on account of him being the employee of the hospital. Thus, in substance, the benefit/perquisite is provided to the hospital. The hospital may subsequently treat this benefit/perquisite as the perquisite given to its employees (if the person who used it is his employee) under section 17 and deduct tax under section 192. In such a case, it would first be taxable in the hands of the hospital and then allowed as a deduction as salary expenditure. Thus, ultimately the amount would get taxed in the hands of the employee and not in the hands of the hospital. Hospital can get credit of tax deducted under section 194R by furnishing its tax return. It has been further clarified that the threshold of ₹ 20,000 is also required to be seen with respect to the recipient entity.

Similarly, the tax is required to be deducted under section 194R if the benefit or perquisite is provided to a doctor who is working as a consultant in the hospital. In this case the benefit or perquisite provider may deduct tax under section 194R with hospital as the recipient and then hospital may again deduct tax under section for providing the same benefit or perquisite to the consultant. To remove difficulty, as an alternative, the original benefit or perquisite provider may directly deduct tax under section 194R in the case of the consultant as a recipient.

The provisions of section 194R would not apply if the benefit or perquisite is being provided to a Government entity, like Government hospital, not carrying on business or profession.

Question 6: How is the valuation of benefit/perquisite required to be carried out?

Answer: The valuation would be based on the fair market value of the benefit or perquisite, except in following cases:-

	Situation	Value for such benefit/perquisite
(i)	The benefit/perquisite provider has purchased the benefit/perquisite before providing it to the recipient	purchase price
(ii)	The benefit/perquisite provider manufactures such items given as benefit/perquisite	the price that it charges to its customers for such items

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No TDS on GST

It has been further clarified that GST would not be included for the purposes of valuation of benefit/perquisite for TDS under section 194R.

Question 7: Many times, a social media influencer is given a product of a manufacturing company so that he can use that product and make audio/video to speak about that product in social media. Is this product given to such influencer a benefit or perquisite?

Answer: Whether this is benefit or perquisite will depend upon the facts of the case.

In case of benefit or perquisite being a product like car, mobile, outfit, cosmetics, etc. and if the product is returned to the manufacturing company after using for the purpose of rendering service, then it will not be treated as a benefit/perquisite for the purposes of section 194R.

However, if the product is retained, then it would be in the nature of benefit/perquisite and tax is required to be deducted accordingly under section 194R.

Question 8: Whether reimbursement of out-of-pocket expenses incurred by service provider in the course of rendering service is benefit/perquisite?

Answer: Any expenditure which is the liability of a person carrying out business or profession, if met by the other person is in effect a benefit/perquisite provided by the second person to the first person in the course of business/profession.

Reimbursement

For example, a consultant is rendering service to a person "X" for which he is receiving consultancy fee. In the course of rendering that service, he has to travel to a different city from the place where is regularly carrying on business or profession. For this purpose, he pays for boarding and lodging expenses incurred exclusively for the purposes of rendering the service to "X". Ordinarily, the expenditure incurred by the consultant is part of his business expenditure which is deductible from the fee that he receives from company "X". In such a case, the fee received by the consultant is his income and the expenditure incurred on travel is his expenditure deductible from such income in computing his total income.

If this travel expenditure is met by the company "X", it is benefit or perquisite provided by "X" to the consultant.

However, sometimes the invoice is obtained in the name of "X" and accordingly, if paid by the consultant, is reimbursed by "X". In this case, since the expense paid by the consultant (for which reimbursement is made) is incurred wholly and exclusively for the purposes of rendering services to "X" and the invoice is in the name of "X", then the reimbursement made

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by “X” being the service recipient will not be considered as benefit/perquisite for the purposes of section 194R.

If the invoice is not in the name of “X” and the payment is made by “X” directly or reimbursed, it is the benefit/perquisite provided by “X” to the consultant for which deduction is required to be made under section 194R.

However, it has been clarified, vide circular no. 18/2022 dated 13.9.2022, that in case of a supplier who is a “pure agent” fulfilling the following conditions, the reimbursement would not be treated as benefit/ perquisite for the purpose of section 194R -

i. the supplier acts as a pure agent of the recipient of the supply, when he makes payment to the third party on authorization by such recipient;

ii. the payment made by the pure agent on behalf of the recipient of supply has been separately indicated in the invoice issued by the pure agent to the recipient of service; and

iii. the supplies procured by the pure agent from the third party as a pure agent of the recipient of supply are in addition to the services he supplies on his own account.

In case these conditions are not satisfied, such expenditure incurred is included in the value of supply under GST. However, in the abovementioned case of "pure agent", if all the conditions are satisfied, the GST input credit is allowed to the recipient and it is not considered as supply of the pure agent. In such a case, it is clarified that the amount incurred by such "pure agent" for which he is reimbursed by the recipient would not be treated as benefit/perquisite for the purpose of section 194R.

Meaning of “Pure Agent” – A "pure agent" means a person who

a) enters into a contractual agreement with the recipient of supply to act as his pure agent to incur expenditure or costs in the course of supply of goods or services or both;

b) neither intends to hold nor holds any title to the goods or services or both, so procured or provided as pure agent of the recipient of supply;

c) does not use for his own interest such goods or services so procured; and

d) receives only the actual amount incurred to procure such goods or services in addition to the amount received for supply he provides on his own account.

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Question 9: Tax deduction under sections 194C and 194J is required to be made from the gross amount of bill, including the reimbursement. A person has provided service to a company and out-of-pocket expenses are charged by him to the company along with service fee in the same bill. Company deducts tax under section 194J on both service fee components as well as on out-of-pocket expense. Is there a noncompliance with the provision of section 194R?

If out-of-pocket expenses (reimbursement) are already part of the consideration in the bill on which tax is deducted under the relevant provisions of the Act, other than section 194R, it is clarified, vide circular no. 18/2022 dated 13.9.2022, that there will not be further liability for tax deduction under section 194R.

In the above example, out-of-pocket expense is part of the consideration in the bill for professional fee that is charged to the company and the tax is deducted under section 194J on the entire consideration, including out-of-pocket expense. In such a case, the out-of-pocket expense is already included as part of professional fee. Hence, there is no further benefit/perquisite which requires tax deduction under section 194R.

Question 10: If there is a dealer conference to educate the dealers about the products of the company - Is it benefit/perquisite?

Answer: The expenditure pertaining to dealer/ business conference would not be considered as benefit/ perquisite for the purposes of section 194R in a case where dealer/ business conference is held with the prime object to educate dealers/customers about any of the following or similar aspects:

(i) new product being launched

(ii) discussion as to how the product is better than others

(iii) obtaining orders from dealers/customers

(iv) teaching sales techniques to dealers/customers

(v) addressing queries of the dealers/customers

(vi) reconciliation of accounts with dealers/customers

However, such conference must not be in the nature of incentives/ benefits to select dealers/customers who have achieved particular targets.

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Further, in the following cases the expenditure would be considered as benefit or perquisite for the purposes of section 194R -

(i) Expense attributable to leisure trip or leisure component, even if it is incidental to the dealer/ business conference.

(ii) Expenditure incurred for family members accompanying the person attending dealer/ business conference

(iii) Expenditure on participants of dealer/ business conference for days which are on account of prior stay or overstay beyond the dates of such conference. However, a day immediately prior to actual start date of the conference and a day immediately following the actual end date of conference would not be considered as over stay.

Question 11: If there is a dealer conference to educate the dealers about the products of the company - (i) is there a requirement that all dealers must be invited in the conference, (ii) how to identify benefit against individual dealers in a group activity?

It has been clarified, vide circular no. 18/2022 dated 13.9.2022, that it is not necessary that all dealers are required to be invited in a dealer/business conference for the expenses to be not considered as benefit/perquisite for the purposes of tax deduction under section 194R.

There may be expenses during such dealer/business conference which need to be classified as benefit/perquisite and tax is required to be deducted under section 194R. However, there may be practical difficulties in identifying such benefit/perquisite to actual recipient due to the fact that it is a group activity and reasonable allocation is not possible. Non compliance of the provision of section 194R, in such a case, would not only result in disallowance under section 40(ia) but may also result in treating the benefit/perquisite provider as assessee in default under section 201 with all other consequences.

In order to remove these practical difficulties, it has been clarified that if benefit/perquisite is provided in a group activity in a manner that it is difficult to match such benefit/perquisite to each participant using a reasonable allocation key, the benefit/perquisite provider may at his option not claim the expense, representing such benefit/perquisite, as deductible expenditure for calculating his total income. If he decides to opt so, he will not be required to deduct tax under section 194R on such benefit/perquisite, and therefore, he will not be treated as an assessee in default under section 201. Thus, in such a case, he must add back the expenditure, representing such benefit/perquisite, to calculate his total income if such expenditure is debited in the account.

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Question 12: Section 194R provides that if the benefit/ perquisite is in kind or partly in kind (and cash is not sufficient to meet TDS) then the person responsible for providing such benefit or perquisite is required to ensure that tax required to be deducted has been paid in respect of the benefit or perquisite, before releasing the benefit or perquisite. How can such person be satisfied that tax has been deposited?

Answer: The requirement of law is that if a person is providing benefit in kind to a recipient and tax is required to be deducted under section 194R, the person is required to ensure that tax required to be deducted has been paid by the recipient. Such recipient would pay tax in the form of advance tax. The tax deductor may rely on a declaration along with a copy of the advance tax payment challan provided by the recipient confirming that the tax required to be deducted on the benefit/perquisite has been deposited. This would then be required to be reported in TDS return along with challan number. Form 26Q has included provisions for reporting such transactions.

In the alternative, as an option to remove difficulty if any, the benefit provider may deduct the tax under section 194R and pay to the Government. The tax should be deducted after taking into account the fact the tax paid by him as TDS is also a benefit under section 194R. In the Form 26Q he will need to show it as tax deducted on benefit provided.

Question 13: Company "A" gifts a car to its dealer "B" and deducted tax on this benefit under section 194R. Dealer "B" uses this car in his business. Will he get deduction for depreciation in calculating his income under the head "profits and gains of business or profession"?

It has been clarified, vide circular no. 18/2022 dated 13.9.2022, that once Company "A" has deducted tax on gifting of car in accordance with section 194R (or released the car after dealer "B" showed him payment of tax on such benefit) and dealer "B" has included this benefit as income in his income tax return, it would be deemed that the "actual cost" of the car for the purposes of section 32 shall be the amount of benefit included by dealer "B" as income in his income-tax return. Hence, dealer "B" can get depreciation on fulfilment of other conditions for claiming depreciation.

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Question 14: Whether Embassy/High Commissions are required to deduct tax under section 194R?

Answer: It has been clarified, vide circular no. 18/2022 dated 13.9.2022, that the provision of section 194R is not applicable on benefit/perquisite provided by, an organization in scope of The United Nations (Privileges and Immunity Act) 1947, an international organization whose income is exempt under a specific Act of Parliament (such as the Asian Development Bank Act 1966), an embassy, a High Commission, legation, commission, consulate and the trade representation of a foreign state.

Question 15: Whether issuance of bonus share/right share is a benefit or perquisite if issued by a company in which the public are substantially interested and whether tax is required to be deducted under section 194R?

Answer: In case of bonus shares which are issued to all shareholders by a company in which the public are substantially interested as defined in clause (18) of section 2 of the Act, it has been represented that this does not result in any benefit to shareholders as the overall value and ownership of their holding does not change. Further cost of acquisition of bonus share is taken as nil for capital gains computation when this share is sold. Similar representations have been received seeking clarity on issuance of right shares.

It has been clarified, vide circular no. 18/2022 dated 13.9.2022, that the tax under section 194R is not required to be deducted on the issuance of bonus or right shares by a company in which the public are substantially interested, where bonus shares are issued to all shareholders by such a company or right shares are offered to all shareholders by such a company, as the case may be.

13.3.27 Deduction of tax at source on salary, remuneration, commission, bonus or interest to a partner of the firm [Section 194T]

(1) Applicability of TDS under section 194T

Any person, being a firm, responsible for paying any sum in the nature of salary, remuneration, commission, bonus or interest to its partner has to deduct tax on such sum.

(2) Rate of TDS

The rate of deduction of tax in respect of such sum is ***10%****.*

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(3) Time of tax deduction at source

The deduction of tax must be made at the time of crediting such sum to the account of the partner (including the capital account) or at the time of its payment, whichever is earlier.

(4) Non-applicability of TDS under section 194T

No deduction of tax shall be made where such sum or the aggregate of such sums credited or paid or likely to be credited or paid to the partner of the firm does not exceed ₹ 20,000 during the financial year.

13.3.28 Non-applicability of TDS provisions on payments made to Corporations whose income is exempt under section 10(26BBB) [Circular No.7/2015, dated 23-04-2015]

The CBDT had earlier issued *Circular No.4/2002 dated 16.07.2002* which laid down that there would be no requirement for tax deduction at source in respect of payments made to such entities, whose income is unconditionally exempt under section 10 of the Income-tax Act, 1961 and who are statutorily not required to file return of income as per the section 139. The said Circular also lists the entities which are unconditionally exempt under section 10 and who are statutorily not required to file return of income as per section 139.

Section 10(26BBB) provides that 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 does not form part of the total income. The corporations covered under section 10(26BBB) are also statutorily not required to file return of income as per the section 139.

The corporations covered under section 10(26BBB) satisfy the two conditions of Circular No. 4/2002 i.e., such corporations are statutorily not required to file return of income as per section 139 and their income is also unconditionally exempt under section 10 of the Income-tax Act, 1961. Accordingly, the CBDT has examined the matter and extended the benefit of the said Circular to such corporations whose income is exempt under section 10(26BBB). Hence, there would be no requirement for tax deduction at source from the payments made to such corporations, since their income is anyway exempt under the Income-tax Act, 1961.

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13.3.29 Income payable "net of tax" [Section 195A]

(1) Where, under an agreement or other arrangement, the tax chargeable on any income referred to in the foregoing provisions of this Chapter is to be borne by the person by whom the income is payable, then, for the purposes of deduction of tax under those provisions such income shall be increased to such amount as would, after deduction of tax thereon, be equal to the net amount payable under such agreement or arrangement.

(2) However, no grossing up is required in the case of tax paid under section 192(1A) by an employer on the non-monetary perquisites provided to the employee.

ILLUSTRATION 17

'X' while making payment "net of tax" to a non-resident for providing technical services on a world bank aided project had deducted tax out of such payments as per rates prescribed but says that the payee is not entitled for the TDS certificate. Examine.

SOLUTION

A payment made of 'net of tax' in terms of section 195A, refers to an agreement/arrangement, where the tax chargeable on any income is borne by the payer of the income, and for the purpose of deduction of tax at source, such income is increased to such an amount as would after deduction of tax thereon, be equal to the net amount payable under the agreement.

As per section 198, any sum deducted in accordance with the provisions of Chapter XVII-B of the Income-tax Act, 1961 is deemed to be income received while computing the income of the payee. Further, section 199 provides that credit for the tax deducted at source and paid to the Central Government shall be given to the person from whose income the deduction was made on the production of a certificate furnished under section 203 of the Income-tax Act.

As per section 203, every person deducting tax at source shall furnish to the payee a certificate in the prescribed form within the prescribed time.

Even in a case where X undertakes to pay the tax on the grossed-up amount, the non-resident shall be entitled for issue of certificate for tax deducted at source in respect of payment made 'net of tax'. This has been clarified vide CBDT *Circular No.785 dated 24.11.1999.*

Therefore, X has a legal obligation to issue TDS certificate to the non-resident, even if he has made payment of income "net of tax" to him.

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13.3.30 Interest or dividend or other sums payable to Government, Reserve Bank or certain corporations [Section 196]

(1) No deduction of tax shall be made by any person from any sums payable to –

(i) the Government; or

(ii) the Reserve Bank of India; or

(iii) a corporation established by or under a Central Act, which is, under any law for the time being in force, exempt from income-tax on its income; or

(iv) a Mutual Fund specified under section 10(23D).

(2) This provision for non-deduction is applicable when such sum is payable to the above entities by way of –

(i) interest or dividend in respect of securities or shares –

(a) owned by the above entities; or

(b) in which they have full beneficial interest or

(ii) any other income accruing or arising to them.

The following is the summary of those TDS provisions which are discussed in detail in other chapters of the Study Material as mentioned in Column (4):

Section	Nature of payment	Rate of TDS	Chapter
(1)	(2)	(3)	(4)
194E	Income referred to under section 115BBA payable to non-resident sportsmen/sports association or an entertainer	20%	21: Non-resident Taxation (Module 4)
194LB	Interest payable by infrastructure debt fund to a non-corporate non-resident or foreign company	5%	
194LBA(1)/(2)	Distribution of any interest income, received or receivable by a business trust from a SPV, to its unit holders.	10% (resident) 5% (Non-resident and foreign company)	10: Assessment of Trusts, Political Parties and Other

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	Distribution of any dividend income, received or receivable by business trust from a SPV exercising option to pay tax at concessional rate under section 115BAA, to its unit holders. However, if the SPV is not exercising the option to pay tax at concessional rate under section 115BAA, dividend income would be exempt in the hands of unit holders and tax would not be deductible at source.	10% (resident, non-resident and foreign Co.)	Special Entities (Module 2)
194LBA(1)/(3)	Distribution of any income received from renting or leasing or letting out any real estate asset directly owned by the business trust, to its unit holders.	10% (resident) At the rates in force (Non-resident and foreign company)	
194LBB	Investment fund paying income to a unit holder [other than income which is exempt under section 10(23FBB)].		
194LBC(1)/(2)	Income in respect of investment made in a securitisation trust (specified in *Explanation* to section 115TCA)	***10% (resident)*** At the rates in force (Non-resident and foreign company)	
194LC	Interest payable by an Indian Company or a business trust to a non-corporate non-resident or foreign company - in respect of money borrowed in foreign currency from a source outside India • under a loan agreement between 1.7.2012 and 30.6.2023 or • by way of issue of long-term infrastructure bonds during the period between 1.7.2012 and 30.9.2014 • by way of issue of long term bonds (including long term infrastructure	5%	21: Non resident Taxation (Module 4)

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	bond) between 1.10.2014 and 30.6.2023 as approved by Central Government or - in respect of money borrowed from source outside India by way of rupee denominated bond on or before 30.6.2023		
	Interest payable by an Indian company or a business trust to a non-corporate non-resident or foreign company, in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or rupee denominated bond - (i) between 1.4.2020 and 30.6.2023, which is listed only on a recognised stock exchange located in any International Financial Services Centre.	4%	
	(ii) on or after 1.7.2023, which is listed only on a recognised stock exchange located in any International Financial Services Centre.	9%	
	Interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the period from 17.9.2018 to 31.3.2019	Nil (Since such interest is exempt u/s 10(4C), no tax is deductible u/s 194LC)	
194S	Payment of any sum to any resident by way of consideration for transfer of virtual digital asset	1%	12: Taxation of digital transactions (Module 2)
195	Any other sum payable to a non-resident	At the rates in force	21: Non resident Taxation (Module 4)
196A	Income on units of a mutual fund specified under section 10(23D) or from the	20% or the rates specified in DTAA,	

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	specified company referred to in section 10(35) payable to non-corporate non-resident or foreign company	whichever is lower (provided tax residency certificate is furnished by the non-resident)	
196B	Income from units of a mutual fund or UTI purchased in foreign currency (including long term capital gain on transfer of such units) payable to an Offshore Fund	10% in respect of income from units 12.5% in respect of long term capital gain on transfer of such units	
196C	Income by way of interest or dividend on bonds of an Indian company or public sector company sold by the Government and purchased by a non-resident in foreign currency or GDRs referred to in section 115AC (including long term capital gain on transfer of such bonds or GDRs) payable to a non-resident	10% in respect of interest or dividend from bonds or GDRs 12.5% in respect of long-term capital gains on transfer of such bonds or GDRs	
196D	Income of Foreign Institutional Investors (FIIs) from securities (not being capital gain arising from such securities)	20% In case DTAA applies to FII, and if FII furnishes a TRC, tax would be deducted @20% or rate provided in DTAA, whichever is lower.	
	Income of specified fund from securities [not being income exempt u/s 10(4D)]	10%	

Note: *In the above cases, wherever payment is made to a non-corporate non-resident or a foreign company, the rate of TDS would be further increased by a surcharge, wherever applicable, and health and education cess @4% except in case of deduction u/s 196D on income of a specified fund.*

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13.4 CERTIFICATE FOR DEDUCTION OF TAX AT A LOWER RATE [SECTION 197]

TDS at lower rate

(1) This section applies where, in the case of any income of any person or sum payable to any person, income-tax is required to be deducted at the time of credit or payment, as the case may be at the rates in force as per the provisions of sections 192, 193, 194, 194A, 194C, 194D, 194G, 194H, 194-I, 194J, 194K, 194LA, 194LBA, 194LBB, 194LBC, 194M, 194-O,194Q and 195.

(2) In such cases, the assessee can make an application to the Assessing Officer for the deduction of tax at a lower rate or for non-deduction of tax.

(3) If the Assessing Officer is satisfied that the total income of the recipient justifies the deduction of income-tax at lower rates or no deduction of income-tax, as the case may be, he may give to the assessee such certificate, as may be appropriate.

(4) Where the Assessing Officer issues such a certificate, then the person responsible for paying the income shall deduct income-tax at such lower rates specified in the certificate or deduct no tax, as the case may be, until such certificate is cancelled by the Assessing Officer.

(5) Enabling powers have been conferred upon the CBDT to make rules for prescribing the procedure in this regard.

13.5 NO DEDUCTION IN CERTAIN CASES [SECTION 197A]

(1) Enabling provision for filing of declaration for receipt of dividend and NSS payment without deduction of tax [Sub-section (1)]

(i) This section enables an individual, who is resident in India and whose estimated total income of the previous year is less than the basic exemption limit, to receive dividends and any sum out of National Savings Scheme Account, without deduction of tax at source under sections 194 and 194EE, on furnishing a declaration in duplicate in the prescribed form and verified in the prescribed manner.

(ii) The declaration in the above form is to be furnished in writing in duplicate by the declarant to the person responsible for paying any income of the nature referred to in sections 194 or 194EE. The declaration will have to be to the effect that the tax on the estimated total income of the declarant of the previous year in which such income is to be included in computing his total income will be **Nil**.

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(2) Enabling provision for filing of declaration for non-deduction of tax under section 192A or 193 or 194A or 194D or 194DA or 194-I or 194K by persons, other than companies and firms [Sub-section (1A)]

No deduction of tax shall be made under the above provisions of the Act, where a person, who is not a company or a firm, furnishes to the person responsible for paying any income of the nature referred to in these sections, a declaration in writing in duplicate in the prescribed form to the effect that the tax on his estimated total income of the previous year in which such income is to be included in computing his total income will be **Nil.**

No TDS

(3) Filing declaration not permissible if income/aggregate of incomes exceed basic exemption limit [Sub-section (1B)]

Declaration cannot be furnished as per the above provisions, where -

(i) payments of dividend; or

(ii) payments in respect of deposits under National Savings Schemes, etc.; or

(iii) payment of premature withdrawal from Employee Provident Fund; or

(iv) income from interest on securities or

(v) interest other than "interest on securities"; or

(vi) insurance commission; or

(vii) payment in respect of life insurance policy; or

(viii) rent; or

(ix) income from units; or

(x) the aggregate of the amounts of such incomes in (i) to (ix) above

credited or paid or likely to be credited or paid during the previous year in which such income is to be included exceeds the basic exemption limit.

(4) Enabling provision for filing of declaration by resident senior citizens for non-deduction of tax at source [Sub-section (1C)]

For a resident senior citizen, who is of the age of 60 years or more at any time during the previous year, no deduction of tax shall be made under section 192A or section 193 or section 194 or section 194A or section 194D or section 194DA or section 194EE or section 194-I or section 194K, if such individual furnishes a declaration in writing in duplicate in Form 15H to the payer, that tax on his estimated total income of the previous year in which

Form 15H

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such income is to be included in computing his total income is **Nil**. The restriction contained in sub-section (1B) will not apply to resident senior citizens.

Further, declaration in Form 15H can also be made in a case where income of the assessee, who is eligible for rebate of income-tax under section 87A, is higher than the basic exemption limit (after allowing for deduction(s) under Chapter VI-A, if any, or set off of loss, if any, under the head "Income from house property" for which, the declarant is eligible) but his tax liability would be "Nil" after taking into account the rebate available to him under section 87A.

(5) Non-deduction of tax in certain cases

(i) Interest payments by an Offshore Banking Unit to a non-resident/not ordinarily resident in India [Sub-section (1D)]

No deduction of tax shall be made by an Offshore Banking Unit from the interest paid on -

(a) deposit made by a non-resident/not-ordinarily resident on or after 1.4.2005; or

(b) borrowing from a non-resident/not-ordinarily resident on or after 1.4.2005.

Applicability of section 197A(1D) and section 10(15)(viii) to interest paid by IFSC Banking Units (IBUs) [*Circular No 26/2016 dated 4.7.2016*]

The CBDT Circular clarifies that in accordance with the provisions of section 197A(1D), tax is not required to be deducted on interest paid by IFSC Banking Units, on deposit made on or after 1.4.2005 by a non-resident or a person who is not ordinarily resident in India, or on borrowings made on or after 1.4.2005 from such persons.

(ii) Payment to any person for, or on behalf of, the NPS Trust [Sub-section (1E)]

No deduction of tax at source shall be made from any payment to any person for, or on behalf of, the New Pension System Trust referred in section 10(44).

(iii) Payments to notified institutions/class of institutions etc. [Sub-section (1F)]

No deduction of tax shall be made or deduction of tax shall be made at such lower rate, from such payment to such person or class of persons, including institution, association or body or class of institutions or associations or bodies as may be notified by the Central Government in the Official Gazette in this behalf. Therefore, in respect of such payments made to a notified person or class of persons, no tax is to be deducted at source or tax is to be deducted at a lower rate.

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Notifications

Non-applicability of TDS provisions in respect of certain payments made to specified units located in IFSC [Notification No. 28/2024 dated 7.3.2024 and Notification No. 67/2025 dated 20.6.2025]

In accordance with the provisions of section 197A(1F) read with section 80LA(1A)/(2), the Central Government has, vide notification no. 28/2024, notified that no tax is required to be deducted at source in respect of the specified payments made by any 'payer' to a payee, being a Unit of IFSC, as specified in the following Table:-

Table: List of payments receivable by a Unit of (IFSC)

Sl. No.	IFSC Unit (Payee)	Nature of receipt	Relevant TDS provisions
1.	Banking Unit	Interest income on External Commercial Borrowings/ Loans	Section 195
		Professional fees	Section 194J
		Referral fees	Section 194H
		Brokerage income	Section 194H
		Commission income on factoring and forfaiting services	Section 194H
2.	IFSC Insurance Intermediary office	Insurance commission	Section 194D
3.	Finance Company	Interest income on External Commercial Borrowings / Loans	Section 195/ 194A
		Dividend income	Section 194
		Commission income on factoring and forfaiting services	Section 194H
4.	Finance Unit	Interest income on External Commercial Borrowings / Loans	Section 195/ 194A
		Dividend income	Section 194
		Commission income on factoring and forfaiting services	Section 194H
5.	Fund Management entity	Professional fee	Section 194J
6.	Broker Dealer	Dividend income	Section 194

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7.	Investment advisor	Investment advisory fee	Section 194J
8.	Registered Distributor	Distribution fee and Commission fee	Section 194H
9.	Custodian	Professional fee	Section 194J
		Commission fee	Section 194H
10.	Credit rating agency	Credit rating fee	Section 194J
11.	Investment banker	Investment banker fee	Section 194J
12.	Debenture trustee	Trusteeship fee	Section 194J
13.	International Trade Finance Service or "ITFS"	Commission income	Section 194H
14.	FinTech Entity	Technical fee/ Professional fee	Section 194J
		Commission income	Section 194H

Further, w.e.f. 1.7.2025, the Central Government has, vide notification no. 67/2025, notified that no tax is required to be deducted at source in respect of the specified payments made by any 'payer' to a payee, being a Unit of IFSC, as specified in the following Table:-

Table: List of payments receivable by a Unit of (IFSC)

Sl. No.	IFSC Unit (Payee)	Nature of receipt	Relevant TDS provisions
1.	BATF Service Provider	Professional or Consulting or Advisory fees	Section 194J
2.	Broker-Dealers	Payment made by Recognised Stock Exchanges	Section 194J
		Commission Incentives	Section 194H/ 194C
3.	Finance Company	Interest on account of lease	Section 194A
		Freight Charges or Hire Charges	Section 194C

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4.	*Fund Management Entity*	*Portfolio management fees*	*Section 194J*
		Investment advisory fees	
		Management Fees	
		Performance Fees	
5.	*Recognised Clearing Corporation*	*Professional or Technical Services fees*	*Section 194J*
		Interest Income	*Section 194A*
		Penalty levied on clearing members	*Section 194J*
6.	*Recognised Depository*	*Professional or Technical or Contractual fees*	*Section 194J/ 194C*
7.	*Recognised Stock Exchange*	*Professional or Technical Services fees*	*Section 194J*
		Rent for Data Centres	*Section 194I*
		Interest Income	*Section 194A*
		Penalty levied on Members by Stock Exchanges	*Section 194J*

The following conditions are required to be satisfied for non-applicability of TDS provisions in respect of above specified payments.

The 'payee' has to furnish a statement-cum-declaration to the payer containing the details of the previous years relevant to the ten consecutive assessment years for which the 'payee' opts for claiming deduction under section 80LA(1A)/(2) and

Such statement-cum-declaration has to be furnished and verified for each previous year relevant to the ten consecutive assessment years for which the 'payee' opts for claiming deduction under section 80LA(1A)/(2).

The 'payer' would not deduct tax on such payments made or credited to the 'payee' after the date of receipt of copy of such statement-cum-declaration from the 'payee';

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and furnish the particulars of all the payments made to 'payee' on which tax has not been deducted in view of this notification in the statement of deduction of tax at source.

The above relaxation is available to the 'payee' only during the said previous years relevant to the ten consecutive assessment years as declared by the 'payee' for which deduction under section 80LA is being opted. The 'payer' shall be liable to deduct tax on payments as referred above for any other year.

Note – *Please refer the above notification for the purpose of definitions of these specified IFSC units.*

Persons notified by the Central Government, on payment to whom no tax is required to be deducted at source [Notification No. 128/2024, dated 18.12.2024, Notification No. 1/2025 and 2/2025, dated 2.1.2025]

The Central Government has, vide Notification No. 128/2024, w.e.f. 18.12.2024, Notification No. 1/2025 and 2/2025, w.e.f. 2.1.2025, notified that no tax is required to be deducted on the payments received by

- *the Credit Guarantee Fund Trust for Micro and Small Enterprises as referred to in section 10(46B) or*
- *the National Credit Guarantee Trustee Company Limited, being a company established and wholly financed by the Central Government for the purposes of operating credit guarantee funds established and wholly financed by the Central Government as referred to in section 10(46B)(i) or*
- *a credit guarantee fund established and wholly financed by the Central Government and managed by the National Credit Guarantee Trustee Company Limited as referred to in section 10(46B)(ii).*

(6) Time limit for delivery of one copy of declaration [Sub-section (2)]

On receipt of the declaration referred to in sub-sections (1), (1A) or (1C), the person responsible for making the payment will be required to deliver or cause to be delivered to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, one copy of the declaration **on or before the 7th of the month following the month in which the declaration is furnished** to him.

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13.6 MISCELLANEOUS PROVISIONS

13.6.1 Tax deducted is income received [Section 198]

Deemed income

(1) All sums deducted in accordance with the foregoing provisions and *the income tax paid outside India by way of deduction, in respect of which an assessee is allowed a credit against the tax payable*, shall, for the purpose of computing the income of an assessee, be deemed to be income received.

(2) However, the following tax paid or deducted would not be deemed to be income received by the assessee for the purpose of computing the total income –

(i) the tax paid by an employer under section 192(1A) on non-monetary perquisites provided to the employees

(ii) tax deducted under section 194N.

13.6.2 Credit for tax deducted at source [Section 199]

(1) Tax deducted at source in accordance with the above provisions and paid to the credit of the Central Government shall be treated as payment of tax on behalf of the-

(i) person from whose income the deduction was made; or

(ii) owner of the security; or

(iii) depositor; or

(iv) owner of property; or

(v) unit-holder; or

(vi) shareholder.

(2) Any sum referred to in section 192(1A) and paid to the Central Government, shall be treated as the tax paid on behalf of the person in respect of whose income, such payment of tax has been made.

(3) The CBDT is empowered to frame rules for the purpose of giving credit in respect of tax deducted or tax paid under Chapter XVII. The CBDT also has the power to make rules for giving credit to a person other than the persons mentioned in (1) and (2) above. Further, the CBDT can specify the assessment year for which such credit may be given.

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(4) Rule 37BA – Credit for tax deducted at source for the purposes of section 199

Rule 37BA(1) provides that credit for tax deducted at source and paid to the Central Government shall be given to the person to whom the payment has been made or credit has been given (i.e., the deductee) on the basis of information relating to deduction of tax furnished by the deductor to the income-tax authority or the person authorized by such authority.

Rule 37BA(2) provides that where under any provision of the Act, the whole or any part of the income on which tax has been deducted at source is assessable in the hands of a person other than the deductee, credit for the whole or any part of the tax deducted at source, as the case may be, shall be given to the other person and not to the deductee.

However, the deductee should file a declaration with the deductor and the deductor should report the tax deduction in the name of the other person in the information relating to deduction of tax referred to in Rule 37BA(1).

Rule 37BA(3), provides that credit for tax deducted at source and paid to the Central Government, shall be given for the assessment year for which such income is assessable.

Where tax has been deducted at source and paid to the Central Government and the income is assessable over a number of years, credit for tax deducted at source shall be allowed across those years in the same proportion in which the income is assessable to tax.

Rule 37BA(3A), provides that, for the purposes of section 194N, credit for tax deducted at source shall be given to the person from whose account tax is deducted and paid to the Central Government account for the assessment year relevant to the previous year in which such tax deduction is made.

13.6.3 Duty of person deducting tax [Section 200]

(1) The persons responsible for deducting the tax at source should deposit the sum so deducted to the credit of the Central Government or as the Board directs, within the prescribed time [Sub-section (1)].

Deposit of TDS

(2) Further, an employer paying tax on non-monetary perquisites provided to employees in accordance with section 192(1A), should deposit within the prescribed time, the tax to the credit of the Central Government or as the Board directs [Sub-section (2)].

(3) For the purpose of improving the reporting of payment of TDS made through book entry and to make existing mechanism enforceable, section 200(2A) provides that where the tax

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deducted or tax referred to in section 192(1A) has been paid without the production of a challan, the Pay and Accounts Officer or the Treasury Officer or the Cheque Drawing and Disbursing Officer (PAO/TO/CDDO) or any other person, by whatever name called, who is responsible for crediting such sum to the credit of the Central Government, shall deliver or cause to be delivered within the prescribed time a statement in the prescribed form, verified in the prescribed manner and setting forth prescribed particulars to the prescribed income-tax authority or the person authorised by such authority.

Statement for deposit of TDS

(4) Sub-section (3) casts responsibility on the following persons for preparing such statements for such periods as may be prescribed, after paying the tax deducted to the credit of the Central Government within the prescribed time –

(i) any person deducting any sum on or after 1st April, 2005 in accordance with the foregoing provisions of this chapter; or,

(ii) any person being an employer referred to in section 192(1A).

(5) Such statements have to be delivered or caused to be delivered to the prescribed income-tax authority or the person authorised by such authority.

(6) Such statements should be in the prescribed form and verified in the prescribed manner.

(7) It should set forth such particulars and should be delivered within such time as may be prescribed.

(8) The deductor may also deliver to the prescribed authority, a correction statement -

(a) for rectification of any mistake; or

(b) to add, delete or update the information furnished in the statement delivered under section 200(3).

(9) There is a time limit for furnishing statements detailing the TDS/TCS, however, there is no time limit for furnishing correction statements. Hence, such statements may be revised multiple times indefinitely. In order to put certainty and finality on the filing process of TDS and TCS statements, it is provided that, w.e.f. 1.4.2025, the deductor cannot submit a correction statement after the expiry of six years from the end of the financial year in which the original statement referred to in section 200(3) is delivered.

Note *– Refer diagram on page no.13.129 for the time limit for payment of TDS to the Government account or tax paid under section 192(1A) prescribed under section 200(1)/(2) read with Rule 30 and furnishing statement of TDS under section 200(3) read with Rule 31A.*

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13.6.4 Consequences of failure to deduct or pay

1. Deemed assessee-in-default [Section 201(1)]

Any person, including the principal officer of a company,

(i) who is required to deduct any sum in accordance with the provisions of the Act; or

(ii) an employer paying tax on non-monetary perquisites under section 192(1A)

would be deemed to be an assessee-in-default, if he does not deduct, or does not pay or after deducting, fails to pay, the whole or any part of the tax, as required by or under the provisions of the Income-tax Act, 1961.

(2) Non-applicability of deeming provision

Any person (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or paid to a payee shall not be deemed to be an assessee-in-default in respect of such tax if such payee –

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income,

and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

(3) No penalty under section 221

No penalty shall be charged under section 221 from such person unless the Assessing Officer is satisfied that such person has failed to deduct and pay the tax without good and sufficient reasons.

(4) Interest Liability

(i) A person deemed to be an assessee-in-default under section 201(1), for failure to deduct tax or to pay the tax after deduction, is liable to pay simple interest

- **@1% for every month or part of month** on the amount of such tax from the date on which tax was deductible to the date on which such tax was actually deducted and
- **@1½% for every month or part of month** from the date on which tax was deducted to the date on which such tax is actually paid [Section 201(1A)].

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ILLUSTRATION 18

An amount of ₹ 40,000 was paid to Mr. X on 1.7.2025 towards fees for professional services without deduction of tax at source. Subsequently, another payment of ₹ 50,000 was due to Mr. X on 28.2.206, from which tax @10% (amounting to ₹ 9,000) on the entire amount of ₹ 90,000 was deducted. However, this tax of ₹ 9,000 was deposited only on 22.6.2026. Compute the interest chargeable under section 201(1A).

SOLUTION

Interest under section 201(1A) would be computed as follows –

Particulars	₹
1% on tax deductible but not deducted i.e., 1% on ₹ 4,000 for 8 months	320
1½% on tax deducted but not deposited i.e. 1½% on ₹ 9,000 for 4 months[1]	540
	860

(ii) Such interest should be paid before furnishing the statements in accordance with section 200(3).

(iii) Where the payer fails to deduct the whole or any part of the tax on the amount credited or payment made to a payee and is not deemed to be an assessee-in-default under section 201(1) on account of payment of taxes by such payee, interest under section 201(1A)(i) i.e., @1% p.m. or part of month, shall be payable by the payer from the date on which such tax was deductible to the date of furnishing of return of income by such payee. The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the payee.

(iv) Where any order is made by the Assessing Officer for the default under section 201(1), the interest shall be paid by the person in accordance with such order.

(v) Where the tax has not been paid after it is deducted, the amount of the tax, together with the amount of simple interest thereon, shall be a charge upon all the assets of the person or the company, as the case may be.

[1] *TRACES, the TDS Centralised Processing Cell, however, calculates interest @1½% for 5 months in the above case.*

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Circular

Guidelines for waiver of interest charged under section 201(1A) of the Income-tax Act, 1961 – *[Circular No. 11/2017, dated 24.03.2017]*

In exercise of the powers conferred under section 119(2)(a), the CBDT has directed that the Chief Commissioner of Income-tax and Director General of Income-tax may reduce or waive interest charged under section 201(1A)(i) in the classes of cases specified below for the period and to the extent the Chief Commissioner of Income-tax/Director General of Income-tax may deem fit. However, no reduction or waiver of such interest shall be ordered unless the principal demand under sections 200A, 201(1) or 234E, as the case may be, stands fully paid or satisfactory arrangements for payment of the principal demand under these sections have been made. The Chief Commissioner of Income-tax or Director General of Income-tax may also impose any other condition as deemed fit for the said reduction or waiver of interest.

The class of cases in which the reduction or waiver of interest under section 201(1A)(i) can be considered, are as follows:

(a) Where during the course of proceedings for search and seizure under section 132, or otherwise, the books of account and other documents necessary for making deduction under Chapter XVII-B of the Act were seized and the assessee was not able to, within the time specified, deduct tax at source from any sum credited to any account (whether called "suspense account" or by any other name) in his books of account.

(b) Where any sum paid or payable was not liable for deduction of tax at source in the case of a deductor on the basis of any order passed by the jurisdictional High Court, and as a result, he did not deduct tax at source in relation to such sum, and subsequently, in consequence of any retrospective amendment of law or a decision of the Supreme Court of India or a decision of a Larger Bench of the jurisdictional High Court (which was not challenged before the Supreme Court and has become final) in any proceedings, as the case may be, tax was held to be deductible or the tax deducted by the deductor during such financial year was found to be less than the tax deductible on such sums paid or payable.

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(c) Where the default under section 201 relates to non-deduction or a lower deduction of tax under section 195 in respect of a payment made to a non-resident (including a foreign company) being a resident of a country or specified territory outside India with whom India has entered into an agreement referred to in section 90 or 90A of the Act, and where —

(i) a dispute regarding the tax payable in India in respect of the said payment had been referred to the Competent Authority in India mentioned in Rule 44H of the Income-tax Rules, 1962, under the said agreement under section 90 or 90A of the Act;

(ii) such reference had been received by the Competent Authority in India within a period of two years of the date on which the notice of demand determining the tax payable was received by the person in default under section 201;

(iii) the dispute has been settled by way of a resolution arrived at under the Mutual Agreement Procedure (MAP) provided in the said agreement; and

(iv) the person in default under section 201 has given his acceptance to the resolution and has withdrawn his appeal(s) pending on the issue, within the meaning of Rule 44H(4) of the Income-tax Rules, within a period of one month of the date on which the resolution is communicated to him.

Even if the interest under section 201(1A)(i) has already been paid by the deductor, the same can be considered for a waiver, subject to the conditions above and a refund may be given to the deductor, if waiver is ordered.

The Chief Commissioner of Income-tax or Director General of Income-tax examining an application for waiver of interest under this order shall pass a speaking order after providing adequate opportunity of being heard to the applicant.

The CBDT reserves the power to examine any grievance arising out of an order passed or not passed by Chief Commissioner of Income-tax or Director General of Income-tax, as the case may be, and issue suitable directions to these authorities for proper implementation of this order. However, no review of or appeal against the orders passed on merits by such authorities would be entertained by the CBDT.

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(5) Time limit for deeming a person to be an assessee-in-default for failure to deduct tax at source

No order under section 201(1), deeming a person to be an assessee-in-default for failure to deduct the whole or any part of the tax from a **person, being a resident or non resident in India**, shall be passed at any time after the expiry of

- six years from the end of the financial year in which the payment is made or credit is given, or
- two years from the end of the financial year in which the correction statement is delivered under the proviso to section 200(3)

whichever is later.

Further, the exclusions from the time limit, as specified in *Explanation 1* to section 153, would also apply to the above time limit for passing an order deeming a person to be an assessee-in-default. Also, the time limit would not apply to an order passed consequent to the direction contained in an order of the Commissioner under sections 263 and 264, Commissioner (Appeals) under section 250, Appellate Tribunal under section 254, Supreme Court/National Tax Tribunal under section 260 and Supreme Court under section 262. Thus, the time limit would be extended where effect is to be given to various appellate proceedings or where proceedings are stayed.

(6) Non-specification of time limit where tax has been deducted but not paid

Section 201(1) deems a person to be an assessee-in-default if he –

(i) does not deduct tax; or

(ii) does not pay; or

(iii) after so deducting fails to pay

the whole or any part of the tax, as required by or under this Act.

Thus, section 201(1) contemplates three types of defaults. The default contemplated in (ii) is covered by the default contemplated in (iii). However, the time limit has been specified only for passing of orders relating to default contemplated in (i) above. There is no time limit specified in respect of the other defaults.

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Therefore, no time-limits have been prescribed for the order under section 201(1) where –

(i) the deductor has deducted but not deposited the tax deducted at source, as this would be a case of defalcation of government dues,

(ii) the employer has failed to pay the tax wholly or partly, under section 192(1A), as the employee would not have paid tax on such perquisites,

13.6.5 Deduction only one mode of recovery [Section 202]

(1) Recovery of tax through deduction at source is only one method of recovery.

(2) The Assessing Officer can use any other prescribed methods of recovery in addition to tax deducted at source.

13.6.6 Certificate for tax deducted [Section 203]

(1) Every person deducting tax at source shall issue a certificate to the effect that tax has been deducted and specify the amount so deducted, the rate at which tax has been deducted and such other particulars as may be prescribed.

(2) Every person, being an employer, referred to in section 192(1A) shall, within such period, as may be prescribed, furnish to the person in respect of whose income such payment of tax has been made, a certificate to the effect that tax has been paid to the Central Government, and specify the amount so paid, the rate at which the tax has been paid and such other particulars as may be prescribed

[Refer diagram given on the next page for the TDS certificate under section 203 read with Rule 31].

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 # In special cases, the A.O. may, with the prior approval of the JC, permit quarterly payment of TDS

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[2] *Except in case of TDS on perquisite of ESOP provided by eligible start-up*
[3] *TDS required to be deducted at the time of payment, if declaration is furnished by the specified senior citizen in Form No. 12BBA*
[4] *If deduction of tax is u/s 192 and section 194P*
[5] *If deduction of tax is u/s 193 to 196D other than section 194P in respect of deductee who is non corporate non resident or a foreign company or RNOR*
[6] *If deduction of tax is u/s 193 to 196D other than section 194P in respect of all other deductees*
[7] *If deduction of tax is u/s 194S by an Exchange in accordance with guidelines u/s 194S(6)*

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13.6.7 Common number for TDS and TCS [Section 203A]

(1) **Application for TAN:** Persons responsible for deducting tax or collecting tax at source should apply to the Assessing Officer for the allotment of a "tax-deduction and collection-account number".

(2) **Quoting of TAN:** Section 203A(2) enlists the documents/ certificates/ returns/ challans in which the "tax deduction account number" or "tax collection account number" or "tax deduction and collection account number" has to be compulsorily quoted. They are -

Tax deduction and collection of Account Number (TAN)

(i) challans for payment of any sum in accordance with the provisions of section 200 or section 206C(3);

(ii) certificates furnished under section 203 or section 206C(5);

(iii) statements prepared and delivered or caused to be delivered in accordance with the provisions of section 200(3) or section 206C(3);

(iv) returns delivered in accordance with the provisions of section 206 or section 206C(5A) or section 206C(5B); and

(v) in all other documents pertaining to such transactions as may be prescribed in the interests of revenue.

(3) **No requirement to obtain TAN in notified cases:** The requirement of obtaining and quoting of TAN under section 203A shall not apply to such person, as may be notified by the Central Government in this behalf.

(4) **Penalty for failure to comply with the provisions of section 203A:** Penalty under section 272BB would be imposable of ₹ 10,000 for

- failure to comply with the provisions of section 203A or
- Quoting false TAN willfully in challans/certificates/statements/other documents referred to in section 203A(2).

Such penalty is imposable by the Assessing Officer. However, no penalty is imposable unless the person on whom penalty is to be imposed is given an opportunity of being heard in the matter.

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13.6.8 Person responsible for paying tax deducted at source [Section 204]

For purposes of deduction of tax at source the expression "person responsible for paying" means:

	Nature of income/payment	Person responsible for paying tax
(1)	Salary (other than payment of salaries by the Central or State Government)	(i) the employer himself; or (ii) if the employer is a company, the company itself, including the principal officer thereof.
(2)	Interest on securities (other than payments by or on behalf of the Central or State Government)	the local authority, corporation or company, including the principal officer thereof.
(3)	Any sum payable to a non-resident Indian, representing consideration for the transfer by him of any foreign exchange asset, which is not a short term capital asset	the "Authorised Person" responsible for remitting such sum to the non-resident Indian or for crediting such sum to his Non-resident (External) Account maintained in accordance with the Foreign Exchange Management Act, 1999 and any rules made thereunder.
(4)	furnishing of information relating to payment to a non corporate non-resident, or to a foreign company, of any sum, whether or not chargeable under the provisions of this Act	(i) the payer himself; or (ii) if the payer is a company, the company itself including the principal officer thereof.
(5)	Credit/payment of any other sum chargeable under the provisions of the Act	(i) the payer himself; or (ii) if the payer is a company, the company itself including the principal officer thereof.
(6)	Credit/payment of any sum chargeable under the provisions of the Act made by or on behalf of the Central Government or the Government of a State.	(i) the drawing and disbursing officer; or (ii) any other person, by whatever name called, responsible for crediting, or as the case may be, paying such sum.
(7)	In case of a person not resident in India (irrespective of the nature of payment or income)	(i) the person himself; or (ii) any person authorized by such person; or (iii) the agent of such person in India including any person treated as an agent under section 163.

13.6.9 Bar against direct demand on assessee [Section 205]

Where tax is deductible at source under any of the aforesaid sections, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income.

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13.6.10 Furnishing of statements in respect of payment of any income to residents without deduction of tax [Section 206A]

(1) This section casts responsibility on every banking company or co-operative society or public company referred to in the proviso to section 194A(3)(i) [i.e., 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 residential houses in India and which is eligible for deduction under section 36(1)(viii)] to prepare such statement, for such period as may be prescribed –

— if they are responsible for paying to a resident,

— the payment should be of any income not exceeding ₹ 40,000, where the payer is a banking company or a co-operative society, and ₹ 5,000 in any other case.

— such income should be by way of interest (other than interest on securities)

(2) The statements have to be delivered or caused to be delivered to the prescribed income-tax authority or the person authorised by such authority.

(3) The statements have to be in the prescribed form, containing such particulars verified in the prescribed manner. The statement has to be filed within the prescribed time.

(4) The CBDT may cast responsibility on any person other than a person mentioned in (1) above, who is responsible for paying to a resident any income liable for deduction of tax at source.

(5) Such persons may be required to prepare statement for such period as may be prescribed in the prescribed form and deliver or cause to be delivered such statement within the prescribed time to the prescribed income-tax authority or the person authorized by such authority.

(6) Such statements should be in the prescribed form, containing such particulars and verified in the prescribed manner.

(7) Such person referred to in (1) and (4) above may also deliver to the prescribed authority, a correction statement -

(a) for rectification of any mistake; or

(b) to add, delete or update the information furnished in the statement delivered referred in (2) & (5) above.

(8) Penalty under section 272A(2) would be levied for failure to deliver or to be delivered the statement within the time specified of **₹ 500** for every day during which default continues.

Penalty

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13.6.11 Mandatory requirement to furnish PAN [Section 206AA]

(1) The non-furnishing of PAN by deductees in many cases led to delays in issue of refunds on account of problems in the processing of returns of income and in granting credit for tax deducted at source.

(2) With a view to strengthening the PAN mechanism, section 206AA provides that any person whose receipts are subject to deduction of tax at source, i.e., the deductee, shall mandatorily furnish his PAN to the deductor failing which the deductor shall deduct tax at source at higher of the following rates –

Higher TDS for non-furnishing of PAN

(i) the rate prescribed in the Act;

(ii) at the rate in force, i.e., the rate mentioned in the Finance Act; or

(iii) at the rate of 20% [**5%**, in case tax, is required to be deducted at source u/s 194-O and u/s 194Q]

> ***Example:*** *In case of rental payment for plant and machinery, where the payee does not furnish his PAN to the payer, tax would be deductible @20% instead of @2% prescribed under section 194-I.*
>
> *However, non-furnishing of PAN by the deductee in case of income by way of winnings from lotteries, card games, etc., would result in tax being deducted at the existing rate of 30% under section 194B. Therefore, wherever tax is deductible at a rate higher than 20%, this provision would not have any impact.*

(3) Tax would be deductible at the rates mentioned above also in cases where the taxpayer files a declaration in Form 15G or 15H (under section 197A) but does not provide his PAN.

(4) Further, no certificate under section 197 will be granted by the Assessing Officer unless the application contains the PAN of the applicant.

(5) Both the deductor and the deductee have to compulsorily quote the PAN of the deductee in all correspondence, bills, vouchers and other documents exchanged between them.

(6) If the PAN provided to the deductor is invalid or it does not belong to the deductee, it shall be deemed that the deductee has not furnished his PAN to the deductor. Accordingly, tax would be deductible at the rate specified in (2) above.

(7) The provisions of section 206AA shall not apply in respect of payment of interest on long-term bonds, as referred to in section 194LC, to a non-corporate non-resident or to a foreign company.

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(8) **Non-applicability of section 206AA to non-residents subject to fulfilment of certain conditions [Rule 37BC]:**

For the purpose of reducing the compliance burden, Rule 37BC provides for relaxation to a non-corporate non-resident or a foreign company not having PAN in respect of payment in the nature of interest, royalty, fees for technical services, dividends and payments on transfer of any capital asset, subject to the deductee furnishing the following details and documents to the deductor, namely:-

a. name, e-mail id, contact number;

b. address in the country or specified territory outside India of which the deductee is a resident;

c. a certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate;

d. Tax Identification Number of the deductee in the country or specified territory of his residence, and in case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified territory of which he claims to be a resident.

13.7 TAX COLLECTION AT SOURCE

(1) Applicability and Rates

(I) Sale of certain goods [Section 206C(1)]

Under section 206C(1), sellers of certain goods are required to collect tax from the buyers at the specified rates. The specified percentage for collection of tax at source is as follows:

	Nature of Goods	Percentage
(a)	Alcoholic liquor for human consumption	1%
(b)	Tendu leaves	5%
(c)	*Timber* ***or any other forest produce (not being tendu leaves)*** *obtained under a forest lease*	***2%***
(d)	Timber obtained by any mode other than (c)	***2%***
(e)	Scrap	1%
(f)	Minerals, being coal or lignite or iron ore	1%

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The tax should be collected at the time of debiting of the amount payable by the buyer to his account or at the time of receipt of such amount from the buyer, whichever is earlier.

Forest Produce shall have the same meaning as defined in any State Act for the time being in force, or in the Indian Forest Act, 1927

As per the Indian Forest Act, 1927, forest-produce means:

(a)	*Whether found in, or brought from, a forest or not*	*Timber, charcoal, caoutchouc, catechu, wood-oil, resin, natural varnish, bark, lac, mahua flowers, mahua seed, kuth and myrabolams*
(b)	*When found in, or brought from, a forest, that is*	*(1) Trees and leaves, flowers and fruits, and all other parts or produce not hereinbefore mentioned, of trees* *(2) plants not being trees (including grass, creepers, reeds and moss), and all parts or produce of such plants* *(3) wild animals and skins, tusks, horns, bones, silk, cocoons, honey and wax, and all other parts or produce of animals, and* *(4) peat, surface soil, rock, and minerals (including limestone, laterite, mineral oils, and all products of mines or quarries)*

Non-applicability of TCS [Section 206C(1A)]

No collection of tax shall be made under section 206C(1) in the case of a resident buyer, if such buyer furnishes to the person responsible for collecting tax, a declaration in writing in duplicate in the prescribed form and verified in the prescribed manner to the effect that goods referred to in above table are to be utilised <u>for the purpose of manufacturing, processing or producing articles or things or for the purposes of generation of power and not for trading purposes.</u>

Non-applicability

Furnishing of copy of declaration within specified time [Section 206C(1B)]

The person responsible for collecting tax under this section shall deliver or cause to be delivered to the Principal Chief Commissioner or Chief Commissioner or Principal

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Commissioner or Commissioner one copy of the declaration referred to in 206C (1A) on or before 7th of the month next following the month in which the declaration is furnished to him.

(II) Lease or a licence of parking lot, toll plaza or mine or a quarry [Section 206C(1C)]

Parking lot

Section 206C(1C) provides for collection of tax by every person who grants a lease or a licence or enters into a contract or otherwise transfers any right or interest in any -

- parking lot or
- toll plaza or
- a mine or a quarry

to another person (other than a public sector company) for the use of such parking lot or toll plaza or mine or quarry for the purposes of business. The tax shall be collected as provided, from the licensee or lessee of any such licence, contract or lease of the specified nature, at the rate of 2%.

Note *– Mining and quarrying excludes mining and quarrying of mineral oil. Mineral oil includes petroleum and natural gas. Thus, mining and quarrying excludes mining and quarrying of petroleum and natural gas. Consequently, the oil exploration and incidental services are relieved from the applicability of TCS provisions, since these services are in the organized sector.*

The tax should be collected at the time of debiting of the amount payable by the licensee or lessee to his account or at the time of receipt of such amount from the licensee or lessee, whichever is earlier.

(III) Sale of motor vehicle or other notified goods of value exceeding ₹ 10 lakhs [Section 206C(1F)]

Motor car or Other Notified Goods

Section 206C(1F) provides that every person, being a seller, who receives any amount as consideration for the sale of a motor vehicle or other notified goods of the value exceeding ₹ 10 lakhs, shall collect tax from the buyer @1% of the sale consideration.

The Central Government has, vide notification no. 36/2025 dated 22nd April 2025, w.e.f. 22.4.2025, notified following goods of the value exceeding ₹ 10 lakh for collection of tax at source:

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S. No	Nature of goods
1.	any wristwatch
2.	any art piece such as antiques, painting, sculpture
3.	any collectibles such as coin, stamp
4.	any yacht, rowing boat, canoe, helicopter
5.	any pair of sunglasses
6.	any bag such as handbag, purse
7.	any pair of shoes
8.	any sportswear and equipment such as golf kit, ski-wear
9.	any home theatre system
10.	any horse for horse racing in race clubs and a horse for polo

Clarification relating to certain issues with respect to section 206C(1F) [Circular No. 22/2016 dated 8.6.2016]

Circular

The CBDT has, vide *Circular No. 22/2016 dated 8.6.2016*, clarified the following issues in "Question & Answer (Q & A)" format.

Q.1 Whether TCS @1% is on sale of motor vehicle at the retail level or also on sale of motor vehicles by manufacturers to dealers/ distributors?

A. To bring high value transactions within the tax net, section 206C has been amended to provide that the seller shall collect the tax @ 1% from the purchaser on sale of motor vehicle of the value exceeding ₹ 10 lakhs. This is brought to cover all transactions of retail sales and accordingly, section 206C(1F) **will <u>not</u> apply on sale of motor vehicles by manufacturers to dealers/distributors.**

Q.2 Whether TCS @1% on sale of motor vehicle is applicable only to luxury cars?

A. No, as per section 206C(1F), the seller shall collect tax @1% from the purchaser on sale of any motor vehicle of the value exceeding ₹ 10 lakhs.

Q.3 Whether TCS @1% is applicable in the case of sale to Government Departments, Embassies, Consulates and United Nation Institutions, of motor vehicle or any other goods or provision of services?

A. Government, institutions notified under the United Nations (Privileges and Immunities) Act 1947, and Embassies, Consulates, High Commission, Legation, Commission and trade representation of a foreign State shall not be liable to levy of TCS @1% under section 206C(1F).

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Q.4 Whether TCS is applicable on each sale of motor vehicle or on aggregate value of sale during the year?

A. Tax is to be collected at source @1% on sale consideration of a motor vehicle exceeding ₹ 10 lakhs. It is applicable to each sale and not to the aggregate value of sale made during the year.

Q.5 Whether TCS @1% on sale of motor vehicle is applicable in case of an individual?

A. The definition of "Seller" as given in clause (c) of the *Explanation* below sub-section (11) of section 206C shall be applicable in the case of sale of motor vehicles also.

Q.6 How would the provisions of TCS on sale of motor vehicle be applicable in a case where part of the payment is made in cash and part is made by cheque?

A. The provisions of TCS on sale of motor vehicle exceeding ₹ 10 lakhs is not dependent on mode of payment. Any sale of motor vehicle exceeding ₹ 10 lakhs would attract TCS @1%.

Meaning of certain terms referred to in Para (I) to (III)

Term	Meaning
Buyer	**For section 206C(1):** A person who obtains in any sale, by way of auction, tender, or any other mode, goods of the nature specified in the Table in point (1) or the right to receive any such goods but does not include – (A) a public sector company, the Central Government, a State Government, and an embassy, a high commission, legation, commission, consulate and the trade representation of a foreign State and a club, or (B) a buyer in the retail sale of such goods purchased by him for personal consumption [*Explanation* to section 206C] **For section 206C(1F):** A person who obtains in any sale, goods of the nature specified therein, but does **not** include – (A) the Central Government, a State Government and an embassy, a High Commission, legation, commission, consulate and the trade representation of a foreign State; or (B) a local authority; or (C) a public sector company which is engaged in the business of carrying passengers. [*Explanation* to section 206C]

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Seller	**For section 206C(1) and section 206C(1F):** (i) The Central Government, (ii) a State Government or (iii) any local authority or (iv) corporation or (v) authority established by or under a Central, State or Provincial Act, or (vi) any company or (vii) firm or (viii) co-operative society Seller also includes an individual or a HUF whose total sales, gross receipts or turnover from the business or profession carried on by him exceed ₹ 1 crore in case of business and ₹ 50 lakhs in case of profession during the financial year immediately preceding the financial year in which the goods of the nature specified in the Table in point (1) are sold. [*Explanation* to section 206C]
Scrap	Waste and scrap from the manufacture or mechanical working of materials which is definitely not usable as such because of breakage, cutting up, wear and other reasons. [*Explanation* to section 206C]

(IV) Remittance under LRS of RBI through an authorized dealer or purchase of an overseas tour package [Section 206C(1G)]

As per section 206C(1G), every person,

- being **an authorized dealer**, who receives amount, under the Liberalised Remittance Scheme of the RBI, for remittance from a buyer, being a person remitting such amount;
- being **a seller of an overseas tour programme package,** who receives any amount from the buyer who purchases the package

is required to collect tax at source on such amount received from the buyer.

Tax has to be collected at the time of debiting the amount payable by the buyer or at the time of receipt of such amount from the said buyer, by any mode, whichever is earlier.

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Rate of TCS in case of collection by an authorized dealer/ seller of an overseas tour programme package

S. No.	*Particulars*	*Rate of TCS*
(i)	*Purchase of an overseas tour programme package*	*5% upto ₹ 10 lakhs and 20% above ₹ 10 lakhs*
(ii)	*Remittances for the purpose of pursuing any education and the amount remitted is out of a loan obtained from any financial institution as defined in section 80E*	*Nil*
(iii)	*Remittances for the purpose of education (other than mentioned in (ii) or medical treatment;*	*No TCS upto ₹ 10 lakhs* *5% of the amount or aggregate of amounts in excess of ₹ 10 lakhs*
(iv)	*Remittances for purposes other than education and medical treatment*	*No TCS upto ₹ 10 lakhs* *20% on the amount or aggregate of amounts in excess of ₹ 10 lakhs*

Cases where no tax is to be collected

(i)	No TCS by the authorized dealer on an amount in respect of which the sum has been collected by the seller.
(ii)	No TCS, if the buyer is liable to deduct tax at source under any other provision of the Act and has deducted such tax.
(iii)	No TCS, if the buyer is the Central Government, a State Government, an embassy, a High Commission, a legation, a commission, a consulate, the trade representation of a foreign State, a local authority[8] or any other person notified by the Central Government, subject to fulfillment of conditions stipulated thereunder. Accordingly, the Central Government has, vide Notification No. 99/2022, dated 17.08.2022, notified that the provisions of section 206C(1G) would not be applicable to a person (being a buyer) who is a non-resident in terms of section 6 and who does not have a permanent establishment in India.

Meaning of certain terms

Term	Meaning
Authorised dealer	A person authorised by the RBI to deal in foreign exchange or foreign security. [Clause (i) of *Explanation* to section 206C(1G)]

[8] as defined in Explanation to section 10(20)

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Overseas tour program package	Any tour package which offers visit to a country/(ies) or territory/(ies) outside India. It includes expenses for travel or hotel stay or boarding or lodging or any other expenditure of similar nature or in relation thereto. [Clause (ii) of *Explanation* to section 206C(1G)]

Power to issue guidelines [Section 206C(1-I): In case any difficulty arises to give effect to, *inter alia,* the provisions of section 206C(1G), the CBDT is empowered to issue guidelines, with the approval of the Central Government, for the purpose of removing the difficulty.

Every guideline issued by the CBDT shall be laid before each House of Parliament, and shall be binding on the income-tax authorities and on the person liable to collect tax.

In exercise of the power to issue guidelines, the CBDT has, with the approval of Central Government, vide **Circular no. 10/2023 dated 30.6.2023**, issued the following guidelines for removing certain difficulties-

Guidelines

Question 1: Whether the threshold of ₹10 lakhs, for TCS to become applicable on LRS, applies separately for various purposes like education, health treatment and others? For example, if remittance of ₹ 10 lakh under LRS is made in a financial year for education purpose and other remittances in the same financial year of ₹ 10 lakh is made for medical treatment and ₹ 10 lakh for other purposes, whether the exemption limit of ₹10 lakh shall be given to each of the three separately?

Threshold limit

Answer: *It is clarified that the threshold of ₹ 10 lakh for LRS is* ***combined threshold*** *for applicability of the TCS on LRS irrespective of the purpose of the remittance. This is clear from the first proviso to section 206C(1G). The first proviso states that the TCS is not required if the amount or aggregate of the amounts being remitted by a buyer is less than ₹ 10 lakh rupees in a financial year.*

Thus, in the given example, upto ₹10 lakh remittance under LRS during a financial year shall not be liable for TCS. However, subsequent ₹ 20 lakh remittance under LRS shall be liable for TCS in accordance with the TCS rates applicable for such remittance. TCS rates would be applicable as under:-

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Remittances	Rate of TCS
First ₹10 lakhs remittance under LRS during the financial year 2025-26 for education purpose (or for that matter any purpose)	*No TCS*
Remittances beyond ₹10 lakhs under LRS during the financial year 2025-26	*TCS will be Nil (if it is for education purpose financed by loan from a financial institution), 5% (if it is for education or medical treatment) and 20% (if it is for other purposes)*

Question 2: Whether the threshold of ₹10 lakh, for TCS to become applicable on LRS, applies separately for each remittance through different authorised dealers? If not, how will authorised dealer know about the earlier remittances by that remitter through some other authorised dealer?

Threshold is Qua remitter

Answer: *It is clarified that the threshold of ₹10 lakh for LRS is qua remitter and not qua authorised dealer. This is clear from the first proviso to section 206C(1G). The first proviso states that the TCS is not required if the amount or aggregate of amounts being remitted by a buyer is less than ten lakh rupees in a financial year. The threshold continues to apply qua remitter.*

Since the facility to provide real time updates of remittance under LRS by remitter is still under development by the RBI, it is clarified that the details of earlier remittances under LRS by the remitter during the financial year may be taken by the authorised dealer through an undertaking at the time of remittance. If the authorised dealer correctly collects the tax at source based on information given in this undertaking, he will not be treated as "assessee in default". However, for any false information in the undertaking, appropriate action may be taken against the remitter under the Act.

It is further clarified that same methodology of taking undertaking from the buyer of overseas tour program package may be followed by the seller of such package.

Question 3: There is threshold of ₹10 lakh for remittance under LRS for TCS to become applicable while there is another threshold of ₹10 lakh for purchase of overseas tour program package. Whether these two thresholds apply independently?

Answer: *Yes, these two thresholds apply independently. For LRS, the threshold of ₹10 lakh applies to make TCS applicable. For purchase of overseas tour program package, the threshold of ₹10 lakh applies to determine the applicable TCS rate as 5% or 20%.*

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Question 4: A resident individual spends ₹ 3 lakh for the purchase of an overseas tour program package from a foreign tour operator and remits money which is classified under LRS. There is no other remittance under LRS or purchase of overseas tour program during the financial year. Whether TCS is applicable?

Answer: *In case of purchase of overseas tour program package which is classified under LRS, TCS provision for purchase of overseas tour program package shall apply and not TCS provisions for remittance under LRS.*

Since for the purchase of overseas tour program package, the threshold of ₹ 10 lakh for applicability of TCS does not apply, TCS is applicable and tax is required to be collected by the seller. In this case the tax shall be required to be collected at 5% since the total amount spent on purchase of overseas tour program package during the financial year is less than ₹ 10 lakh. The TCS should be made by the seller.

Question 5: There are different rates for remittance under LRS for medical treatment/education purposes and for other purposes. What is the scope of remittance under LRS for medical treatment/education purposes?

Answer: *As per the clarification by the RBI, remittance for the purposes of* ***medical treatment*** *shall include,-*

(i) remittance for purchase of tickets of the person to be treated medically overseas (and his attendant) for commuting between India and the overseas destination;

(ii) his medical expense; and

(iii) other day to day expenses required for such purpose.

It may be noted that code 50304 (under the Purpose Group Name "Travel"), in RBI master direction for LRS, pertains to travel for medical treatment. As per BPM6, A.P. (DIR Series) Circular no 50, dated 11 Feb 2016 this code covers the transactions which are related to health services acquired by residents travelling abroad for medical reasons, which includes medical services, other healthcare, food, accommodation and local transport transactions.

In addition, code 51108 (under the Purpose Group Name "Personal, Cultural & Recreational services") covers transactions for health services rendered remotely or onsite (that is no travel by service recipient is involved). This cover services from hospitals, doctors, nurses, paramedical and similar services, etc.

TCS provision for purpose of medical treatment would apply when remittance is under code 50304 or under code 51108.

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Education

Remittance for purpose of education shall include,-

(i) remittance for purchase of tickets of the person undertaking study overseas for commuting between India and the overseas destination;

(ii) the tuition and other fees to be paid to educational institute; and

(iii) other day to day expenses required for undertaking such study.

It may be noted that code 50305 (under the Purpose Group Name "Travel"), in RBI master direction for LRS, pertains to travel for education (including fees, hostel expenses, etc). As per BPM6, A.P. (DIR Series) Circular no 50, dated 11 Feb 2016 this code covers education related services such as tuition, food, accommodation, local transport and health services acquired by resident students while residing overseas.

In addition, code 51107 (under the Purpose Group Name "Personal, Cultural & Recreational services") covers transactions for education (e.g., fees for correspondence courses abroad) where the person receiving education does not travel overseas.

TCS provision for purpose of education would apply when the remittance is under code 50305 or under 51107.

Question 6: Whether purchase of international travel ticket or hotel accommodation on standalone basis is purchase of overseas tour program package?

Answer: *The term 'overseas tour program package' is defined as to mean any tour package which offers a visit to a country or countries or territory or territories outside India and includes expenses for travel or hotel stay or boarding or lodging or any other expenditure of similar nature or in relation thereto.*

*It is clarified that purchase of **only** an international travel ticket or the purchase of **only** hotel accommodation, by in itself is not covered within the definition of 'overseas tour program package'. To qualify as an 'overseas tour program package', the package should include **at least two** of the followings:-*

(i) international travel ticket,

(ii) hotel accommodation (with or without food)/boarding/lodging,

(iii) any other expenditure of similar nature or in relation thereto.

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(2) Higher rate of TCS for non-furnishers of PAN [Section 206CC]

Higher TCS for non-furnishing of PAN

(i) The provisions of section 206CC require tax collection at the higher of the following two rates, in case of failure by the person paying any sum or amount on which tax is collectible at source (collectee) to furnish PAN **[PAN or Aadhar number in case of section 206C(1H)]** to the person responsible for collecting tax at source (collector) -

- at twice the rate specified in the relevant provision of the Act
- at 5% [1%, in case tax is required to be collected at source u/s 206C(1H)].

The higher rate of TCS leviable for non-furnishing of PAN should not exceed 20%.

(ii) Tax would be collectible at the rates mentioned above also in case where the person furnishes a declaration under section 206C(1A) but does not furnish his PAN.

(iii) Both the collectee and collector have to compulsorily quote the PAN of the collectee in all correspondence, bills, vouchers and other documents exchanged between them.

(iv) If the PAN provided to the collector is invalid or it does not belong to the collectee, it shall be deemed that the collectee has not furnished his PAN to the collector. Accordingly, tax would be collectible at the rate specified in (i) above.

Non-applicability

(v) The provisions of section 206CC does **not** apply to a non-resident who does not have a permanent establishment in India.

(3) TCS to be paid within prescribed time [Section 206C(3)]

Deposit of TCS

Any amount collected under this section shall be paid within the prescribed time to the credit of the Central Government or as the Board directs.

Time limit for paying tax collected to the credit of the Central Government [Rule 37CA]

	Person collecting sums in accordance with section 206C	Circumstance		Period within which such sum should be paid to the credit of the Central Government
(1)	An office of the Government	(i)	where the tax is paid without production of an income-tax challan	on the same day

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		(ii)	where tax is paid accompanied by an income-tax challan	on or before 7 days from the end of the month in which the collection is made
(2)	Collectors other than the office of the Government			within one week from the last day of the month in which the collection is made

(4) Statement of TCS to be prepared and delivered within prescribed time

(i) A person collecting tax in accordance with the provisions of the section is vested with the responsibility of preparing such statements for such periods as may be prescribed after paying the tax collected to the credit of the Central Government within the prescribed time.

(ii) The statement should be delivered or caused to be delivered to the prescribed income-tax authority, i.e., DGIT (Systems) or the person authorised by such authority.

(iii) The statement should be in the prescribed form [Form No.27EQ] and verified in the prescribed manner.

(iv) The statement should set forth the prescribed particulars and should be filed within such time as may be prescribed.

Due dates for furnishing statement of TCS [Rule 31AA]

	Quarter ending	Due Date
I	30th June	15th July
II	30th September	15th October
III	31st December	15th January
IV	31st March	15th May

(5) Enabling provision for improving the reporting of payment of TCS made through book entry and making the existing mechanism enforceable [Section 206C(3A)]

Where the tax collected has been paid without the production of a challan, the PAO/TO/CDDO or any other person, by whatever name called, who is responsible for crediting such sum to the credit of the Central Government, shall furnish a statement in the prescribed form [Form No.24G] for the prescribed period to the agency authorised by the Principal Director of Income-tax (Systems) in respect of tax collected by the collectors and reported to him. Such

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statement has to be furnished within the prescribed time by verifying the same in the prescribed manner and setting forth prescribed particulars.

Relevant Rule	Period to which statement relates	Prescribed Time
37CA(3A)(a)	Where the statement relates to the month of March	On or before 30th April
37CA(3A)(b)	In any other case	On or before 15 days from the end of the relevant month

Such statement has to be furnished in the following manner:

(a) electronically under digital signature; or

(b) electronically along with verification of the statement in Form No.27A or verified through an electronic process

in accordance with the procedures, formats and standards for the purpose of furnishing and verification of the statements specified by the Principal DGIT (Systems)

Penalty

Penalty: Failure to furnish such statement would attracted a penalty under section 272A(2) of **₹ 500** for every day during which default continues.

(6) Enabling provision for filing a correction statement of TCS [Section 206C(3B)]

The person collecting tax at source who is required to prepare statements to be delivered to DGIT (Systems) / NSDL after paying the tax collected to the credit of the Central Government, may also deliver to the said authority, a correction statement for rectification of any mistake or to add, delete or update the information furnished in the statement so delivered in the specified form and verified in the specified manner.

The collector cannot submit a correction statement after the expiry of six years from the end of the financial year in which the original statement referred to in proviso to section 206C(3) is delivered.

(7) Credit for TCS [Section 206C(4)]

Any amount collected in accordance with the provisions of this section and paid to the credit of the Central Government shall be deemed to be payment of tax on behalf of the person from whom the amount has been collected and credit shall be given to such person or any other person eligible for credit for the amount so collected in a particular assessment year. The CBDT may prescribe the rules based on which credit shall be given to such person for the amount so collected in a particular assessment year.

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Rule	Case	Manner of allowing credit
Rule 37-I(2)(i)	Where tax has been collected at source and paid to the Central Government	Credit for TCS shall be given for the A.Y. for which the income is assessable to tax.
Rule 37-I(2)(ii)	Where tax has been collected at source and paid to the Central Government and the lease or license is relatable to more than one year	Credit for TCS shall be allowed across those years to which the lease or license relates in the same proportion

For the purposes of section 206C(1F)/ (1G), credit for tax collected at source shall be given to the person from whose account tax is collected and paid to the Central Government account for the assessment year relevant to the previous year in which such tax collection is made.

Income of the collectee assessable in the hands of any person other than the collectee [W.e.f. 16.10.2024]

Where under any provisions of the Act, the income of the collectee is assessable in the hands of any person other than the collectee, the credit for the TCS, shall be given to such other person and not to the collectee.

However, the collectee has to file a declaration with the collector and the collector shall report the tax collection in the name of the other person in the information relating to collection of tax.

The declaration filed by the collectee shall contain the name, address, PAN of the person to whom credit for the tax collectible at source is to be given, the amount of payment in relation to which credit is to be given and reasons for giving credit to such person.

The collector shall issue the certificate for collection of tax at source under section 206C(3), in the name of the person in whose name credit is shown in the information relating to collection of tax and shall keep the declaration in his safe custody.

(8) Furnishing of Certificate of TCS within prescribed time [Section 206C(5)]

(i) Every person collecting tax in accordance with the provisions of this section shall, within such period as may be prescribed from the date of debit or receipt of the amount, furnish to the buyer or licensee or lessee to whose account such

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amount is debited or from whom such payment is received, a certificate to the effect that tax has been collected specifying the sum so collected, the rate at which the tax has been collected and such other particulars as may be prescribed.

(ii) Certificate of tax collected at source under section 206C(5) in Form No.27D shall be furnished by the collector within 15 days from the due date for furnishing the quarterly statement of TCS under Rule 31AA [Rule 37D].

(iii) The prescribed income-tax authority or the person authorized by such authority have now been vested with the responsibility to prepare and deliver a statement in the prescribed form specifying the amount of tax collected and such other particulars as may be prescribed, within the prescribed time after the end of each financial year beginning on or after 1.4.2008 [Proviso to sub-section (5)].

(9) Consequences of failure to collect tax at source

(i) **Personal liability to pay tax collectible at source [Section 206C(6)]** - A person who is responsible for collecting the tax in accordance with the provisions of this section shall be liable to pay the tax to the credit of the Central Government, even if he has failed to collect the tax

(ii) **Deemed assessee-in-default for failure to collect tax [Section 206C(6A)]** - Any person responsible for collecting tax shall be deemed to be an assessee in default in respect of the tax if such person -

Assessee in Default

(1) does not collect the whole or any part of the tax or

(2) fails to pay such tax after having collected the tax

(iii) **Deeming provision not applicable if tax is paid by buyer/licensee/lessee [First Proviso to section 206C(6A)]** - Any person responsible for collecting tax at source in accordance with the provisions of sub-section (1) and sub-section (1C) would not be deemed to be an assessee-in-default for failure to collect tax on the amount received from a buyer or licensee or lessee or on the amount debited to the account of the buyer or licensee or lessee, if such buyer or licensee or lessee has furnished his return of income under section 139, taking into account such amount for computing income and paid the tax due on the income declared by him in such return of income. Further, the person should also furnish a certificate to this effect from an accountant in the prescribed form.

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(iv) **Levy of penalty for failure to collect and pay tax [Second proviso to section 206C(6A)]** - No penalty shall be charged under section 221 from such person unless the Assessing Officer is satisfied that the person has without good and sufficient reasons failed to collect and pay the tax.

(v) **Interest payable for failure to collect and pay tax within the prescribed time [Section 206C(7)]** - If the person responsible for collecting tax does not collect the tax or after collecting the tax fails to pay it as required under this section, he shall be liable to pay simple

Interest @1% p.m. or part of month

- interest at the rate of 1% p.m. or part thereof on the amount of such tax from the date on which such tax was collectible to the date on which such tax is collected; and
- interest at the rate of 1.5% p.m. or part thereof on the amount of such tax from the date on which such tax was collected to the date on which such tax is actually paid.

Such interest shall be paid before furnishing the quarterly statement for each quarter in accordance with the provisions of section 206C(3).

In such cases where a person is not deemed to be an assessee-in-default on account of the tax being paid by the buyer/licensee/lessee, interest shall be payable by the collector from the date on which tax was collectible to the date of furnishing return of income by such buyer or licensee or lessee.

However, where an order is made by the Assessing Officer for assesse-in-default, the interest shall be paid by the person in accordance with such order.

Circular

Waiver of levy of interest under section 201(1A)(ii)/ 206C(7) in specified cases [Circular No. 5/2025 dated 28.03.2025 and Circular No. 8/2025 dated 01.07.2025]

In exercise of the powers under section 119, the CBDT, directs that the Chief Commissioner of Income-tax (CCIT) or Director General of Income-tax (DGIT) [or in case there is no CCIT and DGIT, then Principal Chief Commissioner of Income-tax (PCCIT)] may reduce or waive interest charged under section 201(1A)(ii)/ 206C(7) where-

- *the payment is initiated by the taxpayers/ deductors/ collectors and the amounts are debited from their bank accounts on or before the due date, and*

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- *the tax could not be credited to the Central Government, before due date because of technical problems, beyond the control of the taxpayer/ deductor/collector.*

The CCIT or DGIT or PrCCIT, as the case may be, examining an application for waiver of interest under this order shall pass a speaking order after providing adequate opportunity of being heard to the applicant and after verification of technical glitches from the bank/Directorate of Systems.

Even if the interest under section 201(1A)(ii)/ 206C(7) has already been paid by the taxpayer, the same can be considered for waiver and a refund may be given to the deductor, if waiver is ordered.

No waiver application shall be entertained beyond one year from the end of the financial year for which the interest under section 201(1A)(ii)/ 206C(7) is charged.

An application received for waiver of interest under section 201(1A)(ii)/ 206C(7) shall be disposed of within a period of six months from the end of the month in which such application is received.

The order issued by the CCIT or DGIT or PCCIT, as the case maybe, shall be final and no petition against that order shall be entertained by the Board.

This will come into effect from the date of issue of this Circular i.e., 28.03.2025.

After issuance of the circular, a further question raised whether the prescribed authorities empowered to pass waiver orders is deemed to be effective from 28.3.2025 or whether waiver application are to be entertained only in cases where interest under section 201(1A)(ii)/ 206C(7) is charged on or after 28.3.2025.

It is clarified, vide circular no. 8/2025 dated 1.7.2025, that the prescribed authority (i.e., CCIT/DGIT/PCCIT) is empowered to pass order for waiver from 28.3.2025.

Applications for waiver of interest can be entertained within one year from the end of the financial year for which the interest is charged. For instance, if the interest charged pertains to F.Y. 2024-25, the application for waiver of such interest can be filed by 31.03.2026 i.e. one year from the end of F.Y. 2024-25.

Further, it is also clarified that waiver applications can be entertained for interest u/s 201(1A)(ii)/ 206C(7) charged even before the issuance of the said Circular.

(vi) **Time limit for issuing an order to treat a tax collector as assessee-in-default [Section 206C(7A)] -** No order under section 206C(6A) deeming a person to be an assessee-in-default for failure to collect the whole or any part of the tax from any person, shall be passed at any time after the expiry of -

- 6 years from the end of financial year in which tax was collectable; or
- 2 years from the end of the financial year in which the TCS correction statement is delivered,

whichever is later.

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The provisions of sub-sections (3), (5), and (6) of section 153 and Explanation 1 thereof shall apply to the above time limit of 6 years/2 years.

(vii) **Tax not collected to be a charge upon all assets of the collector [Section 206C(8)]** - Where the tax has not been paid as aforesaid, after it is collected, the amount of tax together with the amount of simple interest thereon referred to in sub-section (7) shall be a charge upon all the assets of the person responsible for collecting tax.

(10) Other Provisions [Section 206C(9)/(10)/(11)/(12)]

(i) **Certificate for collection of tax at lower rate [Section 206C(9)]** - The Assessing Officer can issue certificate for collection of tax at a lower rate than those specified in sub-section (1)/(1C). Such certificate shall be issued on an application made by the buyer or licensee or lessee in this behalf.

TCS at Lower rate

(ii) **Tax to be collected at the rate specified in the certificate [Section 206C(10)]** -The person responsible for collecting tax shall collect the same at the rate specified in such certificate until such certificate is cancelled by the Assessing Officer.

(iii) **CBDT empowered to make rules relating to grant of certificates [Section 206C(11)]** – The CBDT is empowered to make rules specifying the cases in which and the circumstances under which an application may be made for the grant of such certificate and the conditions subject to which certificate may be granted.

(iv) **Government to notify certain persons or class of persons as exempt from TCS or TCS at lower rate [Section 206C(12)] -** No collection of tax shall be made or that collection of tax shall be made at such lower rate in respect of specified transaction, from such person or class of persons, including institution, association or body or class of institutions, associations or bodies, as may be notified by the Central Government. Accordingly, the Central Government has, vide Notification no. 115/2024 dated 16.10.2024 specified that no collection of tax shall be made under section 206C(1F) on any payment received from the Reserve Bank of India.

13.8 PROCESSING OF TDS /TCS STATEMENTS [SECTION 200A/ SECTION 206CB]

(1) Section 200A facilitates processing of TDS statements and section 206CB deals with processing of statements of tax collected at source.

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(2) The manner of processing a statement of tax deduction at source/tax collection at source or a correction statement made by a person deducting/collecting, is as follows -

(a) **Permissible adjustments** - the sums deductible/collectible shall be computed after making the following adjustments -

Processing of TDS or TCS Statement

(i) any arithmetical error in the statement;

(ii) an incorrect claim, apparent from any information in the statement (i.e., a claim, on the basis of an entry, in the statement -

(1) of an item, which is inconsistent with another entry of the same or some other item in such statement;

(2) in respect of rate of deduction/collection of tax at source, where such rate is not in accordance with the provisions of the Income-tax Act, 1961).

(b) **Interest** – The interest, if any, shall be computed on the basis of the sums deductible/collectible as computed in the statement;

(c) **Fee** - The fee, if any, shall be computed in accordance with the provisions of section 234E.

Fee

Section 234E: A fee of ₹ 200 for every day would be levied under section 234E for late furnishing of TDS/TCS statement from the due date of furnishing of TDS/TCS statement to the date of furnishing of TDS/TCS statement. However, the total amount of fee shall not exceed the total amount of tax deductible/tax collectible and such fee has to be paid before delivering the TDS/TCS statement.

(d) **Determination of sum payable by, or the amount of refund due to, the collector** – Such sum shall be determined after adjustment of such interest and fee against any amount paid under section 200 or section 201 or section 234E or under section 206C or section 234E and any amount paid otherwise by way of tax or interest or fee;

(e) **Intimation** - An intimation shall be prepared or generated and sent to the deductor/collector specifying the sum determined to be payable by, or the amount of refund due to, him; and

(f) **Grant of refund** - The amount of refund due to the deductor/collector in pursuance of such determination shall be granted to the deductor/collector:

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However, no intimation shall be sent after the expiry of the period of **one year** from the end of the financial year in which the statement is filed.

No intimation after 1 year

(3) The CBDT is empowered to make a scheme for centralised processing of statements of tax deducted/collected at source to expeditiously determine the tax payable by, or the refund due to, the deductor/collector, as required under section 200A or section 206CB(1), as the case may be.

(4) Section 200A provides for the manner in which statement of TDS or a correction statement made by a person deducting any sum under section 200 is processed. There are statements, such as Form No. 26QF which is filed by an Exchange wherein the deductee is filing details of the tax. Accordingly, to widen the ambit of section 200A, the CBDT is further empowered to make a scheme for processing of statements made by any other person, not being a deductor.

13.9 ADVANCE PAYMENT OF TAX [SECTION 207 TO 219]

13.9.1 Liability for payment of advance tax

(1) Tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219, in respect of an assessee's current income, i.e., the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year [Section 207].

(2) Under section 208, an obligation to pay advance tax arises in every case where the advance tax payable is ₹ 10,000 or more.

Adavnce tax where tax is ₹ 10,000 or more

Note - *An assessee who is liable to pay advance tax of less than ₹ 10,000 will not be saddled with interest under sections 234B and 234C for defaults in payment of advance tax. However, the consequences under section 234A regarding interest for belated filing of return would be attracted.*

(3) In case of senior citizens who have passive source of income like interest, rent, etc., the requirement of payment of advance tax causes genuine compliance hardship. Therefore, in order to reduce the compliance burden on such senior citizens, exemption from payment of advance tax has been provided to a resident individual-

Non-applicability

(i) not having any income chargeable under the head "Profits and gains of business or profession"; and

(ii) of the age of 60 years or more.

Such senior citizens need not pay advance tax and are allowed to discharge their tax liability (other than TDS) by payment of self-assessment tax.

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13.9.2 Computation of advance tax

(1) An assessee has to estimate his current income and pay advance tax thereon. He need not submit any estimate or statement of income to the Assessing Officer, except where he has been served with notice by the Assessing Officer.

(2) Where an obligation to pay advance tax has arisen, the assessee shall himself compute the advance tax payable on his current income at the rates in force in the financial year and deposit the same, whether or not he has been earlier assessed to tax.

(3) In the case of a person who has been already assessed by way of a regular assessment in respect of the total income of any previous year, the Assessing Officer, if he is of the opinion that such person is liable to pay advance tax, can serve an order under section 210(3) requiring the assessee to pay advance tax.

(4) For this purpose, the total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment or the total income returned by the assessee in any return of income for any subsequent previous year, whichever is higher, shall be taken as the basis for computation of advance tax payable.

(5) The above order can be served by the Assessing Officer at any time during the financial year but not later than the last date of February.

(6) If, after sending the above notice, but before 1st March of the financial year, the assessee furnishes a return relating to any later previous year or an assessment is completed in respect of a later return of income, the Assessing Officer may amend the order for payment of advance tax on the basis of the computation of the income so returned or assessed.

(7) If the assessee feels that his own estimate of advance tax payable would be less than the one sent by the Assessing Officer, he can file an estimate of his current income and advance tax payable thereon.

(8) Where the advance tax payable on the assessee's estimation is higher than the tax computed by the Assessing Officer, then, the advance tax shall be paid based upon such higher amount.

(9) In all cases, the tax calculated shall be reduced by the amount of tax deductible or collectible at source.

No reduction of 'tax deductible but not deducted' or 'tax collectible but not collected' while computing advance tax liability

(i) As per the provisions of section 209, the amount of advance tax payable by a person is computed by reducing the amount of income-tax which would be deductible at source during the financial year from any income which has been taken into account in computing the total income.

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(ii) Some courts have opined that in case where the payer pays any amount (on which tax is deductible at source) without deduction of tax at source, the payee shall not be liable to pay advance tax to the extent tax is deductible from such amount.

(iii) With a view to make such a person (payee) liable to pay advance tax, the proviso to section 209(1)(d) provides that the amount of tax deductible at source but not so deducted by the payer shall not be reduced from the income tax liability of the payee for determining his liability to pay advance tax.

(iv) In effect, only if tax has actually been deducted at source, the same can be reduced for computing advance tax liability of the payee. Tax deductible but not so deducted cannot be reduced for computing advance tax liability of the payee.

(v) Similarly, only if tax has actually been collected at source, the same can be reduced for computing advance tax liability of the buyer or licensee or lessee. Tax collectible but not so collected cannot be reduced for computing advance tax liability of the buyer or licensee or lessee.

(10) The amount of advance tax payable by an assessee in the financial year calculated by -

(i) the assessee himself based on his estimation of current income; or

(ii) the Assessing Officer as a result of an order under section 210(3) or amended order under section 210(4)

is subject to the provisions of section 209(2), as per which the net agricultural income has to be considered for the purpose of computing advance tax.

13.9.3 Instalments of advance tax and due dates

(1) Common advance tax payment schedule for both corporates and non-corporates [other than an assessee who declares profits and gains in accordance with section 44AD(1) or section 44ADA(1)]:

Due date of instalment	Amount payable
On or before 15th June	Not less than 15% of advance tax liability
On or before 15th September	Not less than 45% of advance tax liability, as reduced by the amount, if any, paid in the earlier instalment.
On or before 15th December	Not less than 75% of advance tax liability, as reduced by the amount or amounts, if any, paid in the earlier instalment or instalments.
On or before 15th March	The whole amount of advance tax liability as reduced by the amount or amounts, if any, paid in the earlier instalment or instalments.

Note - Any amount paid by way of advance tax on or before 31st March shall also be treated as advance tax paid during each financial year ending on 31st March.

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(2) Eligible assessee computing profits on presumptive basis under section 44AD(1) or section 44ADA(1) to pay advance tax by 15th March

An eligible assessee, opting for computation of profits or gains of business on presumptive basis in respect of eligible business referred to in section 44AD(1) or for computation of profits or gains of profession on presumptive basis in respect of eligible profession referred to in section 44ADA(1), shall be required to pay advance tax of the whole amount in one instalment on or before 15th March of the financial year.

Due date 15th March

However, any amount paid by way of advance tax on or before 31st March shall also be treated as advance tax paid during each financial year ending on 31st March.

(3) Where advance tax is payable by virtue of the notice of demand issued under section 156 by the Assessing Officer, the whole or the appropriate part of the advance tax specified in such notice shall be payable on or before each of such due dates as fall after the date of service of notice of demand.

(4) Where the assessee does not pay any instalment by the due date, he shall be deemed to be an assessee in default in respect of such instalment.

13.9.4 Credit for advance tax [Section 219]

Any sum, other than interest or penalty, paid by or recovered from an assessee as advance tax, is treated as a payment of tax in respect of the income of the previous year and credit thereof shall be given in the regular assessment.

13.10 INTEREST CHARGEABLE IN CERTAIN CASES

13.10.1 Interest for defaults in furnishing return of income [Section 234A]

(1) **Rate and Period for calculation of interest** - Where the return of income for any assessment year under section 139(1) or section 139(4) or section 139(8A) or in response to a notice under section 142(1), is furnished after the due date or is not furnished, the assessee shall be liable to pay simple interest at the rate of 1% for every month or part of a month comprised in the period commencing on the day immediately following the due date and,

Interest @1% p.m. or part of a month

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(a) where the return is furnished after the due date, ending on that date of furnishing the return; and

(b) where no return has been furnished, ending on the date of completion of assessment under section 144.

The interest payable under section 234A shall be reduced by the interest, if any, paid under section 140A towards interest chargeable under this section.

Note - *'Due date' means the date specified in section 139(1) as applicable in the case of the assessee.*

(2) **Amount on which interest is payable** - The amount on which interest will be payable will be the amount of the tax on the total income as determined under section 143(1) or on regular assessment, as reduced by the amount of -

(i) advance tax, if any, paid ;

(ii) any tax deducted or collected at source;

(iii) any relief of tax allowed under section 89;

(iv) any relief of tax allowed under section 90 or 90A;

(v) any deduction of tax allowed under section 91;

(vi) any tax credit allowed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

Notes:

(i) The tax on total income as determined under section 143(1) would not include additional income-tax, if any, payable under section 140B or under section 143.

(ii) Tax on the total income determined under regular assessment would not include the additional income-tax payable under section 140B.

(iii) Where in relation to an assessment year an assessment is made for the first time under section 147, the assessment so made shall be regarded as regular assessment for the purposes of this section.

(3) **Computation of interest where return is furnished after the time period specified in notice under section 148** - Where the return of income for any assessment year, required by a notice under section 148 issued after the determination of income under section 143(1) or after completion of assessment under section 143(3) or section 144 or section 147, is furnished after the expiry of the time allowed under such notice, or is not furnished, the

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assessee shall be liable to pay simple interest at the rate of 1% for every month or part of a month comprised in the period commencing on the date immediately following the expiry of the time allowed as aforesaid and ending on the following dates specified in column (3) below:

	Case	Ending date
(i)	where the return is furnished after the expiry of the time aforesaid	on the date of furnishing the return
(ii)	where no return has been furnished	on the date of completion of the reassessment or re-computation under section 147

(4) **Amount on which interest is payable** - The amount on which the above interest is payable is the amount by which the tax on the total income determined on the basis of such reassessment or re-computation exceeds the tax on the total income determined under section 143(1) or on the basis of the earlier assessment aforesaid.

(5) **Consequence where interest is increased or reduced subsequently as a result of rectification, appeal, revision, etc.** - Where as a result of an order of rectification or appellate order or an order of revision, the interest payable is reduced or increased, the Assessing Officer shall proceed as follows:

	Case	Ending date
(i)	Where the interest is increased	The Assessing Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum payable and such demand notice shall be a notice under section 156.
(ii)	Where interest is reduced	The excess paid shall be refunded

(6) **Interest under section 234A not chargeable on self-assessment tax paid before the due date of filing of return of income [*Circular No. 2/2015, dated 10-2-2015*]**

The Hon'ble Supreme Court has, in the case of *CIT vs Prannoy Roy (2009) 309 ITR 231,* held that interest under section 234A on default of furnishing return of income shall be payable only on the amount of tax that has not been deposited before the due date of filing of the -tax return for the relevant assessment year.

No interest

Accordingly, the CBDT has clarified that **no** interest under section 234A shall be charged on self-assessment tax paid by the assessee on or before the due date of filing of return.

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13.10.2 Interest for non-payment or short-payment of advance tax [Section 234B]

(1) **Rate and period of interest**: Interest under section 234B would be attracted where an assessee, who is liable to pay advance tax, fails to pay such tax or the advance tax paid is less than 90% of assessed tax. Accordingly, interest would be leviable at the rate of 1% for every month or for part of month for the following period, if the advance tax paid falls short of 90% of the 'assessed tax'.

Interest @1% p.m. or part of a month

Period commencing from:	and	Period ending on:		
the 1st April of the following F.Y.		(i)	Where regular assessment is not made	The date of determination of total income u/s 143(1)
		(ii)	Where regular assessment is made	The date of regular assessment
Amount on which interest is payable:				
(i)	Where no advance tax is paid			Assessed tax
(ii)	Where advance tax paid falls short of 90% of assessed tax			Assessed tax **minus** Advance tax paid

(2) **Meaning of the term 'assessed tax':** The tax on the total income determined under section 143(1) or on regular assessment as reduced by the amount of -

(i) any tax deducted or collected at source on any income which is taken into account for calculating the total income;

(ii) any relief of tax allowed under section 89;

(iii) any relief of tax allowed under section 90 or 90A;

(iv) any deduction of tax allowed under section 91;

(v) any tax credit allowed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

Assessed tax

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Notes:

(i) An assessment made for the first time under section 147 shall be deemed to be regular assessment.

(ii) Tax on total income as determined under section 143(1) would not include the additional income-tax, if any, payable under section 140B or section 143.

(iii) Tax on the total income determined under such regular assessment would not include the additional income-tax payable under section 140B.

(3) **Interest paid on self-assessment**: Where, before the date of determination of total income under section 143(1) or completion of regular assessment, tax is paid by the assessee under section 140A or otherwise, interest shall be calculated up to the date on which the tax is so paid and reduced by the interest paid under section 140A towards interest under section 234B.

Thereafter, interest shall be calculated @1% on the amount by which the tax paid under section 140A together with the advance tax paid falls short of the assessed tax.

(4) **Where total income is increased on reassessment under section 147:** As per section 234B(3), where the total income is increased on reassessment under section 147, the assessee shall be liable for interest @1% for every month or part of a month on the amount of the increase in tax on total income as a consequence of reassessment or recomputation [Tax on total income determined on the basis of reassessment or recomputation (–) Tax on total income determined under section 143(1) or on the basis of regular assessment].

Period for which interest is payable

Period commencing from:		Period ending on:
the 1st April next following the financial year	**and**	the date of reassessment or recomputation under section 147.

(5) **Consequence where interest payable is increased or reduced subsequently as a result of rectification, appeal, revision etc.** - Where as a result of an order of rectification or an appellate order or an order of revision, the interest payable is reduced or increased, the Assessing Officer shall proceed as follows:

	Case	Ending date
(i)	Where the interest is increased	The Assessing Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum payable and such demand notice shall be a notice under section 156.
(ii)	Where interest is reduced	The excess paid shall be refunded

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13.10.3 Interest for deferment of advance tax [Section 234C]

(1) Manner of computation of interest under section 234C for deferment of advance tax by corporate and non-corporate assessees:

In case an assessee, other than **an assessee who declares profits and gains in accordance with the provisions of section 44AD(1) or section 44ADA(1)**, who is liable to pay advance tax under section 208 has failed to pay such tax or the advance tax paid by such assessee on its current income on or before the dates specified in column (1) is less than the specified percentage [given in column (2)] of tax due on returned income, then simple interest @1% per month for the period specified in column (4) on the amount of shortfall, as per column (3) is leviable under section 234C.

Interest on deferment of advance tax @1% p.m. or part of a month

Specified date	Specified%	Shortfall in advance tax	Period
(1)	(2)	(3)	(4)
15th June	15%	15% of tax due on returned income (-) advance tax paid up to 15th June	3 months
15th September	45%	45% of tax due on returned income (-) advance tax paid up to 15th September	3 months
15th December	75%	75% of tax due on returned income (-) advance tax paid up to 15th December	3 months
15th March	100%	100% of tax due on returned income (-) advance tax paid up to 15th March	1 month

Note *– However, if the advance tax paid by the assessee on the current income, on or before 15th June or 15th September, is not less than 12% or, 36% of the tax due on the returned income, respectively, then, the assessee shall not be liable to pay any interest on the amount of the shortfall on those dates.*

(2) Computation of interest under section 234C in case of an assessee who declares profits and gains in accordance with the provisions of section 44AD(1) or section 44ADA(1):

In case an assessee, who declares profits and gains in accordance with the section 44AD(1) or section 44ADA(1), as the case may be, who is liable to pay advance tax under section 208 has failed to pay such tax or the advance tax paid by the assessee on its current income on or before 15th March is less than the tax due on the returned income, then, the assessee

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shall be liable to pay simple interest at the rate of 1% on the amount of the shortfall from the tax due on the returned income.

(3) Non-applicability of interest under section 234C in certain cases:

Interest under section 234C shall not be leviable in respect of any shortfall in payment of tax due on returned income, where such shortfall is on account of under-estimate or failure to estimate –

Non-applicability

(i) the amount of capital gains;

(ii) income of nature referred to in section 2(24)(ix) i.e., winnings from lotteries, crossword puzzles etc.;

(iii) income under the head "Profits and gains of business or profession" in cases where the income accrues or arises under the said head for the first time;

(iv) the amount of dividend income u/s 2(22)(a)/(b)/(c)/(d)/(f)

However, the assessee should have paid the whole of the amount of tax payable in respect of such income referred to in (i), (ii), (iii) or (iv), as the case may be, had such income been a part of the total income, as part of the remaining instalments of advance tax which are due or where no such instalments are due, by 31st March of the financial year.

(4) Tax due on the returned income: means the tax chargeable on the total income declared in the return of income furnished by the assessee for the assessment year immediately following the financial year in which the advance tax is paid or payable, as reduced by the amount of –

(i) any tax deductible or collectible at source on any income which is taken into account for calculating the total income;

(ii) any relief of tax allowed under section 89;

(iii) any relief of tax allowed under section 90 or 90A;

(iv) any deduction of tax allowed under section 91;

(v) any tax credit allowed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

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13.10.4 Interest on excess refund granted at the time of summary assessment [Section 234D]

(1) **Applicability**: Where a regular assessment under section 143(3) or section 144 is made, any tax or interest paid under section 143(1) shall be deemed to have been paid towards such regular assessment and if no refund is due on regular assessment or the amount refunded under section 143(1) exceeds the amount refundable on regular assessment, the whole or the excess amount so refunded is deemed to be tax payable by the assessee. In order to charge interest for the period during which the refund amount has been utilised by the assessee, section 234D levies interest on excess refund granted at the time of summary assessment.

Interest on refund @ ½% p.m. or part of a month

(2) **Rate and period of interest**: Where any refund is granted to the assessee under section 143(1) and no refund is due on regular assessment or the amount refunded under section 143(1) exceeds the amount refundable on regular assessment, then, the assessee shall be liable to pay simple interest at the rate of ½% on the whole or the excess amount so refunded for every month or part of the month from the date of grant of the refund to the date of such regular assessment.

Note - An assessment made for the first time under section 147 shall be regarded as regular assessment for the purpose of this section.

(3) **Reduction of interest**: The interest chargeable under sub-section (1) shall be reduced, where, as a consequence to the order passed due to rectification, appeal, revisions etc. under sections 154/155/250/254/260/262/263/264, the amount of refund granted under section 143(1) is held to be correctly allowed.

13.10.5 Fee/ penalty for default in furnishing TDS/ TCS Statements

(1) **Quantum of fee**: A fee of ₹ 200 for every day would be levied under section 234E for late furnishing of TDS/ TCS statement from the due date of furnishing of TDS/ TCS statement to the date of furnishing of TDS/ TCS statement. However, the total amount of fee shall not exceed the total amount of tax deductible/collectible and such fee has to be paid before delivering the TDS/ TCS statement.

Fee/penalty

(2) **Penalty [Section 271H]**: In addition to the said fee, a penalty ranging from a minimum of ₹ 10,000 to a maximum of ₹ 1,00,000 shall also be levied under section 271H for not furnishing TDS/ TCS statements within the prescribed time or furnishing incorrect information in the said statements in respect of tax deducted or collected at source.

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(3) **Fee and penalty where TDS/ TCS statement is furnished after one year**: Since late furnishing of TDS/ TCS statements would attract levy of fees under section 234E, no penalty under section 271H shall be levied for delay in furnishing of TDS/ TCS statement, if the TDS/ TCS statement is furnished within one month of the prescribed due date after payment of tax deducted or collected along with applicable interest and fee. However, if the delay is beyond the period of one month, both fee under section 234E and penalty under section 271H would be leviable.

13.11 COLLECTION AND RECOVERY OF TAX - OTHER METHODS

13.11.1 Payment of tax and defaults by the assessee [Section 220]

(1) Under section 220(1), any amount specified as payable in a notice of demand under section 156 shall be paid within thirty days of the service of notice at the place and to the person mentioned in the notice. On an application made by the assessee before the expiry of the due date of thirty days, 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 in the circumstances of the case.

Notice of demand

The Assessing Officer may with the previous approval of the Joint Commissioner, direct that the sum specified in the notice of demand shall be paid within such period being a period less than the period of thirty days as may be specified by him in the notice of demand, if he has any reason to believe that it will be detrimental to revenue if the full period of thirty days aforesaid is allowed.

(2) If the amount specified in the notice is not paid within the period, the assessee shall be liable to pay interest at 1% for every month or part of a month comprised in the period commencing from the day immediately following the end of the period mentioned in section 220(1) and ending with the day on which the amount is paid. This is provided for in section 220(2).

Interest@1% p.m. or part of a month

(3) The first proviso to section 220(2) states that where, as a result of an order under sections 154/155/250/254/260/262/264, the amount on which interest payable under this section had been reduced, the interest shall be reduced accordingly and the excess interest paid, if any, shall be refunded.

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(4) The liability of the assessee to pay interest is based on the theory of continuity of the proceedings and the doctrine of relation back.

(5) Further, the second proviso to section 220(2) provides that if, as a result of an order under the sections specified in the first proviso to section 220(2), the amount of interest payable was reduced, and thereafter, as a result of another order under any of the sections given in the first proviso or section 263, the interest payable was increased, the assessee would be liable to pay interest under section 220(2) from the day immediately following the end of the period mentioned in the first notice of demand referred to in section 220(1) till the date on which the amount is paid.

(6) Accordingly, section 220(1A) provides that where any notice of demand has been served upon an assessee and any appeal or other proceeding, as the case may be, is filed or initiated in respect of the amount specified in the said notice of demand, then such demand shall be deemed to be valid till the disposal of appeal by the last appellate authority or disposal of proceedings, as the case may be, and any such notice of demand shall have effect as provided in section 3 of the Taxation Laws (Continuation and Validation of Recovery Proceedings) Act, 1964 [See Note below]

Notice of Demand valid till disposal of

Note - Section 3 of the Taxation Laws (Continuation and Validation of Recovery Proceedings) Act, 1964

Continuation and validation of certain proceedings

(1) Where any notice of demand in respect of any Government dues is served upon an assessee by a Taxing Authority under any scheduled Act, and any appeal or other proceeding is filed or taken in respect of such Government dues, then,-

(a) where such Government dues are enhanced in such appeal or proceeding, the Taxing Authority shall serve upon the assessee another notice of demand only in respect of the amount by which such Government dues are enhanced and any proceeding in relation to such Government dues as are covered by the notice or notices of demand served upon him before the disposal of such appeal or proceeding may, without the service of any fresh notice of demand, be continued from the stage at which such proceedings stood immediately before such disposal;

(b) where such Government dues are reduced in such appeal or proceeding,-

(i) it shall not be necessary for the Taxing Authority to serve upon the assessee a fresh notice of demand;

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(ii) the Taxing Authority shall give intimation of the fact of such reduction to the assessee. Further, where a certificate has been issued to the Tax Recovery Officer for the recovery of such amount, intimation of the fact of reduction shall also be given to him;

(iii) any proceedings initiated on the basis of the notice or notices of demand served upon the assessee before the disposal of such appeal or proceeding may be continued in relation to the amount so reduced from the stage at which such proceedings stood immediately before such disposal;

(c) no proceedings in relation to such Government dues (including the imposition of penalty or charging of interest) shall be invalid by reason only that no fresh notice of demand was served upon the assessee after the disposal of such appeal or proceeding or that such Government dues have been enhanced or reduced in such appeal or proceeding.

(2) No fresh notice of demand shall be necessary in any case where the amount of Government dues is not varied as a result of any order passed in any appeal or other proceeding under any scheduled Act.

No fresh notice of demand

(3) The provisions of this section shall have effect notwithstanding any judgment, decree or order of any court, tribunal or other authority.

ILLUSTRATION 19

The Assessing Officer issued a notice of demand under section 156 to Mr. X on 1.10.2025 for payment of ₹ 15 lakhs towards his income-tax liability for the A.Y.2024-25, requiring him to pay the said amount within 30 days.

(a) Is he required to issue fresh notice of demand and if so, for what amount, in the following two cases (each case has to be considered independently) –

(i) If the tax demand is reduced to ₹ 12 lakhs by the Commissioner (Appeals) by issue of order under section 250;

(ii) If the tax demand is increased to ₹ 20 lakhs by the Appellate Tribunal, by issue of an order under section 254.

(b) How would the interest liability under section 220(2) be calculated if the tax demand is reduced to ₹ 12 lakhs by the Commissioner (Appeals) by issue of order under

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section 250 and subsequently increased to ₹ 15 lakhs by the Appellate Tribunal by way of issue of order under section 254?

SOLUTION

(a) (i) No fresh notice of demand is required to be served on Mr. X. The Assessing Officer is only required to give an intimation of the fact of reduction of demand to ₹ 12 lakhs to Mr. X. The proceedings initiated on the basis of the original notice of demand may be continued in relation to the reduced amount of ₹ 12 lakhs from the stage at which such proceedings stood immediately before disposal of appeal.

(ii) A fresh notice of demand has to be given only in respect of ₹ 5 lakhs, being the amount of enhancement. Any proceedings in relation to ₹ 15 lakhs covered by the original notice of demand served upon Mr. X may be continued from the stage at which such proceedings stood immediately before the disposal of appeal.

(b) The interest under section 220(2) has to be paid on ₹ 15 lakhs @1% per month or part of the month comprised in the period commencing from 1.11.2025 and ending with the date on which the amount is paid, assuming that Mr. X has not paid any interest so far.

(7) **Reduction or waiver of interest payable under section 220(2)** - Section 220(2A) empowers the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner for reduction or waiver of any interest payable under section 220(2).

Accordingly, w.e.f. 4.11.2024, the CBDT has, vide Circular no. 15/2024, dated 4.11.2024, for the proper administration of the Act, specified the monetary limits for reduction or waiver of interest:

S.No.	Income-tax Authority	Monetary limits for reduction or waiver of interest
1	Principal Commissioner or Commissioner of Income-tax	Upto ₹ 50 lakhs
2	Chief Commissioner of Income-tax	Above ₹ 50 lakhs to ₹ 1.5 crores
3	Principal Chief Commissioner of Icome-tax	Above ₹ 1.5 crores

The powers of reduction or waiver of the interest paid or payable under section 220(2) in respect of any income-tax authority shall continue if he is satisfied that:

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(i) payment of such amount has caused or would cause genuine hardship to the assessee;

(ii) default in the payment of the amount on which interest was made payable under the said sub-section was due to circumstances beyond the control of the assessee; and

(iii) the assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

The order accepting or rejecting the application of the assessee, either in full or in part, shall be passed **within a period of twelve months from the end of the month in which the application is received**.

Further, no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard.

(8) **Interest under section 220(2) not leviable where interest is charged u/s 201(1A) or section 206C(7)** -

Since the intimation generated after processing the TDS statement under section 200A(1) would be deemed as a notice of demand under section 156, consequently, interest under section 220 would be attracted for failure to pay the tax specified in the intimation. However, interest under section 201(1A) is leviable for non-payment of tax specified in the intimation. Therefore, it has been provided that in cases where interest is charged for any period under section 201(1A) on the tax specified in the intimation under section 200A, then, interest under section 220(2) would not be levied on the same amount for the same period.

Likewise, since the intimation generated after processing of TCS statement shall be deemed as a notice of demand under section 156, failure to pay the tax specified in the intimation shall attract a levy of interest as per the provisions of section 220(2). Section 206C(7) also provides for levy of interest for non-payment of tax specified in the intimation to be issued. In order to remove the possibility of charging interest on the same amount for the same period of default both under section 206C(7) and section 220(2), sub-section (2C) of section 220 specifically provides that **where interest is charged for any period under section 206C(7) on the amount of tax specified in the intimation issued under 206CB(1), no interest shall be charged under section 220(2)** on the same amount for the same period.

Intimation deemed as notice of demand

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13.11.2 Penalty payable [Section 221]

(1) **Penalty for default in payment of tax -** Where an assessee is in default in payment of tax including advance tax and interest payable thereon, the Assessing Officer shall impose a penalty which, in cases of continuing default, may be increased from time to time. However, the total penalty should not exceed the tax in arrears. The Assessing Officer should give the assessee a reasonable opportunity of being heard before levying such a penalty.

Penalty not to exceed tax arrears

No penalty shall be levied on the assessee for default in payment of tax in cases where he proves to the satisfaction of the Assessing Officer that the default was for good and sufficient reasons.

(2) **Payment of tax before levy of penalty not to absolve the assessee from penalty** - The *Explanation* to section 221(1) provides that an assessee would not cease to be liable to pay any penalty for his default or delay in payment of the tax merely by reason of the fact that before the date of levy of such penalty, the tax which was in arrears had actually been paid by him.

Thus, wherever there is a delay on the part of the assessee, he would be liable to penalty even though by the time the Assessing Officer initiates action for the levy of penalty, the amount of tax in arrears is actually paid.

Pay tax before filing appeal

An order imposing penalty is appealable and the assessee's right of appeal subject to the condition that he must first pay the tax or penalty; the assessee should first pay the tax before filing the appeal.

(3) **Circumstance when penalty levied will be cancelled** – If, as a consequence of any final order, the amount of tax, with respect to the default in the payment of which the penalty was levied, has been wholly reduced, the penalty levied shall be cancelled and the amount of penalty paid shall be refunded.

13.11.3 Certificate to Tax Recovery Officer (TRO) [Section 222]

(1) **TRO to draw up statement specifying amount of arrears due from an assessee-in-default [Section 222(1)]** - When an assessee is in default or is deemed to be in default in making a payment of tax, the TRO may draw up under his signature a

Attachment of property

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statement in the prescribed form and specifying the amount of arrears due from the assessee and shall proceed to recover from such assessee the amount specified in the certificate by one of more of the modes mentioned below, in accordance with the Second Schedule.

Method of Tax Recovery

(2) **Property to include property transferred to spouse/minor child/son's wife/son's minor child for inadequate consideration [*Explanation* to section 222(1)]** - For the purpose of this section, the assessee's movable or immovable property shall include any property which has been transferred directly or indirectly by the assessee to his spouse or minor child or son's wife or son's minor child otherwise than for adequate consideration and which is held by any of the persons aforesaid. So far as the movable or immovable property so transferred to his minor child or his son's minor child is concerned, they shall, even after the date of attainment of majority by such minor child or son's minor child, continue to be included in the assessee's movable or immovable property for recovering any arrears from the assessee in respect of any period prior to such date.

(3) The TRO may take action under sub-section (1), notwithstanding that proceedings or recovery of the arrears by any special mode have been taken.

13.11.4 Tax Recovery Officer (TRO) by whom recovery is to be effected [Section 223]

(1) **TRO competent to take action under section 222**: The TRO competent to take action under section 222 shall be the TRO within whose jurisdiction:

Jurisdictional TRO

(i) the assessee carries on business or profession.

(ii) the principal place of his business or profession is situated.

(iii) the assessee resides or any movable or immovable property of the assessee is situated.

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(2) **Assignment of jurisdiction**: The jurisdiction is assigned either by the CBDT or by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner who is authorised on this behalf by the CBDT under section 120.

(3) **Procedure where an assessee has property within the jurisdiction of more than one TRO**: In such a case, if the TRO by whom the certificate is drawn up is not able to recover the entire amount by the sale of the property within his jurisdiction or is of the opinion that, for the purpose of expediting or securing the recovery of the whole or any part of the amount under this Chapter, it is necessary so to do, he may send the certificate to a TRO within whose jurisdiction the assessee has property. Thereupon, that TRO shall proceed to recover the amount as if the certificate was drawn up by him.

13.11.5 Validity of certificate and cancellation and amendment thereof [Section 224]

(1) The assessee cannot dispute the correctness of any certificate drawn up by the TRO on any ground whatsoever.

(2) However, the TRO is empowered to cancel the certificate if, for any reason, he thinks it necessary so to do, or to correct any clerical or arithmetical mistake therein.

13.11.6 Stay of proceedings in pursuance of certificate and amendment or cancellation thereof [Section 225]

(1) **TRO empowered to grant time for payment of tax:** It shall be lawful for the TRO to grant time for the payment of any tax and when he does so he shall stay proceedings for the recovery of such tax until the expiry of the time so granted.

(2) **TRO empowered to stay proceedings where demand is reduced in appeal but subject matter of further proceedings:** Where as a result of appeal, the demand is reduced but the order is the subject matter of further proceedings, the TRO shall stay the recovery of such part of the amount specified in the certificate as pertains to such deduction for the period in which an appeal or other proceedings remains pending.

(3) **TRO empowered to modify or cancel certificate where demand is reduced on appeal**: Where a certificate has been drawn up and subsequently, as a result of appellate order, the amount is reduced, the TRO shall modify the certificate or cancel it if it is necessary, when the order which was the subject matter of appeal or other proceeding becomes final and conclusive.

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13.11.7 Other modes of recovery [Section 226 & 227]

(1) Recovery of tax where a certificate has/has not been drawn up under section 222:

	Whether Certificate has been drawn up under section 222?	Income-tax authority empowered to recover taxes by one or more of the modes specified in section 226
(i)	No	Assessing Officer
(ii)	Yes	TRO, without prejudice to the modes of recovery specified in section 222

Note *- This section enumerates the various modes of recovery by the Assessing Officer and TRO. Students may refer to the section in the Bare Act for details.*

(2) Non-validity of claim in regard to any property where notice is issued: Any claim in regard to any property in relation to which a notice under this section is issued, shall be void as against any demand contained therein.

(3) Consequences where the person on whom notice is served objects on oath: Where a person, on whom a notice (garnishee order) under this section has been served, objects on oath that the amount demanded from him is not due to the assessee or that he does not hold any money for or on account of the assessee, he cannot be compelled by the Assessing Officer to make the payment. However, if it is later on found that such a statement made by him was false, he would personally become liable to pay the amount to the Assessing Officer or TRO to the extent of his own liability to the assessee or to the extent of the assessee's liability, whichever is less.

Such personal liability would arise even in cases where the person in receipt of a notice from the Assessing Officer or TRO, makes a payment in disregard of the notice served on him.

(4) Recovery of tax dues from money in custody of a Court or Receiver by distraint and sale of movable property: Money belonging to the assessee-in-default which are in the custody of a Court or Receiver is also liable for attachment. Further, on being authorised by the Principal Chief Commissioner/Chief Commissioner/Principal Commissioner/ Commissioner, the Assessing Officer or the TRO is also empowered, by general or special order to recover any arrears of tax due by distraint and sale of movable property as laid down in the Third Schedule. For details, students may refer to the Third Schedule in the Act.

(5) Recovery through State Government: In addition, tax may be recovered through the State Government if the recovery of tax in any area has been entrusted to it under the Constitution. In such a case, the State Government may direct that the tax shall be recovered in respect of any particular area together with the municipal taxes or local rates, if any, by the municipality or local authority [Section 227].

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13.11.8 Recovery of tax in pursuance of agreements with foreign countries [Section 228A]

(1) Section 228A provides for the procedure of recovery of tax in pursuance of an agreement entered into by the Central Government with the Government of any country outside India or any authority under that Government.

Recovery of tax from a resident or person having property in India

(2) Where the Government of the foreign country or any authority under that Government sends a certificate to the CBDT for the recovery of any tax due under that law from a resident, or a person having any property in India, the CBDT may forward such certificate to any TRO having jurisdiction over the resident, or within whose jurisdiction such property is situated.

(3) The TRO shall proceed to recover the amount specified in the certificate in the manner in which he would proceed to recover the amount specified in a certificate drawn up by him under section 222.

(4) Thereafter, the TRO has to remit any sum so recovered to the CBDT after deducting the expenses in connection with the recovery proceedings.

(5) Where an assessee is in default or is deemed to be in default in making a payment of tax, the TRO may, if the assessee is a resident of a country (being a country with which the Central Government has entered into an agreement for the recovery of income-tax under the Income-tax Act, 1961 and the corresponding law in force in that country) or has any property in that country, forward to the CBDT a certificate drawn up by him under section 222 and the CBDT may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

13.11.9 Tax Clearance Certificate [Section 230]

(1) Undertaking to be furnished by a person not domiciled in India visiting India in connection with business, profession or employment [Section 230(1)]

(i) No person, who is not domiciled in India and who has come to India in connection with business, profession or employment; and who has income derived from any source in India, shall leave the territory of India by land, sea or air unless he furnishes to the prescribed authority an undertaking in the prescribed form.

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(ii) The said undertaking should be furnished from the employer of the said person or through whom such person is in receipt of the income.

Undertaking from person not domiciled in India

(iii) The undertaking should be to the effect that tax payable by such person who is not domiciled in India shall be paid by the employer or the person through whom any income is receivable by the first-mentioned person.

(iv) The prescribed authority shall, on receipt of the undertaking, immediately give to such person a no objection certificate, for leaving India.

(v) However, the provisions contained in sub-section (1) shall not apply to a person who is not domiciled in India but visits India as a foreign tourist or for any other purpose not connected with business, profession or employment.

(2) Furnishing of PAN by person domiciled in India at the time of departure [Section 230(1A)]

Furnishing of PAN at the time of departure

(i) Every person, who is domiciled in India at the time of his departure, shall furnish, to the income-tax authority or such other authority as may be prescribed, his PAN allotted to him under section 139A, the purpose of his visit and the estimated period of his stay outside India.

(ii) In case, no such PAN has been allotted to him, or his total income is not chargeable to income-tax or he is not required to obtain a PAN under the Income-tax Act, 1961, a certificate in the prescribed form shall be furnished to the income-tax authority or such other authority, as may be prescribed.

(iii) However, where an income-tax authority opines that there exist circumstances which render an Indian domiciled to obtain a certificate under this section, such person shall not leave the territory of India by land, sea or air unless -

(a) he obtains a certificate from the income-tax authority stating that he has no liabilities under the Income-tax Act, 1961 or the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, or

(b) that satisfactory arrangements have been made for the payment of all or any of such taxes which are or may become payable by that person [First proviso to sub-section (1A)]

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(iv) No income-tax authority shall make it necessary for any person who is domiciled in India to obtain a certificate under this section unless he records the reasons therefor and obtains the prior approval of the Principal Chief Commissioner or Chief Commissioner of Income-tax.

(3) Personal liability of owner or charterer of ship or aircraft carrying such persons [Section 230(2) & (3)]

If the owner or charterer of any ship or aircraft carrying persons from any place in India to any place outside India allows any of the above-mentioned persons to travel by such ship or aircraft without first satisfying that such person is in possession of a certificate as required, he shall be personally liable to pay the whole or any part of the tax payable by such person as the Assessing Officer, may determine. In such a case, the owner or charterer shall be deemed to be an assessee in default for such sum and recovery shall be made in the manner as if it were an arrear of tax.

Note *- The expressions "owner" and "charterer" include any representative, agent or employee empowered by the owner or charterer to allow persons to travel by the ship or aircraft.*

(4) Power to make Rules [Section 230(4)]

The CBDT is empowered to make rules for carrying out the provisions of this section.

13.11.10 Faceless collection and recovery of tax [Section 231]

Section 231 empowered the Central Government to notify scheme for faceless collection and recovery of tax for eliminating physical interface.

(1) **Faceless scheme [Section 231(1)]** - The Central Government is empowered to make a scheme [faceless collection and recovery of tax scheme] by notification in the Official Gazette for the purpose of:

a. issuing certificate for deduction of income-tax at any lower rates or no deduction of income-tax under section 197 or

b. deeming a person to be an assessee-in-default under section 201(1) or section 206C(6A) or

c. issuance of certificate for lower collection of tax under 206C(9) or

d. passing of order or amended order under section 210(3)/(4) or

Faceless Collection and recovery of tax

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e. reduction or waiver of the amount of interest paid or payable by an assessee u/s 220(2A); or

f. extending the time for payment or allowing payment by instalment u/s 220(3); or

g. treating the assessee as not being in default u/s 220(6) or u/s 220(7); or

h. levy of penalty u/s 221; or

i. drawing of certificate by the Tax Recovery Officer u/s 222; or

j. jurisdiction of Tax Recovery Officer u/s 223 or

k. stay of proceedings in pursuance of certificate and amendment or cancellation thereof by the Tax Recovery Officer u/s 225 or

l. other modes of recovery u/s 226 or

m. issuance of tax clearance certificate u/s 230

so as to impart greater efficiency, transparency, and accountability by:

(i) eliminating the interface between the income-tax authority and the assessee or any person to the extent technologically feasible

(ii) optimising utilisation of the resources through economies of scale and functional specialisation;

(iii) introducing a team-based issuance of certificate for deduction or collection of income-tax at lower rate, or for no deduction, or for deeming a person to be an assessee-in-default, or for passing of an order or amended order, or extending the time for payment, or allowing payment by instalment, or reduction or waiver of interest, or for treating the assessee as not being in default, or for levy of penalty or for drawing of certificate or stay of proceedings in pursuance of certificate and amendment or cancellation thereof, by, or jurisdiction of, Tax Recovery Officer or other modes of recovery or issuance of tax clearance certificate, with dynamic jurisdiction.

(2) **Applicability or non-applicability of other provisions of the Act [Section 231(2)]** - The Central Government may, for the purpose of giving effect to the scheme, by notification in the Official Gazette, direct that any provision of this Act shall not apply or shall apply with such exception, modification and adaptations as specified in the notification.

No such direction can, however, be issued by the Central Government after 31st March, 2022.

(3) **Notification issued above to be laid before each House of Parliament [Section 231(3)]** - Every such notification issued by the Central Government either under sub section (1) or (2) of the section 231 has to be laid before each House of Parliament as soon as possible.

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13.11.11 Recovery by suit or under other law [Section 232]

Section 232 provides that the Assessing Officer or the Government can have recourse to the other modes of recovery under any other law for the time being in force, over the various modes specified above to recover the tax dues under the Act, in the same way as other debts due to the Government. It shall also be lawful for the Assessing Officer or the Government to take recourse to any other law or file a suit in any manner for the recovery of the arrears due from the assessee.

13.12 REFUNDS

(1) Eligibility [Section 237]

(i) An assessee is entitled to claim a refund of tax if the tax actually paid (and not merely payable) by him or on his behalf or treated as paid by him or on his behalf for any assessment year exceeds the amount of tax with which he is properly chargeable under the Act for that year.

(ii) This may usually arise as a result of excess deduction of tax at source from salaries, dividends, interest, to or as a result of excess payment of advance tax or when the tax originally paid on assessment is reduced on appeal, revision, rectification or reference.

(2) Persons entitled to claim refund in certain cases [Section 238]

(i) Generally, a claim for a refund can be made only by the person on whose account the tax was already paid.

(ii) However, in cases where the income of one person is included in the total income of another person under sections 60 to 65, the latter person alone is entitled to claim the refund.

(iii) If any person is not able to claim or receive the refund due to him on account of his death, incapacity, insolvency, dissolution, liquidation, etc., his legal representative or trustee or guardian or receiver, as the case may be, is entitled to claim or receive the refund on behalf of such person or his estate.

(3) Claim for refund [Section 239]

In order to simplify the procedure for a claim of refund, it has been provided that every claim for refund should be made by furnishing a return in accordance with the provisions of section 139.

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(4) Refund for denying liability to deduct tax under section 195 [Section 239A]:

(i) Application for refund of tax - This section provides that where under an agreement or other arrangement, in writing, the tax deductible on any income, other than interest, under section 195 is to be borne by the person by whom the income is payable, and such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income, he may file an application before the Assessing Officer for a refund of such tax in prescribed form and manner.

(ii) Time limit for filing application - Such application may be filed within 30 days from the date of payment of such tax.

(iii) Passing of order by Assessing Officer - The Assessing Officer has to, by an order in writing, allow or reject the application. However, no application would be rejected unless an opportunity of being heard has been given to the applicant. The Assessing Officer, may, before passing an order make such inquiry as he considers necessary.

(iv) Time limit for passing order - The order has to be passed within 6 months from the end of the month in which the application for refund is received.

(5) Refund on appeal etc. [Section 240]

(i) Where a refund becomes due to the assessee as a result of an order passed in appeal or any other proceeding under the Income-tax Act, 1961, he need not make an application to claim the same.

(ii) In such a case, the Assessing Officer is bound to pass an order of refund without waiting for the application from the assessee.

(iii) 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 shall become due only on the making of such fresh assessment.

(iv) 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.

(6) Correctness of assessment not to be questioned [Section 242]

(i) While making a claim for refund, an assessee cannot question the correctness of any assessment or other matter decided which has become final and conclusive or ask for a review of the same.

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(ii) The assessee shall not be entitled to any relief on such claim except for a refund of tax wrongly paid or paid in excess.

(7) Interest on Refunds [Section 244A]

(i) **Applicability and Rate**: Interest at 0.5% for every month or part of a month shall be payable on tax or penalty becoming refundable on account of excess payment of advance tax, tax deducted at source or collected at source and other tax or penalty becoming refundable.

Interest @ 0.5% p.m. or part of a month

(ii) **Period of interest**: Interest @0.5% for every month or part of a month for the period specified in the following table for each of the cases mentioned in column (2) hereunder–

	Case		Period for grant of interest on refund	
			Beginning from	Ending with
(1)	(2)		(3)	(4)
(a)	Where the refund is out of TCS u/s 206C or paid by way of advance tax or treated as paid u/s 199, during the financial year immediately preceding the A.Y.			
	(1)	Where the return is filed on or before the due date u/s 139(1)	1st April of the assessment year	Date of grant of refund
	(2)	Where the return is filed after the due date	the date of filing of return	
(b)	Where the refund is out of self-assessment tax paid u/s 140A		Date of furnishing return of income or payment of tax, whichever is later	Date of grant of refund
(c)	In any other case		Date of payment of tax or penalty	Date of grant of refund

***Note** – The assessee can claim interest on refund due also in pursuance of determination of total income u/s 143(1) or on regular assessment. However, no interest shall be payable if the amount of refund due is less than 10% of the tax determined u/s 143(1) or on regular assessment, in case of (a) and (b) above.*

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(iii) **Additional interest payable on refund arising out of fresh assessment order giving effect to appellate or revisionary order**: Where a refund arises as a result of giving effect to an order under section 250/254/260/262/263/264, wholly or partly, otherwise than by making a fresh assessment or reassessment, the assessee shall be entitled to receive, in addition to the interest payable under section 244A(1), an additional interest on such refund amount calculated at the rate of 3% p.a., for the period beginning from the date following the date of expiry of the time allowed under section 153(5) to the date on which the refund is granted.

However, if proceedings for assessment or reassessment are pending in respect of an assessee, the period beginning from the date on which such refund is withheld by the Assessing Officer and ending with the date upto which such refund is withheld, will be excluded for computing additional interest payable.

Further, in cases where extension is granted by the Principal Commissioner or Commissioner by invoking proviso to section 153(5), the period of additional interest, if any, shall begin from the expiry of such extended period.

Circumstance	Period beginning from[9]
Where a refund arises as a result of giving effect to an order under section 250/254/260/262/263/264, wholly or partly, otherwise than by making a fresh assessment or reassessment or resh order u/s 92CA	From the expiry of 3 months from the end of the month in which the order u/s 250/254/260/262 is received by PCC/CC/PC/CIT, or order u/s 263 or 264 is passed, by the PC/CIT.
Where extension is granted by the Principal Commissioner or Commissioner by invoking proviso to section 153(5)	From the expiry of 9 months from the end of the month in which the order u/s 250/254/260/262 is received by PCC/CC/PC/CIT, or order u/s 263 or 264 is passed, by the PC/CIT.
Where the order of rectification, appeal or revision requires verification of any issue by way of submission of any document by the assessee or any other person or where an opportunity of being heard is to be provided to the assessee	From the expiry of 9 months from the end of the F.Y. in which order u/s 254 is received by the PCC/CC/PC/CIT or order u/s 263 or 264 is passed by the PC/CIT.

[9]Period for which assessee would be entitled to receive additional interest on refund

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(iv) **Interest on refund payable to deductor [Section 244A(1B)]**: Interest @0.5% for every month or part of a month for the period specified in the following table for each of the cases mentioned in column (1) hereunder –

Case		Period for grant of interest on refund	
		Beginning from	Ending with
(1)		(2)	(3)
Where the refund of any amount becomes due to the deductor in respect of any amount paid to the credit of the Central Government under Chapter XVII-B			
(1)	Where refund arises on account of giving effect to an order u/s 250/254/260/262	Date on which tax is paid	Date of grant of refund
(2)	In any other case	Date on which claim for refund is made in prescribed form	

(v) **Consequence where delay in granting refund is attributable to the assessee or the deductor [Section 244A(2)]** : Where there is a delay in granting refund and the reasons for such delay are attributable to the assessee or the deductor, as the case may be, either wholly or in part, the period of the delay so attributable to the assessee shall be excluded from the period for which interest is payable. In case any question arises as to the period of delay attributable to the assessee, it shall be decided by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

(vi) **Increase or reduction of interest of refund as a result of assessment/ rectification/ appellate/ revisionary order [Section 244A(3)]**

(a) Where as a result of an order under sections 143(3)/144/147/154/155/ 250/254/260/262/263/264, the amount on which interest payable under this section has been increased or reduced, the interest shall be increased or reduced accordingly.

(b) If the interest is reduced, the Assessing Officer has to serve a notice of demand on the assessee in the prescribed form specifying the amount of excess interest paid and require him to pay such amount.

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(c) Such notice of demand shall be deemed to be notice under section 156 and the provisions of the Act shall accordingly apply.

(vii) **Interest under section 244A is income of the P.Y. in which it is allowed**

Interest allowed under section 244A is the income of the previous year in which it is allowed and should be declared in the return of income furnished in the assessment year relevant to the previous year.

(viii) **Payment of interest on refund under section 244A of excess TDS deposited under section 195 [Circular No.11/2016 dated 26.4.2016]**

The procedure for refund of tax deducted at source under section 195 to the person deducting the tax is set out in CBDT *Circular No.7/2007 dated 23.10.2007*. *Circular No.7/2007* states that no interest under section 244A is admissible on refunds to be granted in accordance with the circular or on the refunds already granted in accordance with *Circular No.769* or *Circular No.790 dated 20.4.2000*.

The issue of eligibility for interest on refund of excess TDS to a tax deductor has been a subject matter of controversy and litigation. The Supreme Court of India, in *Tata Chemical Limited, Civil Appeal No. 6301 of 2011 vide order dated 26.02.2014,* held that the refund due and payable to the assessee is debt-owed and payable by the Revenue. The State, having received the money without right and having retained and used it, is bound to make the party good, just as an individual would be under like circumstances. The obligation to refund money received and retained without right implies and carries with it the right to interest."

In view of the above judgment of the Apex Court, it is settled that if a resident deductor is entitled for the refund of tax deposited under section 195, then, it has to be refunded with interest under section 244A from the date of payment of such tax.

(8) Set off of refunds against tax remaining payable or withholding of refund [Section 245]

(i) **Set-off of refunds against any sum payable**: Where a refund becomes due or is found to be due to any person, the Assessing Officer or Commissioner or Principal Commissioner or Chief Commissioner or Principal Chief Commissioner, as the case may be, may, in lieu of payment of the refund, **set-off the amount to be refunded** or any part of that amount, **against the sum**, if any, remaining payable by the person to whom the refund is due, **after giving an intimation in writing** to such person of the action proposed to be taken.

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(ii) **Withholding of refund:** Where a part of the refund is set-off as stated above or where no such amount is set-off, and refund becomes due to a person, and the Assessing Officer, having regard to the fact that **proceedings for assessment or reassessment are pending in the case of such person,** he may, for reasons to be recorded in writing and with the previous approval of the Principal Commissioner or the Commissioner, as the case may be, **withhold the refund up to sixty days from the date on which such assessment or reassessment is made**

13.13 PENAL CONSEQUENCES FOR FAILURE TO DEDUCT OR COLLECT OR PAY TAX AT SOURCE

The following penal consequences would be attracted for failure to deduct or collect or pay tax at source:

Section	Nature of Default	Penalty Leviable/	Rigorous imprisonment	Remarks
271C	Failure to deduct the whole or any part of tax at source as per Chapter XVII-B	A sum equal to the amount of tax which he failed to deduct	-	***Penalty imposable by the Assessing Officer***
276B	Failure to pay to the credit of the Central Government, tax deducted at source under Chapter XVII-B However, if the payment has been made to the credit of the Central Government on or before the time prescribed for filing the statement under section 200(3), no prosecution would be attracted.		3 months to 7 years (**+) fine [See Note below]**	No limit specified with respect to fine

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271C & 276B	Failure to pay or ensure payment of whole or any part thereof in cases where the consideration/benefit/ perquisite, winnings as the case may be, is wholly or partly in kind and the tax deductor has to ensure that tax to be deducted has been paid as required - by the proviso to section 194B [Winnings from lottery or crossword puzzle]; or - the first proviso to section 194R(1) [on benefits and perquisites in respect of business or profession] or - the proviso to section 194S(1) [on transfer of virtual digital assets] or - as per section 194BA(2) [winning from online]	A sum equal to the amount of tax which such person has failed to pay or ensure payment of	3 months to 7 years (**+**) **fine [See Note below]**	***Penalty imposable by the Assessing Officer***
271CA	Failure to collect the whole or any part of the tax as required by or under the provisions of Chapter XVII-BB	A sum equal to the amount of tax which he failed to collect.	-	***Penalty imposable by the Assessing Officer***

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276BB	Failure to pay to the Central Government tax collected under section 206C ***However, w.e.f. 1.4.2025, if the payment has been made to the credit of the Central Government any time on or before the time prescribed for filing the statement under section 206C(3), no prosecution would be attracted.***	-	3 months to 7 years (**+) fine**	No limit specified with respect to fine
278A	Second and subsequent offences under section 276B & 276BB		6 months to 7 years for every subsequent offence (**+) fine**	No limit specified with respect to fine

Section 278AA provides that where a reasonable cause for the failure is proved, punishment shall not be imposed for offences *inter alia* specified in sections 276B and 276BB.

Note - *The CBDT has, vide Circular No. 24/2019 dated 9.9.2019, in the exercise of the powers under section 119, listed out the offences covered under Chapter XXII of the Income-tax Act, 1961 in respect of which prosecution proceedings shall be launched by Approving Authority being the Sanctioning Authority where the quantum of offences exceed the prescribed monetary threshold.*

Accordingly, in case of failure to pay TDS under section 276B or failure to pay TCS u/s 276BB, no prosecution will be processed if the TDS/TCS amount does not exceed ₹ 25 lakhs and the delay in deposit is less than 60 days. However, for these offences, in exceptional cases like habitual defaulters, based on particular facts and circumstances of each case, prosecution may be initiated only with the previous administrative approval of the Collegium of two CCIT/DGIT rank officers, though the amount involved does not exceed the threshold limit of ₹ 25 lakhs. Students may read the detailed circular available at the following link –

https://incometaxindia.gov.in/communications/circular/circular-24-2019-11-09-2019.pdf

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SIGNIFICANT SELECT CASES

S. No.	Case Law	
1.	***ITC Ltd v. CIT (2016) 384 ITR 14 (SC)***	
	Issue	**Analysis & Decision**
	Whether "tips" received by the hotel-company from its customers (who made payment through credit card) and distributed to the employees would fall within the meaning of "Salaries" to attract tax deduction at source u/s 192?	Section 15 applies when an employee has a vested right to claim any salary from an employer or former employer. However, in the case on hand, there is no vested right on the part of the employee to claim any amount of tips from the employer, since tips are purely voluntary amounts that may or may not be paid by customers for services rendered. **The amount of tips paid by the employer to the employees had no reference to the contract of employment at all.** Tips were received by the employer in a fiduciary capacity as trustee for payments that were received from customers, which they disbursed to their employees for service rendered to the customer. There was, therefore, no reference to the contract of employment when these amounts were paid by the employer to the employee. Therefore, **the tips received by the employees could not be regarded as "profits in lieu of salary" in terms of section 17(3).** The payment by the employer of tips collected from the customers to the employees would not be a payment made "by or on behalf of" an employer. Such payments would be outside the purview of section 15(b) of the Act. **The person who paid the tip was the customer and not the employer.** Even though the amounts were with the employer, he had no title to the money, and it was held in a fiduciary capacity as trustee for and on behalf of the employees. Therefore, in such a case, **no liability to deduct tax at source u/s 192 arises**, and hence, the assessee company cannot be treated as an assessee in default for non-deduction of tax at source from the amount of tips collected and distributed to its employees.

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2.	***Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)***	
	Issue	**Analysis & Decision**
	Are landing and parking charges paid by an airline company to Airports Authority of India in the nature of rent to attract tax deduction at source u/s 194-I?	The charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport. Hence, **the charges are not for use of the land *per se* and, therefore, it cannot be treated as "rent" within the meaning of section 194-I.**
3.	***CIT v. Ahmedabad Stamp Vendors Association (2012) 348 ITR 378 (SC)***	
	Issue	**Analysis & Decision**
	Can discount given to stamp vendors on purchase of stamp papers be treated as 'commission or brokerage' to attract the provisions for tax deduction u/s 194H?	Although the Government has imposed a number of restrictions on the licensed stamp vendors regarding the manner of carrying on the business, the stamp vendors are required to purchase the stamp papers on payment of price less discount on "principal to principal" basis and there is no "contract of agency" at any point of time. The definition of "commission or brokerage" under clause (i) of the *Explanation* to section 194H indicates that the payment should be received, directly or indirectly, by a person acting on behalf of another person, *inter alia*, for services in the course of buying or selling goods. Therefore, the element of agency is required in case of all services and transactions contemplated by the definition of "commission or brokerage" under *Explanation (i)* to section 194H. **When the licensed stamp vendors take delivery of stamp papers on payment of full price less discount and they sell such stamp papers to the retail customers, neither of the two activities (namely, buying from the Government and selling to the customers) can be termed as service in the course of buying and selling of goods. The discount on**

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		purchase of stamp papers, therefore, does not fall within the expression "commission or brokerage" to attract the provisions of tax deduction at source u/s 194H.
4.	***CIT v. Kotak Securities Ltd (2016) 383 ITR 1 (SC)***	
	Issue	**Analysis & Decision**
	Would transaction charges paid by the members of the stock exchange for availing fully automated online trading facility, being a facility provided by the stock exchange to all its members, constitute fees for technical services to attract the provisions of tax deduction at source u/s 194J?	The assessee company was engaged in the business of share broking, depositories, mobilisation of deposits and marketing public issues. Being a member of the BSE, it made payment to the Stock Exchange by way of transaction charges in respect of a fully automated online trading facility and other facilities. • The services provided by the stock exchange are available to all members in respect of every transaction that is entered into. There is nothing special, exclusive or customized in the service that is rendered by the stock exchange. • A member who wants to conduct his daily business in the stock exchange has no option but to avail such services. Each and every transaction by a member involves the use of such services provided by the stock exchange for which the member is required to pay transaction charges based on the transaction value besides charges for the membership of the stock exchange. • Technical services like managerial and consultancy service are in the nature of specialised services made available by the service provider to cater to the special needs of the customer-user as may be felt necessary. It is the above feature that would distinguish or identify a service provider from a facility offered. The service provided by the BSE for which transaction charges are paid failed to satisfy the test of specialized, exclusive and individual requirements of the user or the consumer who may approach the service provider for such assistance or service.

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		Therefore, the **transaction charges paid to BSE by its members are not for technical services but are in the nature of payments made for facilities provided by the stock exchange. Such payments would, therefore, not attract the provisions of tax deduction at source u/s 194J.**
5.	***UCO Bank v. Dy. CIT (2014) 369 ITR 335 (Del)***	
	Issue	**Analysis & Decision**
	Is section 194A applicable in respect of interest on fixed deposits in the name of Registrar General of High Court?	The expression "payee" u/s 194A would mean the recipient of income whose account is maintained by the person paying interest. **The Registrar General is neither recipient of the amount credited to his account nor to interest accruing thereon. Therefore, he cannot be considered as a 'payee' for the purposes of section 194A.** In the absence of a payee, the machinery provisions for deduction of tax to his credit are ineffective. **The credit by the bank in the name of the Registrar General would, thus, not attract the provisions of section 194A.** ***Note*** *- The CBDT has accepted the aforesaid judgment and accordingly, vide Circular No.23/2015 dated 28.12.2015, clarified that interest on FD₹ made in the name of Registrar General of the Court or the depositor of the fund on the directions of the Court, will not be subject to TDS till the matter is decided by the Court. However, once the Court decides the ownership of the money lying in the fixed deposit, the provisions of section 194A will apply to the recipient of the income.*
6.	***Indus Towers Ltd v. CIT (2014) 364 ITR 114 (Del)***	
	Issue	**Analysis & Decision**
	Is payment made for the use of passive infrastructure facility such as mobile towers be subject to tax deduction u/s 194C or 194-I?	The assessee owned a network of telecom towers and infrastructure services which were let out to major telecom operators in the country. The infrastructure was given for the use of mobile operators. The towers were the neutral platform, and without them, the mobile operators could not operate. Each mobile operator has to carry out this activity, by necessarily renting premises and installing the same equipment. **The dominant**

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		intention was the use of equipment or plant or machinery i.e., the passive infrastructure, and the use of premises was only incidental. Hence, tax has to be deducted@2% as per section 194-I(a), the rate applicable for payment made for use of plant and machinery.
7.	***CIT v. Senior Manager, SBI (2012) 206 Taxman 607 (All.)***	
	Issue	**Analysis & Decision**
	In respect of a co-owned property, would the threshold limit mentioned in section 194-I for non-deduction of tax at source apply for each co-owner separately or is it to be considered for the complete amount of rent paid to attract liability to deduct tax at source?	Since the share of each co-owner is definite and ascertainable, they cannot be assessed as an association of persons as per section 26. The income from such property is to be assessed in the individual hands of the co-owners. Therefore, it is not necessary that there should be a physical division of the property by metes and bounds to attract the provisions of section 26. In this case, since the payment of rent is made to each co-owner by way of separate cheque and their share is definite, the threshold limit mentioned in section 194-I has to be seen separately for each co-owner.
8.	***CIT (TDS) v. Shree Mahalaxmi Transport Co. (2011) 339 ITR 484 (Guj.)***	
	Issue	**Analysis & Decision**
	Can the payment made by an assessee engaged in transportation of building material and transportation of goods to contractors for hiring dumpers, be treated as rent for machinery or equipment to attract provisions of tax deduction at source u/s 194-I?	Since the assessee had given contracts to the parties for the transportation of goods and not for renting out machinery and equipment, such payments could not be termed as rent paid for the use of machinery. The provisions of section 194-I would, therefore, not be applicable. **The transactions being in the nature of contracts for the shifting of goods from one place to another, would be covered under works contracts, thereby attracting the provisions of section 194C.**
9.	***CIT v. V.S. Dempo & Co P Ltd (2016) 381 ITR 303 (Bom) (FB)***	
	Issue	**Analysis & Decision**
	Is tax is required to be deducted u/s 195 on the	Since section 172, dealing with the shipping business of non-residents contains a non-obstante clause and

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	demurrage charges paid to a foreign shipping company which is governed by section 172 for the purpose of levy and recovery of tax?	applies both for the purpose of the levy and recovery of tax in the case of any ship carrying passengers etc., belonging to or chartered by a non-resident and shipping at a port in India, **there would be no obligation on the payer-assessee to deduct the tax at source u/s 195 on payment of demurrage charges to the non-resident shipping company**.
10.	***Sun Outsourcing Solutions Private Limited v. CIT (Appeals) (2018) 407 ITR 480 (T&AP)***	
	Issue	**Analysis & Decision**
	Is interest u/s 201(1A) attracted even in a case where non-deduction of tax at source was under a *bona fide* belief that tax was not deductible and the default was not wilful?	The assessee is a private limited company engaged in the business of software development with its office in Hyderabad and branch office in London. In the course of executing software projects in the U.K., the assessee had deputed some employees from Hyderabad to London. The assessee did not deduct tax at source on the allowances paid to the staff deputed to the U. K. **Since the company had failed to deduct tax on the payments made to its employees, being Indian residents deputed to work in the U.K., section 201(1A) is automatically attracted; even if such non-deduction was due to the *bona fide* belief that tax is not deductible in such case, the company is, nevertheless, liable to pay interest u/s 201(1A).**
11.	***Director, Prasar Bharati v. CIT [2018] 403 ITR 161 (SC)***	
	Issue	**Analysis & Decision**
	Are the provisions of tax deduction at source under section 194H attracted in respect of amount retained by accredited advertising agencies out of remittance of sale proceeds of "airtime" purchased from Doordarshan and sold to customers?	The assessee, Prasar Bharati Doordarshan Kendra, functions under the Ministry of Information and Broadcasting, Government of India and runs the television channel called Doordarshan. For the purpose of telecasting advertisements of consumer companies on its channel, the assessee entered into agreements with advertising agencies, on the basis of the application made by such agencies to the assessee for gaining "accredited status". The agencies were to give a minimum annual business of ₹ 6 lakhs to the assessee in a financial year and furnish a bank guarantee for a sum of ₹ 3 lakhs. The agreement provided that the

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		accredited agencies would retain 15% by way of commission out of the amount collected from customers and paid to the assessee. The agencies were to retain the commission earned and not to part with the same either directly or indirectly to any other person. In the relevant assessment years, the agencies retained ₹ 4.87 crores towards commission as per the terms of the agreement. The definition of "commission or brokerage" under section 194H is inclusive and covers any payment received or receivable directly or indirectly by a person acting on behalf of another person for the services rendered. The agreement itself uses the expression "commission" in all relevant clauses. The payment clause is free of ambiguity and the terms of the agreement indicate that both parties intended that the amount to be paid/retained is in the nature of commission. It is for this reason that the parties used the expression "commission" in the agreement. The relationship in question was a pure agency arrangement because the agency acted on behalf of the assessee and the actions of the agency were binding on the assessee. Moreover, the agreement itself contained a clause for deduction of tax at source on trade discount. Thus, the amount retained by the accredited advertising agencies is commission and consequently, the provisions of tax deduction at source under Section 194H are attracted. Consequently, for failure to deduct tax at source under section 194H, the assessee would be treated as an assessee-in-default. ***Note*** *- It may be noted that the CBDT has, vide Circular No.5/2016 dated 29.2.2016, clarified that TDS under section 194H is not attracted on retentions by an advertising agency (for booking or procuring of or canvassing for advertisements) from payments remitted to television channels/newspaper companies. The CBDT has issued this clarification on the basis of the Allahabad High Court ruling in Jagran Prakashan Ltd.'s case and Delhi High Court ruling in Living Media Ltd.'s case that the relationship between the media company*

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		and advertising agency is that of a "principal to principal". However, the Supreme Court, in this case, has distinguished from the Allahabad High Court ruling, on the basis of the fact that an agreement has been entered into by Doordarshan with the accredited agencies specifically appointing them as agents; and the agreement also contains a specific clause for deduction of tax at source on trade discount, which is in the nature of commission. Accordingly, the Supreme Court held that the relationship between Doordarshan and its accredited agencies is that of a principal and agent, consequent to which TDS provisions under section 194H would get attracted in respect of retentions by accredited advertising agencies from payments remitted to Doordarshan. Therefore, the applicability or otherwise of the CBDT Circular will depend on the facts of the specific case.
12.	***Bharti Cellular Ltd. vs. ACIT [2024] 462 ITR 247 (SC)***	
	Issue	**Relevant provision of law, analysis and decision**
	Are cellular mobile telephone service providers required to deduct tax at source under section 194H on the difference between the discounted price at which it sold start-up kits and recharge vouchers to franchisees or distributors and the sale price at which these products were subsequently sold by the franchisees or distributors?	**Analysis and Decision:** The obligation to deduct tax at source in terms of section 194H arises when the legal relationship of principal and agent is established. Agency is a triangular relationship between the principal, agent and the third party. To decide whether a contracting party acts for himself as an independent contractor (and not as an agent), it needs to be examined whether in the course of work, he intends to make profits for himself, or is entitled to receive pre-arranged remuneration. If the party is concerned about acting for himself and making the maximum profits possible, he is usually regarded as a buyer, or an independent contractor and not as an agent of the principal. The legal position of a distributor is generally regarded as different from that of an agent. The distributor buys goods on his account and sells them in his territory. The profit made is the margin of difference between the purchase price and the sale price. Unlike an agent, he does not act as a communicator or creator of a

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		relationship between the principal and a third party. Based on perusal of agreement between assessee and distributors / franchisee, the franchisee/distributor paid the discounted price regardless of, and even before, the pre-paid products being sold and transferred to the retailers or the actual consumer. The franchisee/distributor was free to sell the prepaid products at any price below the price printed on the pack. The franchisee/distributor determined his profits/ income. Section 194H fixes the liability to deduct tax at source on the 'person responsible to pay' and the liability to deduct tax at source arises when the income is credited or paid by the person responsible for paying. The expression "direct or indirect" used in Explanation (i) to section 194H is meant to ensure that "the person responsible for paying" does not dodge the obligation to deduct tax at source, even when the payment is indirectly made by the principal-payer to the agent-payee. However, deduction of tax at source in terms of section 194H is not to be extended and widened in ambit to apply to true/genuine business transactions, where the assessee is not the person responsible for paying or crediting income. In the present case, the assessee neither pays nor credit any income to the person with whom he has contracted. The assessee is not privy to the transactions between distributors/franchisees and third parties. It is, therefore, impossible for the assessee to deduct tax at source and comply with section 194H, on the difference between the total/sum consideration received by the distributors/franchisees from third parties and the amount paid by the distributors/ franchisees to them. Accordingly, the Apex Court held that the contractual obligations of the franchises or distributors did not reflect a fiduciary character of the relationship, or the business being done on the Principal's account. Hence, section 194H is not applicable to the facts and circumstances of this case and the assessee would not be under a legal obligation to deduct tax at source on the income/profit

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		component in the payments received by the distributors/ franchisees from the third parties/customers, or while selling/transferring the pre-paid coupons or starter-kits to the distributors.
13.	***DIT (International Taxation) v. Wizcraft International Entertainment (P) Ltd (2014) 364 ITR 227 (Bom)***	
	Issue	**Analysis & Decision**
	Is payment made to an overseas agent, who did not perform any service in India, liable for tax deduction at source?	The assessee, an event management company, engaged the services of an agent to bring artistes to India. The assessee-company paid commission to overseas agent. The assessee-company did not deduct tax at source on the commission paid to the agent. With regard to the payment of commission, the agent did not act as a performing artist or entertainer. He was concerned only with the services rendered outside India. Thus, the income of the agent did not arise from the personal activities in the contracting state of an entertainer or artist. He only contacted the artists and negotiated with them for performance in India in terms of the authority given by the assessee. Hence, the commission paid to the overseas agent was not liable to tax in India. Consequently, there was no obligation for deducting tax at source at the time of making payment to the overseas agent.
14.	***BDR Finvest Pvt. Ltd. v. DCIT [2024] 462 ITR 141 (Delhi)***	
	Issue	**Facts, Relevant provision of law, analysis and decision**
	Is the deductee entitled to claim credit for tax deducted at source (TDS) if the amount of TDS is not reflected in Form 26AS because the deductor has not deposited it with the Government?	The assessee received interest income from "Ninex" (Deductor). In the return of income filed for the relevant year, the assessee offered the entire interest income and claimed the credit for tax deducted at source (TDS) by the said deductor. TDS credit was not allowed by the department, pursuant to intimation issued u/s 143(1) and application filed under section 154 was also rejected for the reason that TDS credit is not reflected in Form 26AS and

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		consequently, the said tax was recovered from the assessee itself. The High Court referring the Delhi High Court ruling in case of *Sanjay Sudan v. Asst. CIT [2023] 452 ITR 107* emphasized that deduction of taxes at source is one of the methods of collecting tax. The tax deducted at source is part of the assessee's income and therefore, the gross amount is included in the total income and offered to tax. It is on this premise that the tax deducted at source would have to be treated as tax paid on behalf of the assessee. Section 205 provides for restriction against direct demand on assessee to the extent to which tax has been deducted from that income. Thus, no recovery of TDS can be made from the deductee. The amount retained against remittance made by the payer is nothing but tax which the assessee/deductee has offered for tax by grossing up the remittance. If credit is not given, the Department would end up doing indirectly what they cannot do directly i.e., that recover tax directly from the deductee. Accordingly, the High Court held that section 199 cannot come in the way of the deductee in case deductor failed to deposit the TDS. Therefore, the deductee should be given credit for TDS though it was not reflected in form 26AS and no recovery towards TDS could be made from the assessee in terms of the provisions of section 205. The assessee had followed the regime put in place in the Act for collecting tax albeit, through an agent (deductor) of the Government. The recovery proceedings could only be initiated against the deductor as the deductor, an agent for collecting tax had failed to deposit the tax with the Government.
15.	***CIT (International Taxation) v. Air India Ltd. [2023] 456 ITR 139 (SC)***	
	Issue	**Facts, Analysis and Decision**
	Can the provisions of section 206AA, which prescribe a higher rate of	**Facts of the case:** Assessee had taken an engine on lease under an agreement with a foreign company (lessor), a tax resident of the Netherlands, having no

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	tax deduction at source in case of non-furnishing of PAN, override the Double Taxation Avoidance Agreement (DTAA) that specify a lower rate of tax?	permanent establishment (PE) in India. The foreign company also does not have PAN in India. The assessee company deducted tax at source @ 10% on lease rental as per provisions contained under DTAA between India and the Netherlands. However, revenue contended that in the absence of furnishing of PAN, the assessee was under an obligation to deduct tax at a higher rate of 20% following the provisions of section 206AA. **Analysis and Decision:** The High Court noted that section 90(2) provides that the provisions of the DTAAs would override the provisions of the Act in cases where the provisions of DTAAs are more beneficial to the assessee. Even the charging sections 4 and 5 of the Act, which deal with the principle of ascertainment of total income under the Act, are also subordinate to the principle enshrined in section 90(2). Thus, in so far as the applicability of the scope/rate of taxation with respect to the impugned payments made to the non-residents is concerned, no fault can be found with the rate of taxation invoked by the assessee based on the DTAAs, which prescribe a beneficial rate of taxation. The provisions of tax withholding, i.e., section 195 of the Act, would apply only to sums that are otherwise chargeable to tax under the Act. The provisions of DTAAs, along with sections 4, 5, 9, 90 & 91 of the Act, are relevant while applying the provisions of tax deduction at source. Therefore, section 206AA of the Act cannot be understood to override charging sections 4 and 5 of the Act. Accordingly, the High Court upheld the Tribunal's ruling which held that where the tax has been deducted on the strength of the beneficial provisions of DTAAs, the provisions of section 206AA cannot be invoked to insist on the tax deduction @ 20%, having regard to the overriding nature of the provisions of section 90(2). The Supreme Court upheld the decision of the High Court, resulting in the dismissal of the SLP filed by the Revenue.

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16.	***CIT v. Priya Blue Industries (P) Ltd (2016) 381 ITR 210 (Guj)***	
	Issue	**Analysis & Decision**
	Can items of finished products from ship breaking activity which are usable as such be treated as "Scrap" to attract provisions for tax collection at source under section 206C?	The assessee-company, engaged in ship breaking activity, sold old and used plates, wood etc. The assessee did not collect tax at source on the sale of certain items, viz. old and used plates; non-excisable (exempted) goods like wood etc. The products obtained from the ship breaking activity were finished products which constituted a sizable chunk of production done by the ship breakers. Such products though commercially known as 'scrap' were definitely not "waste and scrap". For the purpose of collection of tax at source u/s 206C, the 'waste and scrap' must be from manufacture or mechanical working of material which is *definitely not usable as such because of breakage, cutting up, wear and other reasons.* However, in this case, these items were usable as such and, therefore, do not fall within the definition of "scrap" as given in clause (b) of *Explanation* to section 206C(1).
17.	***Pioneer Overseas Corporation USA (India Branch) v. CIT (International Taxation) (2022) 449 ITR 186 (SC)***	
	Issue	**Analysis & Decision**
	Is pendency of dispute resolution under MAP a valid ground for a waiver of interest under section 220(2A)?	**Relevant provision of law**: Section 220(2) provides for levy of simple interest@1% for every month or part of a month comprised in the period commencing from the day immediately following the 30 days period specified in section 220(1) (from service of notice of demand under section 156) and ending on the day on which the amount is paid. Section 220(2A) provides for reduction or waiver of interest payable under section 220(2), if the PCC/CC/PC/Commissioner is satisfied that payment of such amount has caused or would cause genuine hardship to the assessee, default in payment of amount specified in notice of demand was due to circumstances beyond the control of the assessee and the assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

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		Facts of the case: The assessee applied for waiver of interest under section 220(2A) on the ground that the dispute was pending for resolution under the mutual agreement procedure under the Double Taxation Avoidance Agreement between India and the United States of America, which subsequently culminated in the year 2012 and the liability to pay the tax arose thereafter. The Commissioner, however, rejected the assessee's application. The same was confirmed by the High Court. **Decision:** The Supreme Court observed that merely raising the dispute before any authority cannot be a ground not to levy the interest and/or waiver of interest under section 220(2A). Otherwise, each and every assessee may raise a dispute and thereafter, may contend that since the litigation was *bona fide*, no interest is leviable. It is required to be noted that under section 220(2), the levy of simple interest on non-payment of the tax at 1 per cent. per annum is, as such, mandatory. **Note** – It may be noted that under section 220(2A), the Commissioner may reduce or waive the interest payable by an assessee on the ground of genuine hardship. In this case, the assessee is a part of a global conglomerate which had in the earlier year $ 37.96 billion in net sales and $ 6.253 billion as operating profit, cannot be an irrelevant factor in considering whether any 'genuine hardship' was undergone by the petitioner. Further, in comparison to the profitability of the petitioner over the years, the amount paid by it towards interest under section 220(2) was merely $ 0.004 billion (approx.). In the circumstances, the Commissioner of Income-tax concluded that no 'genuine hardship' can be said to have been caused to the petitioner on account of payment of interest.
18.	***Singapore Airlines Ltd/ KLM Royal Dutch Airlines v. CIT/ British Airways Plc v. CIT(TDS) [2022] 49 ITR 203 (SC)***	
	Issue	**Analysis & Decision**
	Would the additional income (supplementary commission) earned by a travel agent over and above the minimum fare fixed by the airlines be also	**Facts of the case:** Within the aviation industry, the base fare for air tickets was set by the International Air Transport Association (IATA) with discretion provided to airlines to sell their tickets for a net fare lower than the base fare, but not higher. The air carriers were also required to provide a

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	subjected to tax deduction at source under section 194H besides the standard commission on base fare?	fare list to the Director General of Civil Aviation (DGCA) for approval. The prices that were rubber stamped by the DGCA may be equivalent to or lower than the base fare set by the IATA. • Simultaneously, the IATA would provide blank tickets to the travel agents acting on behalf of the airlines to market and sell the travel tickets. The arrangement between the airlines and the travel agents would be governed by Passenger Sales Agency Agreements ("PSA"). The PSA set the conditions under which the travel agents carry out the aforementioned sale of flight tickets, along with other ancillary services, and the remuneration they are entitled to for these activities. • Once these tickets were sold, a fixed per cent commission designated by the IATA would, be paid to the travel agent for its services as "standard commission" based on base fare set by the IATA. This would be independent of the net fare quoted by the air carriers themselves. The standard commission is subjected to TDS under section 194H. The details of the amounts at which the tickets were sold would be transmitted by the travel agents to an organization known as the Billing and Settlement Plan ("BSP"), which functions under the aegis of the IATA. The BSP stores a plethora of financial information, including the net amount payable to the aviation companies, discounts, and commission payable to the agents. • Within this framework, the airlines would have no control over the actual fare at which the travel agents would sell the tickets. The additional amount that the travel agents charged over and above the net fare that was quoted by the airline would be retained by the agent as its own income. This auxiliary amount charged on top of the net fare was portrayed on the BSP as a "supplementary commission" in the hands of the travel agent. The airline companies had failed to deduct tax at source on the supplementary commission amounts earned by the travel agent. They were declared “assessee-in-default” under

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		section 201 and subject to payment of interest under section 201(1A). Penalty proceedings were directed to be initiated against the airlines under section 271C. • **Relevant provision of the Income-tax Act, 1961:** *Explanation* (i) to section 194H defines the expression 'commission or brokerage'. It is an inclusive definition and includes therein any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to assets, valuable article or thing, not being securities. • **Analysis and Conclusion:** • Section 194H does not distinguish between direct and indirect payments. Both fall within the meaning of "commission" under clause (i) of the *Explanation* thereto. Therefore, if the ambit of section 194H is viewed in an expansive manner, TDS would be attracted even on an indirect payment stemming from the consumer. • Section 194H is to be read with section 182 of the Contract Act, 1872. If a relationship between two parties as culled out from their intentions as manifested in the terms of the contract between them indicates the existence of a principal-agent relationship as defined under section 182 of the Contract Act, the definition of "commission" under section 194H stands attracted, and the requirement to deduct tax at source arises. • The Apex Court noted that the tickets remained the property of the airline. There was no transfer in terms of the title in the tickets, and they remained the property of the airline company throughout the transaction. Every action taken by the travel agents is on behalf of the air carriers and the services they provide is with express prior authorization. The terms of the PSA also indicated that the actions of the agents in procuring customers were done on behalf of the airlines and not independently.

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		• Accordingly, the Apex Court concluded that the contract is one of agency that does not distinguish in terms of stages of the transaction involved in selling flight tickets. The fact that the travel agent had discretion to set an actual fare above the net fare had no effect on the nature of the relationship between the parties. The accretion of the supplementary commission to the travel agents was an accessory to the actual principal-agent relationship under the PSA agreement. • Apart from this, the PSA agreement set out that any payments collected by an agent pursuant to sale of air transportation and ancillary services were held in a fiduciary capacity for the carrier until a proper accounting was made. Notwithstanding the lack of control over the actual fare, the contract definitively stated that "all monies" received by the agent were held as the property of the air carrier until they were recorded on the billing and settlement plan and properly gauged. The billing and settlement plan demarcated "supplementary commission" under a separate heading. • Hence, once the IATA made the payment of the accumulated amounts shown on the billing and settlement plan, it would be feasible for the assessees, being the airlines to deduct tax at source on this additional income earned by the agent. • Further, as regards penalty under section 271C, the Apex Court stated that there were contradictory pronouncements by different High Courts, which clearly highlighted the genuine and bona fide legal conundrum that was raised by the prospect of section 194H being applied to the supplementary commission. Hence, there was clearly an arguable and "nascent" legal issue that required resolution by the Supreme Court. Thus, there was "reasonable cause" for the air carriers not to have deducted tax at source at the relevant period. Thus, penalty proceedings against the airlines under section 271C were to be quashed. • As regards applicability of interest u/s 201(1A), if the recipient of income on which tax has not been deducted at source, even though it was liable to

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such deduction as per the provisions of the Income-tax Act, 1961, has already included that amount in its income and paid taxes on the same, the assessee can no longer be proceeded against for recovery of the short fall in TDS. However, it would be open to the Revenue to seek payment of interest u/s 201(1A) for the period between the date of default in deduction of tax at source and the date on which the recipient actually paid income-tax on the amount for which there had been a shortfall in such deduction.

- ***Notes –*** *An illustration showing how additional income arises in the hands of travel agent is given hereunder -*

Base fare for Wingfly Airline, Delhi (Set by the IATA)	***Net fare (Set by the airline)***	***Actual fare (Set by the travel agent)***	***Standard commission (7% of the base fare)***	***Supplement-ary commission (Actual fare – net fare)***
₹1 lakh	*₹,000*	*₹0,000*	*7% of ₹1 lakh = ₹7,000*	*₹ 80,000 (-) 60,000 = ₹20,000*
Seiling price	*Income of the assessee (Airline)*	*₹ 20,000 left after payment of net fare to the assessee*	*Income of the travel agent*	*Additional Income of the travel agent*
Applying the rationale of the Apex Court in the above case, TDS u/s 194H is required to be deducted both on the standard commission of ₹ 7,000 and on the supplementary commission of ₹ 20,000.				

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TEST YOUR KNOWLEDGE

QUESTIONS

1. *Mr. Madhusudan is regular in deducting tax at source and depositing the same. In respect of the quarter ended 31st December, 2025, a sum of ₹ 80,000 was deducted at source from the contractors. The statement of tax deducted at source under section 200 was filed on 23rd March, 2026 for the quarter ended 31.12.2025.*

   (i) Is there any delay on the part of Mr. Madhusudan in filing the statement of TDS?

   (ii) If the answer to (i) above is in the affirmative, how much amount can be levied on Mr. Madhusudan for such default under section 234E?

   (iii) Is there any remedy available to him for reduction/waiver of the levy?

2. *Smt. Vijaya, proprietor of Lakshmi Enterprises, made a turnover of ₹ 210 lakhs during the previous year 2024-25. Her turnover for the year ended 31.3.2026 was ₹ 90 lakhs.*

   Decide whether provisions relating to deduction of tax at source are attracted for the following payments made during the financial year 2025-26:

   (i) Purchase commission paid to one agent ₹ 25,000 on 13.6.2025 towards purchases made during the year.

   (ii) Payments to a Civil engineer of ₹ 5,00,000 on 23rd August, 2025 for construction of a residential house for self-use.

3. *What is the rate at which the tax is either to be deducted or collected under the provisions of the Act in the following cases?*

   (i) A partnership firm making sales of timber in September 2025, which was procured and obtained under a forest lease.

   (ii) A nationalized bank receiving professional services from a registered society made provision on 31-03-2026 of an amount of ₹ 25 lakh against the service charges bills to be received.

4. *Examine the liability for tax deduction at source in the following cases for the A.Y.2026-27:*

   (i) Wings Ltd. has paid amount of ₹ 15 lakhs during the year ended 31-3-2026 to Airports Authority of India towards landing and parking charges.

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(ii) *₹ 4,45,000 paid to Mr. X on 01-02-2026 by Karnataka State Government on compulsory acquisition of his urban land. What would be your answer if the land is agricultural land?*

5. *"Come Air Ltd." has paid a sum of ₹ 12 lakhs during the year ended 31-3-2026 to the Airports Authority of India towards landing and parking charges. The company has deducted tax at source @2% under section 194C on the said payment and remitted the tax deducted within the prescribed time. The Assessing Officer contended that landing and parking charges were levied for use of the land of the airport and hence, the payment was in the nature of rent attracting TDS @10% under section 194-I. Discuss the correctness or otherwise of the contention of the Assessing Officer.*

6. *Mr. Harish, Vice President of ABC Bank, sold his house property in Chennai as well as his rural agricultural land for a consideration of ₹ 60 lakh and ₹ 15 lakh, respectively, to Mr. Suresh, a retail trader of garments, on 10.10.2025. Mr. Harish had purchased the house property and rural agricultural land in December 2023 for ₹ 40 lakh and ₹ 10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 10.10.2025, is ₹ 85 lakh and ₹ 20 lakh for the house property and rural agricultural land, respectively.*

   (a) *Determine the capital gain tax implications in the hands of Mr. Harish and Mr. Suresh, if the date of agreement for sale of house property and rural agricultural land is 1.7.2025 and the stamp duty value on the said date was ₹ 75 lakh and ₹ 15 lakh, respectively. On the said date, Mr. Suresh made payment of ₹ 5 lakh by way of an account payee cheque to Mr. Harish for purchase of house property.*

   (b) *Would your answer be different if Mr. Harish is a property dealer and sold the house property in the course of his business?*

7. *Siddharth Hospitals Pvt. Ltd. has recently been accorded recognition by several insurance companies to admit and treat patients on cashless hospitalization basis. Payment to the assessee hospital will be made by Third Party Administrators (TPA) who will process the claims of the patients admitted and make payments to the various hospitals, including the assessee. All TPAs are corporate entities. The assessee wants to know whether the TPAs are bound to deduct tax at source under section 194J or under section 194C. Examine.*

8. *Examine in the context of provisions contained in Chapter XVII-B of the Act and also work out the amount of tax to be deducted by the payer of income in the following cases:*

   (i) *Payment of ₹ 5 lakh made by JCP & Co. to Pingu Events Co. Ltd. on 4th September, 2025 for organizing a debate competition on the subject "Preservation of Rural Heritage of Rajasthan".*

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(ii) *KD, a part-time director of DAF Pvt. Ltd., was paid an amount of ₹ 2,25,000 as fees which was actually in the nature of commission on sales for the period 1.7.2025 to 30.9.2025.*

9. *Examine the applicability of the provisions relating to deduction of tax at source in the following transactions:*

(i) *Max Limited pays ₹ 1,02,000 to Mini Limited, a resident contractor who, under the contract dated 15th October, 2025, manufactures a product according to the specification of Max Limited by using materials purchased from Max Limited.*

(ii) *A company operating a television channel makes payment of ₹ 5 lakh to a former Indian cricketer on 10th March, 2026 for making running commentary of a one-day cricket match.*

10. *Examine in the following cases, the obligation of the person paying the income in respect of tax deduction at source:*

(i) *MNO Ltd., the employer, credited salary due for the month of March 2026 amounting to ₹ 15,40,000 to the account of Q, an employee, in its books of account on 31.3.2025. Q has not intimated his intended tax regime.*

(ii) *T, an individual whose total sales in business during the year ended 31.3.2025 was ₹ 2.20 crores, paid ₹ 9 lakh by cheque on 1.1.2026 to a contractor (an individual), for construction of his factory building. No amount was credited earlier to the account of the contractor in the books of T.*

(iii) *BCD Ltd. credited ₹ 28,000 towards fees for professional services and ₹ 27,000 towards fees for technical services to the account of HG in its books of account on 6.10.2025. The total sum of ₹ 55,000 was paid by cheque to HG on 18.12.2025.*

11. *Examine the liability for tax deduction at source in the following cases for the assessment year 2026-27:*

(i) *Mr. Anand has been running a sole proprietary business with turnover of ₹ 202 lakhs for the F.Y.2024-25. He pays a monthly rent of ₹ 15,000 for the office premises to Mr. R, the owner of building and an individual.*

(ii) *By virtue of an agreement with a nationalised bank, a catering organisation receives a sum of ₹ 50,000 per month towards supply of food, water, snacks, etc., during office hours to the employees of the bank.*

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(iii) *An Indian company pays gross salary, including allowances and monetary perquisites amounting to ₹ 12,30,000 to its General Manager (aged 45 years). Besides, the company provides non-monetary perquisites to him, whose value is estimated at ₹ 1,20,000. The general manager has not given any declaration regarding opting out of section 115BAC.*

12. *The following issues arise in connection with the deduction of tax at source under Chapter XVII-B. Examine the liability for tax deduction in these cases:*

(a) *An employee of the Central Government receives arrears of salary for the earlier 3 years. He enquires whether he is liable for deduction of tax on the entire amount during the current year.*

(b) *₹ 10 lakh is payable by a T.V. Channel on 1.9.2025 as prize money to the winner of a quiz programme, "Who will be a Millionaire".*

(c) *State Bank of India pays ₹ 55,000 per month as rent to the Central Government for a building in which one of its branches is situated.*

(d) *₹ 80,000 is payable by a television company to a cameraman on 6th January, 2026 for shooting of a documentary film.*

(e) *₹ 22,000 is payable by the Maharashtra State Government on 2.7.2025 as commission to one of its agents on the sale of lottery tickets.*

(f) *A Turf Club awards a jackpot of ₹ 5 lakh to the winner of one of its races on 1.2.2026.*

13. *Examine and compute the liability for deduction of tax at source, if any, in the cases stated hereunder, for the financial year ended 31st March, 2026:*

(i) *On 20.6.2025, Mr. X, a resident, made three separate transactions for acquiring house property at Mumbai from Mr. Y for a consideration of ₹ 90 lakhs, an urban plot in Kolkata from Mr. C for a sum of ₹ 49,50,000 and rural agricultural land from Mr. D for a consideration of ₹ 60 lakhs. Stamp duty value of house property, plot and rural agricultural land is ₹ 95 lakhs, ₹ 48 lakhs and ₹ 65 lakhs, respectively.*

(ii) *On 17.6.2025, a commission of ₹ 50,000 was retained by the consignee 'ABC Packaging Ltd.' and not remitted to the consignor 'XYZ Developers', while remitting the sale consideration. Examine the obligation of the consignor to deduct tax at source.*

(iii) *Raj (aged 35 years) is working with AB Ltd. He is entitled to a salary of ₹ 85,000 per month w.e.f. 1.4.2025. He has a house property which is self-occupied. He paid an*

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interest of ₹ 1,95,000 on loan during the previous year 2025-26. The loan was taken for construction of house. He has notified his employer AB Ltd. that there will be a loss of ₹ 1,95,000 in respect of this house property for financial year ended 31.3.2026. Raj declared that he has exercised option to shift out of default regime of section 115BAC.

14. *"Tax Recovery Officer, can recover the arrear demands from the assessee in default out of sale proceeds of the property attached after making a proclamation". How can such a proclamation be made under the Act? Is there any time limit for sale of the attached immovable property? Discuss.*

ANSWERS

1. **(i)** Yes, there has been a delay on the part of Mr. Madhusudan in filing the statement of TDS.

As per section 200(3) read with Rule 31A, the statement of tax deducted at source for the quarter ended 31st December, 2025 has to be filed on or before 31st January, 2026. However, the same was filed only on 23rd March, 2026. Hence, there has been a delay of 51 days on the part of Mr. Madhusudan in filing the statement of TDS.

(ii) As per section 234E of the Income-tax Act, 1961, where a person fails to file deliver or cause to be delivered the statement of tax deducted at source within the prescribed time, then, he shall be liable to pay, by way of fee, a sum of ₹ 200 for every day during which the failure continues.

The amount of fee shall not, however, exceed the amount of tax deductible.

In this case, since Mr. Madhusudhan has delayed filing the statement of TDS by 51 days, he would be liable to pay a fee of ₹ 10,200 (₹ 200 x 51 days) under section 234E. The said fee does not exceed the tax deductible (₹ 80,000, in this case).

(iii) Under section 119, the CBDT is empowered to issue general or special orders, whether by way of relaxation of any of the provisions of sections 139, 143, 144, 147, etc., or otherwise, in respect of any class of incomes or class of cases. The CBDT may issue such order(s) from time to time, if it considers it expedient to do so, for the purpose of proper and efficient management of the work of assessment and collection of revenue. Section 234E is included in the list of sections in respect of which the CBDT is empowered to issue order for relaxation of the provisions of the Act.

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Hence, the remedy available to Mr. Madhusudhan is that he can file an application to the CBDT under section 119 and seek a waiver/reduction of the penalty levied/leviable under section 234E.

2. Since Smt. Vijaya's turnover from business was ₹ 210 lakhs in the immediately preceding financial year (i.e., F.Y. 2024-25), she is liable to deduct tax at source in the P.Y.2025-26, irrespective of her turnover being only ₹ 90 lakhs in the F.Y.2025-26.

(i) Tax @2% has to be deducted under section 194H in respect of purchase commission of ₹ 25,000 to an agent for purchases made during the year, since the same exceeds the threshold limit of ₹ 20,000 for non-deduction of tax at source thereunder.

(ii) Tax has to be deducted under section 194C in case of payment to resident contractors. The rate of tax is 1% if the payee is an individual or HUF and 2% in case of payees, other than individuals and HUFs.

However, as per section 194C(4), no individual or HUF shall be liable to deduct income tax on the sum credited or paid to the account of the contractor where such sum is credited or paid exclusively for personal purposes of such individual or any member of the HUF. In such case, the provisions of section 194M would be attracted if the aggregate payment to the contractor exceeds ₹ 50 lakhs.

In this case, since Smt. Vijaya, an individual, makes payment of ₹ 5 lakh to a civil engineer for the construction of residential house for self-use, she is not liable to deduct tax at source either under section 194C or under section 194M from such sum.

3. **(i)** As per section 206C(1), tax has to be collected at source@2% by the partnership firm, being a seller, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount, whichever is earlier.

(ii) Tax has to be deducted at source@10% under section 194J, by the nationalized bank at the time of credit of fees for professional services to the account of the registered society (i.e., on 31.3.2026), even though payment is to be made after that date.

4. **(i)** **TDS on landing and parking charges:** The landing and parking charges which are fixed by the Airports Authority of India are not merely for the "use of the land". These charges are also for services and facilities offered in connection with the aircraft operation at the airport, which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport *[Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)]*. Thus, tax is **not**

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deductible under section 194-I, which provides deduction of tax for payment in the nature of rent.

Hence, tax is deductible @2% under section 194C by the airline company, Wings Ltd., on payment of ₹ 15 lakhs made towards landing and parking charges to the Airports Authority of India for the previous year 2025-26.

(ii) **TDS on compensation for compulsory acquisition:** Tax is deductible at source @2% under section 194LA, where payment is made to a resident as compensation or enhanced compensation on compulsory acquisition of any immovable property (other than agricultural land).

However, no tax deduction is required if the aggregate payments in a year do not exceed ₹ 5,00,000.

Therefore, no tax is required to be deducted at source on payment of ₹ 4,45,000 to Mr. X, since the aggregate payment does not exceed ₹ 5,00,000.

If the land is agricultural land, no tax would be deductible under section 194LA, irrespective of the amount of compensation.

5. The issue as to whether the charges fixed by the Airport Authority of India (AAI) for landing and take-off facilities and parking facilities for the aircraft are for the "use of the land" by the airline company came up before the Supreme Court in *Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372*.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport, which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

Various international protocols mandate all authorities manning and managing these airports to construct the airport of desired standards, which are stipulated in the protocols. The services that are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as safe landing and parking of aircraft. Therefore, the services are not restricted to merely permitting "use of the land" of airport. On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

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The Supreme Court observed that the charges levied on air traffic include landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would be tantamount to adopting a totally simplistic approach, which is far away from reality.

The Supreme Court opined that the substance behind such charges has to be considered, and when the issue is viewed from this angle, keeping the larger picture in mind, it becomes very clear that the charges are not for use of the land *per se* and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in *Singapore Airlines* case and overruled the view taken by the Delhi High Court in *United Airlines/Japan Airlines* case.

Applying the rationale of the Supreme Court ruling to the facts of this case, the contention of the Assessing Officer that landing and parking charges are levied for the use of the land of airport and, hence, the charges are in the nature of rent to attract the provisions of tax deduction at source under section 194-I is ***not*** correct.

6. (a) Tax implications on sale of rural agricultural land and house property representing a capital asset in the hands of Mr. Harish, a salaried employee

(i)	**Tax implications in the hands of Mr. Harish, a salaried employee**
	Since rural agricultural land is not a capital asset, the gains arising on sale of such land is not taxable in the hands of Mr. Harish. However, capital gains would arise on the sale of house property, being a capital asset. As per section 50C(1), the stamp duty value of house property on the date of agreement (i.e., ₹ 75 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, ₹ 35 lakh (i.e., ₹ 75 lakh – ₹ 40 lakh, being the purchase price) would be taxable as **short-term capital gains** in the A.Y.2026-27. It may be noted that as the date of the agreement is different from the date of registration and part of the consideration was received on or before the date of agreement by way of account payee cheque, the stamp duty value on the date of agreement is to be adopted as the deemed sale consideration.
(ii)	**Tax implications in the hands of the buyer – Mr. Suresh, a retail trader**
	The house property purchased would be a capital asset in the hands of Mr. Suresh, who is a retail trader of garments. The provisions of section

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	56(2)(x) are attracted in the hands of Mr. Suresh who has acquired the immovable property, being a capital asset, for inadequate consideration. For the purpose of section 56(2)(x), Mr. Suresh can take the stamp duty value on the date of agreement instead of the date of registration since he has paid a part of the consideration by account payee cheque on the date of agreement. Therefore, ₹ **15 lakh,** being the difference between the stamp duty value of the property **on the date of agreement** (i.e., ₹ 75 lakh) and the actual consideration (i.e., ₹ 60 lakh) would be taxable as per section 56(2)(x) under the head "**Income from other sources**" in the hands of Mr. Suresh, since such difference exceeds the higher of ₹ 50,000 or 10% of consideration. As rural agricultural land is not a capital asset, the provisions of section 56(2)(x) are not attracted in respect of acquisition of agricultural land for inadequate consideration, since the definition of "property" under section 56(2)(x) includes only **capital assets** specified thereunder.

(b) Tax implications on sale of house property representing stock-in-trade in the hands of Mr. Harish, a property dealer:

(i)	**Tax implications in the hands of Mr. Harish**
	If Mr. Harish is a property dealer who has sold the house property in the course of his business, the provisions of section 43CA would be attracted, since the house property represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value. For the purpose of section 43CA, Mr. Harish can take the stamp duty value on the date of agreement instead of the date of registration, since he has received part of the sale consideration by an account payee cheque on the date of agreement and it exceeds 110% of the consideration. Therefore, **₹ 35 lakh**, being the difference between the stamp duty value on the date of agreement (i.e., ₹ 75 lakh) and the purchase price (i.e., ₹ 40 lakh), would be chargeable as **business income** in the hands of Mr. Harish.
(ii)	**Taxability in the hands of Mr. Suresh**
	There would be no difference in the taxability in the hands of Mr. Suresh, whether Mr. Harish is a property dealer or a salaried employee. Therefore, the provisions of section 56(2)(x) would be attracted in the hands of Mr. Suresh who has received house property, being a capital asset, for inadequate consideration.

7. This issue has been clarified by the CBDT *Circular No.8/2009 dated 24.11.2009*. As per provisions of section 194J(1), any person, who is responsible for paying to a resident any sum by way of fees for professional services, shall, at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to 10% of such sum as TDS.

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Further, as per clause (a) of *Explanation* to section 194J "professional services" includes services rendered by a person in the course of carrying on medical profession.

The services rendered by hospitals to various patients are primarily medical services and therefore, **the provisions of section 194J are applicable on payments made by TPAs to hospitals,** etc. Further, for invoking provisions of section 194J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to the hospital. Therefore, TPAs who are making payment on behalf of insurance companies to hospitals for settlement of medical/ insurance claims, etc. under various schemes, including Cashless Schemes, are liable to deduct tax at source under section 194J on all such payments to hospitals, etc.

In view of the above, all such transactions between TPAs and hospitals would fall within the ambit of provisions of section 194J.

8. **(i)** The services of Event Managers in relation to sports activities alone have been notified by the CBDT as "professional services" for the purpose of section 194J. In this case, payment of ₹ 5 lakh was made to an event management company for organization of a debate competition. Hence, the provisions of section 194J are not attracted.

However, TDS provisions under section 194C relating to contract payments would be attracted and consequently, tax has to be deducted @2% under section 194C. The tax deductible under section 194C would be ₹ 10,000, being 2% of ₹ 5 lakh.

(ii) Section 194J provides for deduction of tax at source @10% on any remuneration or fees or commission, by whatever name called, paid to a director, which is not in the nature of salary in respect of which tax is deductible at source under section 192.

Hence, tax is to be deducted at source under section 194J @10% by DAF Pvt. Ltd. on the commission of ₹ 2,25,000 paid to KD, a part-time director. The tax deductible under section 194J would be ₹ 22,500, being 10% of ₹ 2,25,000.

9. **(i)** The definition of "work" under section 194C includes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer or its associate. In the instant case, Mini Limited manufactures the product as per the specification given by Max Limited **by using the raw materials purchased from Max Limited**. **Therefore, it falls within the definition of "work"** under section 194C. Consequently, tax is to be deducted on the invoice value, excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. If the material component is not

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mentioned separately in the invoice, tax is to be deducted on the whole of the invoice value.

(ii) Provisions for deduction of tax at source under section 194J are attracted in respect of payment of fees for professional services, if the amount of such fees exceeds ₹ 50,000 in the relevant financial year. The service rendered by a commentator in relation to sports activities has been notified by the CBDT as a professional service for the purposes of section 194J vide its *Notification No. 88 dated 21st August, 2008.* Therefore, tax is required to be deducted @10% from the fee of ₹ 5 lakhs payable to the former cricketer.

10. (i) Section 192 requires deduction of tax from salary at the time of payment. Thus, the employer is not required to deduct tax at source when salary has not been paid but is merely credited to the account of the employee in its books of account. MNO Ltd., therefore, is not required to deduct tax at source in respect of the salary merely credited to the account of employee Q which is not paid.

If salary has been paid during the year to Q, then, MNO Ltd., a deductor, being an employer, shall seek information from each of its employees having income under section 192 regarding their intended tax regime, and each such employee shall intimate the same to the deductor, being his employer, regarding his intended tax regime for each year and upon intimation, the deductor shall compute his total income, and deduct tax at source thereon according to the option exercised.

If intimation is not made by the employee, it shall be presumed that the employee continues to be in the default tax regime and has not exercised the option to opt out of the new tax regime. Accordingly, in such a case, MNO Ltd. shall deduct tax at source, on income under section 192, in accordance with the rates provided under section 115BAC(1A).

(ii) An individual who has total sales, gross receipts or turnover from the business carried on by him exceeding ₹ 1 crore in the immediately preceding financial year, i.e., F.Y. 2024-25, is liable to deduct tax at source under section 194C for the financial year 2025-26 in respect of the payment made to contractor exceeding ₹ 30,000 in a single contract and ₹ 1,00,000 in aggregate of contracts during the financial year. Since, turnover of the individual T is ₹ 2.20 crores in the financial year 2024-25 and as the payment during financial year 2025-26 to the contractor has exceeded the limits prescribed in section 194C, tax has to be deducted under section 194C.

The rate of tax deduction is 1% as the contractor is an individual.

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(iii) The limit of ₹ 50,000 for non-deduction of tax under section 194J would apply separately for fees for professional services and fees for technical services. This means that if a person has rendered services falling under both the categories, tax need not be deducted if the fee for each category does not exceed ₹ 50,000, even though the aggregate of the amounts credited to the account of such person or paid to him for both categories of services exceeds ₹ 50,000. Therefore, BCD Ltd. is not required to deduct tax at source in respect of the fees either at the time of credit or at the time of payment.

11. **(i)** Where the payer is an individual or HUF whose total sales, gross receipts or turnover from the business carried on by him exceeds ₹ 1 crore during the financial year immediately preceding the financial year in which such rent was credited or paid, is liable to deduct tax at source. Since the turnover from the business of Mr. Anand was ₹ 202 lakhs for the F.Y. 2024-25, he is liable to deduct tax at source under section 194-I in respect of rental payments during the financial year 2025-26.

Accordingly, Mr. Anand is liable to deduct tax at source under section 194-I on the rental payments made. Since the monthly rental payments of ₹ 15,000 to Mr. R during the financial year 2025-26 do not exceed ₹ 50,000, Mr. Anand is not liable to deduct tax under section 194-I from rent paid to Mr. R.

(ii) The definition of "work" under *Explanation* to section 194C includes catering services and therefore, TDS provisions under section 194C are attracted in respect of payments to a caterer. As the payment exceeds ₹ 30,000, the nationalised bank is required to deduct tax at source at 2% on the payments made to catering organisation. If the catering organization is an individual or HUF, then, the tax deduction shall be made @1%

(iii)

	₹
Gross salary, allowances and monetary perquisites	12,30,000
Non-Monetary perquisites	1,20,000
	13,50,000
Less: Standard deduction under section 16(ia)	75,000
	12,75,000
Tax Liability	74,100
Average rate of tax (₹ 74,100 / ₹ 12,75,000 × 100)	5.81%

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The company can deduct ₹ 74,100 at source from the salary of the General Manager at the time of payment.

Alternatively, the company can pay tax on non-monetary perquisites as under –

Tax on non-monetary perquisites =5.81% of ₹ 1,20,000 = ₹ 6,972

Balance to be deducted from salary = ₹ 67,128

If the company pays a tax of ₹ 6,972 on non-monetary perquisites, the same is not a deductible expenditure as per section 40(a)(v). The amount of tax paid towards non-monetary perquisite by the employer, however, is not chargeable to tax in the hands of the employee as per section 10(10CC).

12. **(a)** As per section 192, tax is deductible at source by any person who is responsible for paying any income chargeable under the head 'Salaries'. However, as per sub-section (2A) of said section, the employee will be entitled to relief u/s 89 and consequently, he will be required to furnish to the person responsible for making the payment, such particulars in the prescribed form (i.e., Form No.10E). The person responsible for making the payment shall compute the relief and take into account the same while deducting tax at source from salary.

(b) Under section 194B, the person responsible for paying by way of winnings from any card game and other game in an amount exceeding ₹ 10,000 shall, at the time of payment, deduct income-tax at 30%. Therefore, tax of ₹ 3 lakh has to be deducted at source from the prize money of ₹ 10 lakh payable to the winner.

(c) Section 194-I, which governs the deduction of tax at source on payment of rent, exceeding ₹ 50,000 per month or part of the month, is applicable to all taxable entities except individuals and HUFs, whose total sales, gross receipts or turnover from the business or profession carried on by him does not exceed ₹ 1 crore in case of business and ₹ 50 lakhs in case of profession during the financial year immediately preceding financial year in which such rent was credited or paid, is liable to deduct tax at source. Section 196, however, provides an exemption in respect of payments made to the Government from the application of the provisions of tax deduction at source.

Therefore, no tax is required to be deducted at source by the State Bank of India from rental payments to the Government.

(d) If the cameraman is an employee of the T.V. company, the provisions of section 192 will apply. However, if he is a professional, TDS provisions under section 194J will apply. Tax at 10% will have to be deducted at the time of credit of ₹ 80,000 or on its payment, whichever is earlier.

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(e) Under section 194G, the person responsible for paying to any person, stocking, distributing, purchasing or selling lottery tickets shall at the time of credit of the commission or payment thereof, whichever is earlier, amounting to more than ₹ 20,000, deduct income-tax at source @2%.

Accordingly, tax @2% under section 194G amounting to ₹ 440 has to be deducted from the commission payment of ₹ 22,000 to the agent of the State Government.

(f) The TDS on payment by way of winnings from horse race is governed by section 194BB. Under this section, the person responsible for payment shall, at the time of payment, deduct tax at source @ 30%, if the payment exceeds ₹10,000.

Accordingly, tax @30% amounting to ₹ 1,50,000 has to be deducted from the winnings of ₹ 5 lakh payable to the winner of the race.

13. Liability for deduction of tax at source

	Reasoning	Amount of TDS (₹)
(i)	Since the consideration and stamp duty value for transfer of house property in Mumbai both are not less than ₹ 50 lakhs, Mr. X, being the transferee, is required to deduct tax @1% under section 194-IA on ₹ 95 lakhs, being higher of stamp duty value and the amount of consideration for transfer of property, at the time of credit to the transferor account or payment, whichever is earlier.	95,000
	Mr. X is not required to deduct tax as source under section 194-IA from the consideration of ₹ 49,50,000 paid to Mr. C for transfer of urban plot, since the consideration and stamp duty value, both are less than ₹ 50 lakhs.	Nil
	Mr. X is also not required to deduct tax at source under section 194-IA for transfer of rural agricultural land, since the same is specifically excluded from the scope of immovable property for the purpose of tax deduction under section 194-IA.	Nil
	Note - *Section 194-IA requires every transferee responsible for paying any sum as consideration for transfer of immovable property (land, other than agricultural land, or building or part of building) to deduct tax, at the rate of 1% of higher of consideration and stamp duty value, at the time of credit of such sum to the account of the resident transferor or at the time of payment of such consideration to the resident transferor, whichever is earlier. However, no tax is required to be deducted where the consideration for transfer of an immovable property and stamp duty value of such property, both are less than ₹ 50 lakhs.*	

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(ii)	Section 194H requires the deduction of tax at source @2% from commission and brokerage payments to a resident. However, no tax is to be deducted at source where the amount of such payment does not exceed ₹ 20,000. In the given case, 'ABC Packaging Ltd.', the consignee, has not remitted the commission of ₹ 50,000 to the consignor 'XYZ Developers' while remitting the sales consideration. Since the retention of commission by the consignee/agent amounts to constructive payment of the same to him by the consignor/principal, deduction of tax at source is required to be made from the amount of commission *[CBDT Circular No.619 dated 4/12/1991].* Therefore, XYZ Developers has to deduct tax at source on ₹ 50,000 at the rate of 2%.		1,000
(iii)	Section 192 provides that tax is required to be deducted on the payment made as salaries. Tax is to be deducted on the estimated income at the rates specified under section 115BAC(1A) or at the average of income tax computed on the basis of the rates in force for the financial year in which payment is made in case the employee submitted a declaration of opt out of the default regime under section 115BAC. The employee may declare details of his other incomes (including loss under the head "Income from house property" but not any other loss) to his employer. In this case, since Mr. Raj has submitted a declaration of opt out of section 115BAC and also notified his employer AB Ltd. of loss from self-occupied house property, the employer has to take the same into consideration for deduction of tax at source. Therefore, AB Ltd. is required to deduct tax at source on the salary of ₹ 85,000 per month paid to Mr. Raj, in the following manner:		
	Income under the head salaries (₹ 85,000 x 12)	10,20,000	
	Less: Standard deduction under section 16(ia)	50,000	
		9,70,000	
	Income under the head "house property"	(1,95,000)	
	Gross total income	7,75,000	
	Less: Deduction under Chapter VI-A	Nil	
	Total Income	7,75,000	

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	Tax on ₹ 7,75,000	67,500	
	Add: Health and Education cess@4%	2,700	
	Tax to be deducted at source	**70,200**	**70,200**

14. Manner of making a proclamation

Movable Property [Rules 38 & 39 of Schedule II to the Income-tax Act, 1961]

Where the Tax Recovery Officer orders sale of movable property, he should issue a proclamation in the language of the district of the intended sale, specifying the time and place of sale and whether the sale is subject to confirmation or not.

The proclamation should be made by the beat of drum or other customary mode, -

(a) in the case of property attached by actual seizure –

(i) in the village in which the property was seized, or, if the property was seized in a town or city, then, in the locality in which it was seized; and

(ii) at such other places as the Tax Recovery Officer may direct;

(b) in the case of property attached otherwise than by actual seizure, in such places, if any, as the Tax Recovery Officer may direct.

A copy of the proclamation should also be affixed in a conspicuous part of the office of the Tax Recovery Officer.

Immovable Property [Rule 54 of Schedule II to the Income-tax Act, 1961]

The Tax Recovery Officer shall make a proclamation for the sale of immovable property at some place on or near such property by beat of drum or other customary mode. A copy of the proclamation shall be affixed on a conspicuous part of the property and also upon a conspicuous part of the office of the Tax Recovery Officer.

Where the Tax Recovery Officer directs, such proclamation shall also be published in the Official Gazette or in a local newspaper or in both, and the cost of such publication shall be deemed to be cost of the sale.

Where the property to be sold is divided into lots for the purpose of being sold separately, then it is not necessary to make a separate proclamation for each lot of property, unless, in the opinion of the Tax Recovery Officer, proper notice of sale cannot otherwise be given.

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Time limit for the sale of attached immovable property [Rule 68B of Schedule II to the Income-tax Act, 1961]

The sale of immovable property attached has to be made on or before the expiry of 7 years from the end of the financial year in which the order giving rise to a demand of any tax, interest, fine, penalty or any other sum, for the recovery of which the immovable property has been attached,

- has become conclusive under the provisions of section 245-I (where the order of settlement under section 245D(4) is deemed to be conclusive as to the matters stated therein) or
- has become final in terms of the provisions of Chapter XX (Appeals and Revision).

However, the CBDT may, for reasons to be recorded in writing, extend the aforesaid period for a further period not exceeding 3 years.

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CHAPTER 14

INCOME TAX AUTHORITIES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the various income-tax authorities and comprehend the provisions of law relating to their appointment, control and jurisdiction;
- **appreciate** the powers of income-tax authorities under the Income-tax Act, 1961;
- **examine** the provisions relating to survey, search and seizure and the related powers of various income-tax authorities;
- **analyse and apply** such provisions to address related issues.

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CHAPTER OVERVIEW

14.1 APPOINTMENT AND CONTROL [SECTIONS 116 TO 119A]

(1) Income-tax Authorities [Section 116]

The following are the classes of income-tax authorities-

Income-tax Authorities
1. Central Board of Direct Taxes (CBDT) or Board- - A statutory body constituted under the Central Board of Revenue Act, 1963. It comprises of Chairman & Members. - It functions under the jurisdiction of the Ministry of Finance. - It is the highest executive authority, exercises control and supervision over all officers of the Income-tax Department. - It is authorised to exercise certain powers conferred upon it by the Income-tax Act, 1961. - The CBDT frames rules as empowered u/s 295 subject to the control and approval of the Central Government for the proper administration of Act.

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	Authority with nomenclature "Director"	Authority with nomenclature "Commissioner"
2.	**Principal Directors-General** of Income-tax (PDGIT)	**Principal Chief Commissioners** of Income-tax (PCCIT)
3.	**Directors-General** of Income-tax (DGIT)	**Chief Commissioners** of Income-tax (CCIT)
4.	**Principal Directors** of Income-tax (PDIT)	**Principal Commissioners** of Income-tax (PCIT)
5.	**Directors** of Income-tax (DIT)	**Commissioner** of Income-tax (CIT) or Commissioner of Income-tax (Appeals) [CIT(A)]
6.	**Additional Directors** of Income-tax (Add. DIT)	**Additional Commissioners** of Income-tax (Add. CIT) or Additional Commissioners of Income-tax (Appeals) [Add. CIT(A)]
7.	**Joint Directors** of Income-tax (JDIT)	**Joint Commissioners** of Income-tax (JCIT) ***or*** **Joint Commissioners** of Income-tax (Appeals)
8.	**Deputy Directors** of Income-tax (DDIT)	**Deputy Commissioners** of Income-tax (DCIT) or Deputy Commissioners of Income-tax (Appeals) [DCIT(A)]
9.	**Assistant Directors** of Income-tax (ADIT)	**Assistant Commissioners** of Income-tax (ACIT)
10.	Income-tax Officers (ITOs)	
11.	Tax Recovery Officers (TROs)	
12.	Inspectors of Income-tax	

Note - As per section 2(7A), "Assessing Officer" means -

- ACIT or DCIT or ADIT or DDIT; or
- ITO who is vested with the relevant jurisdiction by virtue of directions or orders issued by CBDT; and
- the Add. CIT or Add. DIT or JCIT or JDIT who is directed to exercise or perform all or any of the powers and functions conferred on, or assigned to, an Assessing Officer.

(2) Appointment and Control of Income-tax Authorities [Sections 117 & 118]

(i) Section 117 empowers the Central Government to appoint such persons as it thinks fit to be income-tax authorities.

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(ii) It may also authorise the Board or a Principal Director General or Director General, a Principal Chief Commissioner or Chief Commissioner or a Principal Director or Director or a Principal Commissioner or Commissioner to appoint income-tax authorities below the rank of an Assistant Commissioner or Deputy Commissioner.

(iii) An income-tax authority authorised by the CBDT may appoint such executive or ministerial staff as may be necessary to assist it in the execution of its functions.

(iv) Section 118 authorises the CBDT to also direct, by way of notification, that any income-tax authority or authorities shall be subordinate to such other income-tax authority or authorities, as may be specified.

(3) Instruction to Subordinate Authorities [Section 119]

(i) The CBDT has been empowered under section 119 to issue orders, instructions and directions to its subordinates for the proper administration of the Act.

(ii) It is obligatory for the various authorities and all other persons employed in the execution of the Act to observe and follow such orders, instructions and directions of the CBDT.

(iii) The CBDT, however, is not empowered to issue orders, instructions or directions in such a way as to –

(1) require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner; or

(2) interfere with the discretion of the Joint Commissioner (Appeals) or Commissioner (Appeals) in the exercise of his appellate functions.

(iv) The CBDT may, if it considers necessary or expedient to do so, for the purpose of proper and effective management of the work of assessment and collection of revenue, issue general or special orders from time to time in respect of any class of incomes or class of cases setting forth directions and instructions not being prejudicial to the assessee.

(v) In appropriate cases, the CBDT may relax the provisions of sections 139, 143, 144, 147, 148, 154, 155, 158BFA, 201(1A), 210, 211, 234A, 234B, 234C, 234E, 234F, 270A, 271C, 271CA and 273.

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The following table gives a brief glimpse of what these sections relate to –

Section	Particulars of section
139	Filing of Return of income
143	Scrutiny Assessment of income
144	Best Judgment Assessment of income
147	Income escaping assessment
148	Issue of notice where income has escaped assessment
154	Rectification of mistake apparent on record
155	Other amendments relating to assessment of income
158BFA	Interest and penalty in certain cases of search
201(1A)	Interest for non-deduction of tax or non-payment of tax after deduction by such person/principal officer/company, as the case may be.
210	Payment of advance tax by the assessee of his own accord or in pursuance of order of Assessing Officer.
211	Installments of advance tax and due dates
234A	Interest for default in furnishing return of income
234B	Interest for default in payment of advance tax
234C	Interest for deferment of advance tax
234E	Fee for failure to deliver the statement of deduction of tax at source under section 200(3) and for failure to deliver the statement of collection of tax at source under section 206C(3) within the prescribed time.
234F	Fee for default in furnishing return of income under section 139(1)
270A	Penalty for underreporting and misreporting of income
271C	Penalty for failure to deduct tax at source
271CA	Penalty for failure to collect tax at source
273	Penalty for false estimate of, or failure to pay, advance tax

(vi) The CBDT is empowered to authorise any income-tax authority [not being a Joint Commissioner (Appeals) or a Commissioner(Appeals)] by general or special order to admit an application or claim for any exemption, deduction, refund or any other relief under the Act after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of late filing of a return is relatable to a claim arising under the category of "any other relief available under the Act".

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Accordingly, the CBDT issued Circular No. 11/2024 dated 1.10.2024, to deal with the applications for condonation of delay in filing returns claiming refund and returns claiming carry forward of loss and set off thereof containing comprehensive guidelines on the conditions for condonation and the procedures to be followed for deciding such matters:

(1) **Monetary Limits:** The Income-tax Authorities have vested with the powers of acceptance/rejection of such applications/claims upto certain threshold monetary limits:

Quantum of claim	Income-tax authority with whom powers of acceptance/rejection is vested
Where the claim is upto ₹ 1 crore for any one A.Y.	Principal CIT or CIT
Where the claim is above ₹ 1 crore but upto ₹ 3 crores for any one A.Y.	CCIT
Where the claim is above ₹ 3 crores for any one A.Y.	Principal CCIT

(2) **Condonation of delay in verifying the return:** The Commissioner of Income-tax, Central Processing Centre (CPC), Bengaluru shall be vested with the powers for acceptance/rejection of petitions under section 119(2)(b) of the Act seeking condonation of delay in verifying the return of income by sending the ITR-V to centralized processing Cell (CPC), Bengaluru within the prescribed time limit.

(3) **Period for which application can be made:** No condonation application for claim of refund/loss shall be entertained beyond five years from the end of the assessment year for which such application/claim is made.

A condonation application should be disposed of within six months from the end of the month in which the application is received by the competent authority, as far as possible.

Note: However, for the application filed before 1.10.2024, time period upto which application can be made is six years from the end of the assessment year.

(4) **In case of updated return u/s 139(9A):** In view of the amendment in section 139(9A) vide Finance Act, 2024, the powers of acceptance/rejection of the application within the monetary limits delegated to the authorities in case of such claims will be subject to following conditions:

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- At the time of considering the case under Section 119(2)(b), it shall be ensured that assessee was prevented by reasonable cause from filing the return of income within the due date and that the case is of genuine hardship on merits.
- The authorities dealing with the case shall be empowered to direct the jurisdictional Assessing Officer to make necessary inquiries in accordance with the provisions of the Act to ensure that the application is dealt on merits in accordance with law.

(5) **Refund consequent to Court order:** In a case where refund claim has arisen consequent to a Court order, the period for which any such proceedings were pending before any Court of Law shall be ignored while calculating the said period of five or six years, as the case may be, provided such condonation application is filed within six months from the end of the month in which the Court order was issued or the end of financial year, whichever is later.

(6) **Application claiming additional amount of refund:** A belated application for supplementary claim of refund (claim of additional amount of refund after completion of assessment for the same year) can be admitted for condonation provided other conditions as referred above are fulfilled. The powers of acceptance/rejection within the monetary limits delegated to the Principal CCIT/ CCIT/Principal CIT/CIT in case of returns claiming refund and supplementary claim of refund would be subject to the following further conditions:

(a) The income of the assessee is not assessable in the hands of any other person under any of the provisions of the Act.

(b) No interest will be admissible on belated claim of refunds.

(c) The refund has arisen as a result of excess tax deducted/collected at source and/or excess advance tax payment and/or excess payment of self-assessment tax as per the provisions of the Act.

(vii) The CBDT is empowered to relax the requirements specified in Chapter IV or Chapter VI-A, by general or special order, where the assessee failed to comply with such requirements for claiming deduction due to circumstances beyond the control of the assessee and such requirements were complied with before completion of the assessment for that year. Every order issued under this clause shall, however, to be laid before each House of Parliament by the Central Government.

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(4) Taxpayer's Charter [Section 119A]

The CBDT shall adopt and declare a taxpayer's charter and issue orders, directions, instructions and guidelines to other Income tax authorities for the administration of such Charter.

Taxpayer's Charter
Income-tax department is committed to
1. **Provide fair, courteous, and reasonable treatment:** The Department shall provide prompt, courteous, and professional assistance in all dealings with the taxpayer.
2. **Treat taxpayer as honest:** The Department shall treat every taxpayer as honest unless there is a reason to believe otherwise.
3. **Provide mechanism for appeal and review:** The Department shall provide fair and impartial appeal and review mechanism.
4. **Provide complete and accurate information:** The Department shall provide accurate information for fulfilling compliance obligations under the law.
5. **Provide timely decisions:** The Department shall take decision in every income-tax proceeding within the time prescribed under law.
6. **Collect the correct amount of tax**: The Department shall collect only the amount due as per the law.
7. **Respect privacy of taxpayer:** The Department will follow due process of law and be no more intrusive than necessary in any inquiry, examination, or enforcement action.
8. **Maintain confidentiality:** The Department shall not disclose any information provided by taxpayer to the department unless authorized by law.
9. **Hold its authorities accountable:** The Department shall hold its authorities accountable for their actions.
10. **Enable representative of choice:** The Department shall allow every taxpayer to choose an authorized representative of his choice.
11. **Provide mechanism to lodge complaint:** The Department shall provide mechanism for lodging a complaint and prompt disposal thereof.
12. **Provide a fair & just system:** The Department shall provide a fair and impartial system and resolve the tax **issues** in a time-bound manner.

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13. **Publish service standards and report periodically:** The Department shall publish standards for service delivery in a periodic manner.

14. **Reduce cost of compliance:** The Department shall duly take into account the cost of compliance when **administering** tax legislation.

Income-tax department expects taxpayers to:

1. **Be honest and compliant:** Taxpayer is expected to honestly disclose full information and fulfil his **compliance** obligations.
2. **Be informed:** Taxpayer is expected to be aware of his compliance obligations under tax law and seek help of department if needed.
3. **Keep accurate records:** Taxpayer is expected to keep accurate records required as per law.
4. **Know what the representative does on his behalf:** Taxpayer is expected to know what information and submissions are made by his authorised representative.
5. **Respond in time:** Taxpayer is expected to make submissions as per tax law in timely manner.
6. **Pay in time:** Taxpayer is expected to pay amount due as per law in a timely manner.

14.2 JURISDICTION

(1) Jurisdiction of income-tax authorities [Section 120]

(i) Income-tax authorities to exercise powers in accordance with CBDT directions [Section 120(1)]: The income-tax authorities shall exercise all or any of the powers and perform all or any of the functions conferred on, or assigned to, such authorities in accordance with the directions issued by the CBDT for the exercise of such powers and performance of the functions by all or any of those authorities.

Jurisdiction

(ii) Deemed directions under section 120(1) by CBDT [*Explanation* to section 120(1)]: Any income-tax authority, being an authority higher in rank, may exercise the powers and perform the functions of the income-tax authority lower in rank, if so directed by the CBDT. Such direction issued by the CBDT shall be deemed to be a direction issued under the said section 120(1).

(iii) CBDT may authorize income-tax authorities to exercise powers/perform functions: The directions of the Board may authorise any other income-tax authority

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to issue orders in writing for the exercise of the powers and performance of the functions by all or any of the other income-tax authorities who are subordinate to it.

(iv) Criteria for issue of directions [Section 120(3)]: In issuing such directions, the Board may have regard to the following criteria:

(a) Territorial area.

(b) Persons or classes of persons.

(c) Incomes or classes of incomes.

(d) Cases or classes of cases.

(v) CBDT authorisation assigning functions [Section 120(4)]: The CBDT may authorise any Principal Director General or Director General or Principal Director or Director of Income-tax to perform such functions of any other income-tax authority as may be assigned to him. Such authorisation may be through a general or special order.

The CBDT can empower the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner to issue orders in writing to the effect that the powers and functions conferred on or assigned to the Assessing Officer under this Act in respect of any specified area or person or class of person or persons or incomes or classes of income or cases or classes of cases shall be exercised or performed by an Additional Commissioner or Additional Director or a Joint Commissioner or Joint Director.

The CBDT or any other authority authorised in this behalf can confer jurisdiction with more than one income-tax authority in relation to any case.

(2) Jurisdiction of Assessing Officers [Section 124]

(i) Persons in respect of whom Assessing Officer has jurisdiction: Where the Assessing Officer has been vested with jurisdiction over any area within the limits of such area, he shall have jurisdiction:

(a) in respect of any person carrying on business or profession within that area or in respect of a person whose business or profession is carried on in more than one place, if his principal place of business or profession is in that area and

(b) in respect of any other person residing within the area.

(ii) Income-tax Authorities higher in rank to determine question of Assessing Officer's jurisdiction: Where a question arises under this section as to whether an Assessing Officer has jurisdiction to assess any person, the question shall be

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determined by the Principal Director General or Director General or the Principal Chief Commissioner or Chief Commissioners or Principal Commissioner or Commissioner.

In case the question relates to an area within the jurisdiction of different Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioners or Principal Commissioner or Commissioner, then the question shall be determined by the Principal Directors General or Directors General or Principal Chief Commissioners or Chief Commissioners or Principal Commissioners or Commissioner concerned or if they are not in agreement, then the same shall be determined by the Board or by such Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner as the Board may specify by way of notification in the Official Gazette.

(iii) Time limit for calling in question jurisdiction of the Assessing Officer:

S. No.	Case	Time Limit
(a)	Where a return of Income has been filed under section 139(1)	**One month from the date of service of notice** under section 142(1) or 143(2) or completion of assessment, whichever is earlier.
(b)	Where no return of income has been filed	**Time allowed by notice under section 142(1) or 148** for filing return of income or by notice under the first proviso to section 144 to show cause why the best judgement assessment should not be made, whichever is earlier.
(c)	Where search is initiated under section 132 or books of accounts or other documents or any assets are requisitioned under section 132A	**One month from the date on which notice** was served under section 153A(1) or 153C(2)[1] or completion of assessment, whichever is earlier.

(iv) Assessing Officer may refer matter for determination: Where the assessee questions the jurisdiction of an Assessing Officer, then, the Assessing Officer shall, if not satisfied with the correctness of the claim refer the matter for determination under (ii) above before the assessment is made.

[1] *These provisions (i.e., sections 153A and 153C) were applicable in case of search, initiated under section 132 or books of accounts or other documents or any assets requisitioned under section 132A before 1.4.2021..*

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(v) **Jurisdictional Powers of Assessing Officer:** Every Assessing Officer shall have all the powers conferred by or under this Act on an Assessing Officer in respect of the income accruing or arising or received within the area, if any, over which he has been vested with jurisdiction by virtue of the direction or order issued under section 120(1) and 120(2).

(3) Power to transfer cases [Section 127]

(i) **Authorities empowered to transfer cases from one Assessing Officer to another:** The power to transfer a case from one Assessing Officer to another subordinate Assessing Officer or Officers is vested with the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner of Income-tax. However, this power can be exercised only after giving the assessee a reasonable opportunity of being heard and after recording reasons for doing so, wherever possible.

Transfer of case from one AO to another AO

(ii) **Mutual agreement between higher authorities to transfer cases:** There may be situations where the Assessing Officer(s) from whom the case is transferred and the Assessing Officer to whom the case is transferred do not fall under the control of the same Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner of Income-tax. In such cases, the Principal Director General or Director General of Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner of Income-tax from whose jurisdiction the case is transferred shall pass an order, if such concerned higher authorities mutually agree for such transfer.

If the higher authorities are not in agreement about the transfer, then, the CBDT or any such authority authorized by the Board may pass the order.

(iii) **No requirement of giving opportunity to be heard in certain cases:** If the case is transferred between Assessing Officers within the same city or locality or place, then, it is not necessary to give the assessee an opportunity of being heard.

(iv) **Re-issue of notice not required:** The transfer of a case may be made at any stage of the proceedings and it is not necessary to re-issue any notice already issued.

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(v) **Meaning of 'Case':** For the purpose of section 120 and section 127, "case" in relation to any person whose name is specified in any order or direction issued thereunder, means all proceedings under this Act in respect of any year which may be pending on the date of such order or direction or which may have been completed on or before such date, and includes also all proceedings under this Act which may be commenced after the date of such order or direction in respect of any year.

(4) Change of Income-tax Authority [Section 129]

(i) **Stage from which the succeeding Income-tax authority would continue:** In cases where an income-tax authority succeeds another income-tax authority, who ceases to exercise jurisdiction, then, the succeeding income-tax authority may continue the proceedings from the stage at which the proceedings was left by his predecessor.

(ii) **Opportunity to be reheard:** The assessee concerned may demand that before continuance of proceedings as in (i) above, the previous proceedings or any part thereof be reopened or be reheard before passing of any assessment order against him.

(5) Faceless jurisdiction of income-tax authorities [Section 130]

(i) Section 130(1) empowered the Central Government to notify scheme for faceless jurisdiction of income-tax authorities. The Central Government may make a scheme, by notification in the Official Gazette, for the purposes of—

(a) exercise of all or any of the powers and performance of all or any of the functions conferred on, or, as the case may be, assigned to income-tax authorities by or under this Act as referred to in section 120; or

(b) vesting the jurisdiction with the Assessing Officer as referred to in section 124; or

(c) exercise of power to transfer cases under section 127; or

(d) exercise of jurisdiction in case of change of incumbency as referred to in section 129,

so as to impart greater efficiency, transparency and accountability by—

(i) eliminating the interface between the income-tax authority and the assessee or any other person, to the extent technologically feasible;

(ii) optimising utilisation of the resources through economies of scale and functional specialisation;

(iii) introducing a team-based exercise of powers and performance of functions by two or more income-tax authorities, concurrently, in respect of any area or

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persons or classes of persons or incomes or classes of income or cases or classes of cases, with dynamic jurisdiction.

(ii) Every notification issued shall, as soon as may be after the notification is issued, be laid before each House of Parliament.

(iii) Accordingly, the Central Government has, vide Notification No. 15/2022 dated 28.03.2022 issued the Faceless Jurisdiction of Income-tax Authorities Scheme, 2022.

14.3 POWERS OF INCOME TAX AUTHORITIES [SECTIONS 131 TO 136]

Powers of Income-tax Authorities [Sections 131 to 136]
• Power regarding discovery, production of evidence, etc [Section 131] • Search and seizure [Section 132] • Powers to requisition books of account, etc [Section 132A] • Application of seized or requisitioned assets [Section 132B] • Power to call for information [Section 133] • Power of survey [Section 133A] • Power to collect certain information [Section 133B] • Power to call for information by prescribed income-tax authority [Section 133C] • Power to inspect registers of companies [Section 134] • Power of certain income-tax authorities [Section 135]

(1) Powers regarding discovery, production of evidence etc. [Section 131]

(i) Income-tax Authorities to have powers vested in a Civil Court in certain matters [Section 131(1)]: The Assessing Officer, Joint Commissioner, Joint Commissioner (Appeals), Commissioner (Appeals), Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner and the Dispute Resolution Panel referred to in section 144C have the powers vested in a Civil Court under the Code of Civil Procedure, 1908, while dealing with the following matters:

Have powers vested with in a Civil Court

(a) discovery and inspection;

(b) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

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(c) compelling the production of books of account and documents; and

(d) issuing commissions.

The powers aforementioned are normally those exercisable by a Court when it is trying a suit. While exercising these powers, the authorities act in a quasi-judicial capacity and ought to conform to the principles of judicial procedure.

(ii) Powers under section 131(1) to be exercised in certain cases, even if no proceeding is pending [Section 131(1A)/(2)]:

(a) If the Principal Director General or Director General or Principal Director or Director or Joint Director or Assistant Director or Deputy Director or the authorized officer referred to in section 132(1), before he takes action under the said sub-section, has reason to suspect that any income has been concealed, or is likely to be concealed, by any person or class of persons, within his jurisdiction, then for the purposes of making an enquiry or investigation relating thereto, it shall be competent for him to exercise the powers conferred in section 131(1) on the income-tax authorities referred to therein, even if no proceedings with respect to such person or class of persons are pending before him or any other income-tax authority.

Powers can be exercised even in a case where no proceedings are pending

(b) For facilitating quick collection of information on request from tax authorities outside India, income-tax authorities (not below the rank of Assistant Commissioner of Income-tax), as may be notified by the Board, to have powers under section 131(1) for making an inquiry or investigation in respect of any person or class of persons relating to an agreement under section 90 or 90A, even if no proceeding is pending before it or any other income-tax authority with respect to the concerned person or class of persons.

(iii) Power to impound or retain books of account [Section 131(3)]: The income-tax authority is vested with the power to impound or retain in its custody for such period as it may think fit, any books of account or other documents produced before it in any proceeding under this Act.

AO/AD/DD can retain books for > 15 days with prior approval

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The powers are unrestricted in the case of all the authorities except the Assessing Officer or an Assistant Director or Deputy Director, whose powers are subjected to two restrictions;

(a) he must record his reasons for impounding books of account or other documents; and

(b) if he desires to retain in his custody any such books or documents for a period exceeding 15 days (excluding holidays), he must obtain the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Commissioner or Commissioner or Principal Director or Director, as the case may be, for the purpose.

(2) Search and Seizure [Section 132]: Under this section, wide powers of search and seizure are conferred on the income-tax authorities.

(I) Authorities empowered to issue authorisation [Section 132(1)]: Search and seizure can be authorised by Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner. However, the said operations can be authorised by Additional Director or Additional Commissioner or Joint Director or Joint Commissioner if they are empowered by the Board.

The authorities mentioned above (Authorising officer) shall authorise their subordinates (Authorised officer) specified below to conduct the search and seizure operations:

Authorising Officer	Authorised Officer
A Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner	Joint Director, Joint Commissioner, Additional Director or Additional Commissioner, Assistant Director, or Deputy Director, Assistant Commissioner or Deputy Commissioner or Income-tax Officer.
Additional Director or Additional Commissioner, Joint Director or Joint Commissioner (If empowered by the Board)	Assistant Director or Deputy Director or Assistant Commissioner or Deputy Commissioner or Income-tax Officer.

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(II) 'Reason to believe' pre-requisite for authorisation [Section 132(1)]: Such authorisation could take place if the authorising officer has reason to believe, on the basis of information in his possession:

Reasons to believe - Pre-requisite for search

Reason not required to be disclosed to any person, authority or ITAT

(a) that the person to whom a summons under section 131(1) or notice under section 142(1) was issued to produce or cause to produced, any books of account or other documents has omitted or failed to do so; or

(b) that a person to whom a summons or a notice aforesaid has been or might be issued, will not or would not produce or caused to be produced, any books of account or other documents which will be useful or relevant to any proceeding under the Income-tax Act, 1961; or

(c) that a person is in possession of any valuable articles or things, including money, bullion or jewellery etc. representing either wholly or partly income or property which has not been disclosed or would not be disclosed by such person concerned for income-tax purposes.

However, the reason to believe, as recorded by the income-tax authority, shall not be disclosed to any person or any authority or the Appellate Tribunal.

(III) Powers of Authorised Officer [Section 132(1)]

(A) Power with reference to search of person: The authorized officer is empowered to-

Power of Search

(i) **enter and search any building or place** or vehicle or vessel or aircraft, where he has reason to suspect that such books of account, other documents, money, bullion, jewellery, other valuable article or thing are kept;

(ii) **break open the locks of any door**, box, safe, almirah or other receptacle, in case keys are not readily available for discharge of duties mentioned above;

(iii) **search any person** who has got out of, or is able to get into, or is in, the building, place, vessel, vehicle or aircraft in respect of which a search has been authorised, if he has reason to suspect that such person has

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secreted about his person any books of account or other documents, money, bullion, jewellery or other valuable article or thing for which the search is being made.

Power exercisable outside jurisdiction, if delay would be prejudicial to the interests of the revenue: The Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner has the power to authorise the search of any building, place, vessel, vehicle, aircraft etc., within his territorial jurisdiction and also in cases where he has no jurisdiction over the persons concerned, if he has reason to believe that any delay in obtaining authorisation from the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner having jurisdiction over the person would be prejudicial to the interests of revenue [First proviso to section 132(1)].

(B) Power with reference to money, jewellery, valuable article or thing: The authorized officer is empowered to

(i) seize money, bullion, jewellery, valuable articles, etc. found as a result of search.

However, any bullion, jewellery or other valuable article or thing, which is in the nature of stock-in-trade of the business, found as a result of search shall not be seized but the authorised officer shall make a note or inventory of such stock-in-trade of the business.

Power to Seize

Second proviso to section 132(1) provides that where it is not possible or practicable to take physical possession of any valuable article or thing and remove it to a safe place due to its volume, weight or other physical characteristics or due to its being of a dangerous nature, the authorized officer may serve an order on the owner or the person who is in immediate possession thereof that he shall not remove, part with or otherwise deal with it, except with the previous authorised officer shall be deemed to be seizure of such valuable article or thing. However, such a deeming seizure would not apply to stock-in-trade of the business.

Deemed Seizure not to apply for Stock-in trade

Further, where it is not practicable to seize any such money, bullion, jewellery or other valuable permission of such authorised officer and

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such action of the article or thing (for reasons other than those mentioned above), the authorized officer may serve an order on the owner or the person who is in immediate possession or control thereof that he shall not remove, part with or otherwise deal with it except with the previous permission of such officer and such officer may take such steps as may be necessary for ensuring compliance [Section 132(3)]. However, serving of such an order shall not be deemed to be seizure of such valuable article or thing. Such order shall not be in force for a period exceeding 60 days from the date of the order [Section 132(8A)].

(ii) Make a note or inventory of any such money, bullion, jewellery or other valuable article or thing.

(C) Power with reference to books of account/other documents: The authorized officer is empowered to –

(i) inspect books of account and other documents.

The person who is in possession or control of books of account or other documents maintained in the form of electronic records, shall be required to afford the necessary facility to authorised officer to inspect all such books of account or other documents.

"Electronic record" as defined in section 2(1)(t) of the Information Technology Act, 2000 means data, record or data generated, image or sound stored, received or sent in an electronic form or microfilm or computer-generated micro fiche.

(ii) seize books of account and other documents.

Where it is not practicable to seize any such books of account and other documents, the authorized officer may serve an order on the owner or the person who is in immediate possession or control thereof that he shall not remove, part with or otherwise deal with it, except with the previous permission of such officer and such officer may take such steps as may be necessary for ensuring compliance [Section 132(3)]. However, serving of such an order shall not be deemed to be seizure of such books of account and other documents. Such order shall not be in force for a period exceeding 60 days from the date of the order [Section 132(8A)].

(iii) place marks of identification on books and other documents.

(iv) make or cause to be made extracts or copies from the books or documents.

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Authorisation for search in other place not specified in the warrant: Where a search for any books of account or other documents or assets has been authorised by any authority who is competent to do so, and the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, in consequence of information in his possession, has reason to suspect that such books of account, other documents, money, bullion, jewellery or other valuable article or things of the assessee are kept in any building, place, vessel, vehicle or aircraft not specified in the search warrant, he may authorise the authorised officer to search such other building, place, vessel, vehicle or aircraft. Accordingly, if a search warrant is issued by the Principal Commissioner or Commissioner of Income-tax, authorising the search of a premises in a particular place specified in the search warrant and the authorised officer finds that the books of account or other documents and/or assets have been secreted in a building or place not specified in the search warrant, he could request the Commissioner to authorise him to search that building or place [Section 132(1A)].

However, the reason to suspect, as recorded by the income-tax authority, shall not be disclosed to any person or any authority or the Appellate Tribunal [*Explanation* below to section 132(1A)].

(D) Other powers:

(i) The authorized officer may requisition the service of

- any police officer or any officer of Central Government or of both; or
- any person or entity as may be approved by the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or the Director General in accordance with prescribed procedure,

to assist him in carrying out the search operations and it shall be duty of every such officer or person or entity to comply with such requisition [Section 132(2)].

(ii) The authrorised officer may examine on oath any person who is found to be in possession or control of any books, documents, money, bullion jewellery etc. However, the examination of any person may be not merely in respect of any books of account, other documents or assets

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found as a result of the search but also in respect of all matters relevant for the purposes of any investigation under the Act [Section 132(4)].

Other points relating to books, other documents, money, bullion, jewellery etc. seized:

(i) The person from whose custody any books of account or other documents are seized under sub-section (1) or sub-section (1A) **may make copies thereof, or take extracts therefrom**, in the presence of the authorised officer or any other person empowered by him in this behalf, at such place and time as the authorised officer may appoint in this behalf [Section 132(9)].

(ii) The books of account and other documents seized should be returned within a period of ***one month from the end of the quarter in which the order of assessment or reassessment or recomputation is made*** under section 143(3) or section 144 or section 147 or under section 153A[2] or section 158BC(c), unless the reasons for retaining the same are recorded in writing and approved by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner or Principal Director General or Director General or Principal Director or Director. With the approval, the books or other records can be retained but however the same cannot be retained for a period exceeding 30 days after the assessment proceedings in respect of the years for which the books of account or other documents are relevant are completed [Section 132(8)].

Seized books of account to be returned within one month from end of the quarter of assessment order.

(iii) Where the authorised officer has no jurisdiction over the person referred to in clause (a) or clause (b) or clause (c) of point (ii) above, the books of account or other documents, or any money, bullion, jewellery or other valuable article or thing seized under that sub-section shall be handed over

Handover to other AO within 60 days from the date of last authorisation for search

[2] *Section 153A deals with assessment in case of search, initiated under section 132 or books of accounts or other documents or any assets requisitioned under section 132A before 1.4.2021.*

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by the authorised officer to the Assessing Officer having jurisdiction over such person within a period of 60 days from the date on which the last of the authorizations for search was executed and thereupon, the powers exercisable by the authorized officer under sub-section (8) or sub-section (9) shall be exercisable by such Assessing Officer [Section 132(9A)].

(iv) If a person, legally entitled to the books of account or other documents seized, objects for any reason to the approval given by the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director to extend the period of retention of the same by the Assessing Officer beyond one month, he may make an application to the Board stating therein the reasons for such objection and requesting for the return of the books of account or other documents. The Board may, after giving the applicant an opportunity of being heard, pass such orders as it thinks fit. [Section 132(10)]

(IV) Rebuttable presumption [Section 132(4A)]: The law presumes in the course of search and seizure proceedings that

Rebuttable Presumption

(a) the books of account or other documents and assets found in the possession of any person belong to such person

(b) the contents of such books of account and other documents are true

(c) the signature and every other part of such books of account and other documents are in the handwriting of the persons who can reasonably be assumed to have signed or written the books of account or other documents. In the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

It may be noted that this is a rebuttable presumption. On facts and with evidence the assessee may rebut the above presumption and prove that the facts are otherwise.

(V) Provisional attachment of property [Section 132(9B)]: For the purpose of protecting the interest of the revenue and safeguarding recovery in search cases, the

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authorized officer during the course of search or seizure or within a period of **sixty days** from the date on which the last of the authorisations for search was executed is satisfied for reasons to be recorded in writing, it is necessary so to do, he may **with the prior approval** of the Principal Director General or Director General or the Principal Director or Director, by order in writing, **attach provisionally any property belonging to the assessee**.

(VI) Period of provisional attachment [Section 132(9C)]: Every provisional attachment made under sub-section (9B) shall cease to have effect **after the expiry of a period of six months** from the date of the order referred to in sub-section (9B).

(VII) Reference to Valuation Officer or any other person or entity [Section 132(9D)]: The authorised officer may, during the course of the search or seizure or within a period of 60 days from the date on which the last of the authorisations for search was executed, make a reference

- to a Valuation Officer referred to in section 142A,
- any other person or entity or any valuer registered by or under any law for the time being in force, as may be approved by the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or the Director General, in accordance with the prescribed procedure,

who shall estimate the fair market value of the property in the prescribed manner and submit a report of the estimate to the said officer or the Assessing Officer within a period of 60 days from the date of receipt of such reference.

Last of authorisation for search

For the purpose of sub-sections (9A), (9B) and (9D) of section 132, the last of ***authorisations*** for search shall be deemed to have been executed -

(a) in the case of search, on the conclusion of search as recorded in the last panchnama drawn in relation to any person in whose case the warrant of authorisation has been issued; or

(b) in the case of requisition under section 132A, on the actual receipt of the books of account or other documents or assets by the authorised officer. [*Explanation 1* to section 132].

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(VIII) Rules providing for procedure to be followed by Authorised Officer [Section 132(14)]: The Board may make rules in relation to any search or seizure under this section; in particular, and without prejudice to the generality of the foregoing power, such rules may provide for the procedure to be followed by the authorised officer—

(a) for obtaining ingress into any building, place, vessel, vehicle or aircraft to be searched where free ingress thereto is not available;

(b) for ensuring safe custody of any books of account or other documents or assets seized.

Rule 112 states the procedure to be followed by authorised officer while exercising the power of search and seizure under section 132.

(IX) Meaning of 'Proceeding' [*Explanation 2* below Section 132]: For the purpose of this section, the word "proceeding" means any proceeding in respect of any year under this Act, which may be pending on the date on which a search is authorised under this section or which may have been completed on or before such date and includes also all proceedings under this Act which may be commenced after such date in respect of any year.

(X) Applicability of CrPC: The provisions of the Criminal Procedure Code relating to searches and seizure would, as far as possible, apply to the searches and seizures under this Act. Contravention of the orders issued under this section would be punishable with imprisonment for upto 2 years and fine under section 275A.

(3) Power to requisition books of account etc. [Section 132A]

(i) Requirement of "reasons to believe" for requisition of books of account [Section 132A(1)]: Where the Principal Director General or Director General or Principal Director or Director or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner (authorising officer) on the basis of information in his possession, has reason to believe that-

Requisition of books of A/c

(a) any person to whom a summons under section 131(1) or a notice under section 142(1) was issued to produce, or cause to be produced, any books of account or other documents has omitted or failed to produce, or cause to be produced, such books of account or other documents, as required by such summons or notice and the said books of account or other documents have been taken into custody by any officer or authority under any other law for the time being in force, or

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(b) any books of account or other documents will be useful for, or relevant to, any proceeding under this Act and any person to whom a summons or notice as aforesaid has been or might be issued will not, or would not, produce or cause to be produced, such books of account or other documents on the return of such books of account or other documents by any officer or authority by whom or which such books of account or other documents have been taken into custody under any other law for the time being in force, or

(c) any assets represent either wholly or partly income or property which has not been, or would not have been, disclosed for the purposes of this Act by any person from whose possession or control such assets have been taken into custody by any officer or authority under any other law for the time being in force

then, the authorising officer may authorise any Additional Director, Additional Commissioner, Joint Director, Joint Commissioner, Assistant Director or Deputy Director, Assistant Commissioner, Deputy Commissioner or Income-tax Officer (referred to as the requisitioning officer) to require the officer or authority under any other law referred above, as the case may be, to deliver such books of account, other documents or assets to the requisitioning officer.

However, the reason to believe, as recorded by the income-tax authority, shall not be disclosed to any person or any authority or the Appellate Tribunal.

Clarificatory provision for non-disclosure of reason to believe or reason to suspect recorded by the Income-tax Authorities

- ✓ The need for this clarification arose because the Commissioner of Income-tax (Appeals) & Benches of the Income-tax Appellate Tribunal, in the context of appeals before them, started demanding copies of reasons to believe in search, seizure and requisition cases, which the Income Tax Department has not been giving to them on ground of secrecy.
- ✓ Though there are some decisions wherein it has already been held that search cannot be held invalid on the ground that reasons to believe not disclosed to assessee, the said amendment provides statutory recognition to such decisions so as to avoid any further litigation on the issue. These decisions are:

  (i) In *M.S. Associates v. Union of India (2005) 275 ITR 502 (Gau),* it was observed that revenue authorities are not required to disclose to the person challenging the warrant of authorisation as to what materials were available against him, which had led to the issuance of the warrant. It is required to be disclosed only when the authorities concerned resolve to impose tax or penalties.

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(ii) In *Genom Biotech (P) Ltd. & Ors. v. Director of IT (Investigation) & Ors. (2009) 180 Taxman 395 (Bom),* it was observed that it is not the mandate of section 132 or any other provision in the Act that the reasonable belief recorded by the designated authority before issuing the warrant of authorisation must be disclosed to the assessee.

(ii) Delivery of books of accounts to the Requisition Officer [Section 132A(2)]: On a requisition being made under (i), the officer or authority under any other law referred above, as the case may be, shall deliver the books of account, other documents or assets to the requisitioning officer either forthwith or when such officer or authority is of the opinion that it is no longer necessary to retain the same in his or its custody.

(iii) Certain provisions relating to search to apply in case of requisition also [Section 132A(3)]: Where any books of account, other documents or assets have been delivered to the requisitioning officer, the provisions of sections 132(4A) to 132(14) and section 132B shall, so far as may be, apply as if such books of account, other documents or assets had been seized under section 132(1) by the requisitioning officer from the custody of the concerned person.

(4) *Penal provisions on undisclosed income found during search or assets requisitioned [Section 158BFA(2)]:*

The Assessing Officer or the Commissioner (Appeals) during the course of proceeding under section 132 or section 132A may direct the assessee to pay a penalty of an amount equal to 50% of tax so leviable in respect of the undisclosed income determined by the Assessing Officer under section 158BC(1)(c).

The procedure for block assessment under section 158BC, along with penal provisions under section 158BFA, are dealt with in detail in Chapter 15: Assessment Procedure.

(5) Presumption with regard to assets, books of account [Section 278D]

(i) **Presumption with regard to books of account and other documents in search cases -** Section 278D provides that in case where, during the course of any search made u/s 132, any money, bullion, jewellery or other valuable articles or things or any books of account or other documents had been found in the possession or control of any person and such assets or books of account or other documents are tendered by the prosecution in evidence against such person and/or against any person who is

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convicted of an offence u/s 278, the provisions of section 132(4A) would apply, in relation to all such books of account and other documents. Accordingly, it would be presumed that such books of account or other documents and assets belong to the person in whose control or possession they were found at the time of search and also that the contents of such books of account and other documents are true.

(ii) **Presumption with regard to books of account and documents in case of requisition -** Similarly, in cases where any books of accounts or other documents and assets are taken into custody from the possession or control of any person by the officer or authority specified in section 132A(1)(a) to (c) and these are delivered to the requisitioning officer under section 132A(2), it would be presumed that the presumption similar to the one mentioned earlier would operate in these cases as well.

(iii) **Presumption rebuttable -** It would be for assessee to rebut the presumption wherever necessary by producing cogent and reliable evidence.

(6) Application of seized or requisitioned assets [Section 132B]

(i) Permissible adjustment of assets seized or requisitioned [Section 132B(1)(i)]: The permissible adjustment of assets seized under section 132 or requisitioned under section 132A are shown below:

Note - "**Existing liability**" does **not** include **advance tax payable** in accordance with the provisions of Part C of Chapter XVII of the Income-tax Act, 1961.

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(ii) **Manner of application of assets seized [Section 132B(1)(ii)/(iii)]:** If the assets consist solely of money or partly of money and partly of other assets, the Assessing Officer may apply the money in discharge of the liabilities mentioned above. The assessee shall be discharged of such liability to the extent of the money so applied.

Application of asset seized

The assets other than money may also be applied for the discharge of such liabilities which still remains undischarged. For this purpose, such assets shall be deemed to be under distraint, as if such distraint was effected by the Assessing Officer or, as the case may be, the Tax Recovery Officer under authorisation from the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner under section 226(5). The Assessing Officer or the Tax Recovery Officer, as the case may be, may recover the amount of such liabilities by the sale of such assets in the manner laid down in the Third Schedule. Any assets or proceeds thereof which remain after the liabilities referred above are discharged shall be forthwith made over or paid to the persons from whose custody the assets were seized.

(iii) **Release of seized asset [Proviso to section 132B(1)(i) and section 132B(4)]:** Where the person concerned makes an application to the Assessing Officer within 30 days from the end of the month in which the asset was seized, for release of the asset and explains the nature and source of acquisition of seized assets to the satisfaction of the Assessing Officer, then, such assets are required to be released within a period of 120 days from the date on which last of the authorisations for search under section 132 or requisition under section 132A was executed after meeting any existing liabilities, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

(iv) **Entitled to interest on the amount of assets seized exceeds the liabilities:** The assessee shall be entitled to simple interest at ½ % per month or part of a month, if the amount of assets seized exceeds the liabilities eventually, for the period immediately following the expiry of 120 days from the date on which the last of the authorisations for search under section 132 or requisition under section 132A was executed to the date of completion of the assessment or reassessment or recomputation.

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(7) Power to call for information [Sections 133]

(i) **Details of information to be furnished by different persons:** The Assessing Officer, the Joint Commissioner or the Joint Commissioner (Appeals) or the Commissioner (Appeals)] may call for following information from the following persons for the purposes of this Act-

S. No.	Person	Information to be furnished
(1)	Firm	The names and addresses of the partners of the firm and their respective shares.
(2)	Hindu undivided family	The names and addresses of the manager and the members of the family.
(3)	A trustee, guardian or agent	The names of the persons for or of whom he is trustee, guardian or agent, and of their addresses.
(4)	Any assessee	A statement of the names and addresses of all persons to whom he has paid in any previous year rent, interest, commission, royalty or brokerage, or any annuity, not being any annuity taxable under the head "Salaries" amounting to more than ₹ 1,000, or such higher amount as may be prescribed, together with particulars of all such payments made.
(5)	Any dealer, broker or agent or any person concerned in the management of a stock or commodity exchange	A statement of the names and addresses of all persons to whom he or the exchange has paid any sum in connection with the transfer, whether by way of sale, exchange or otherwise, of assets, or on whose behalf or from whom he or the exchange has received any such sum, together with particulars of all such payments and receipts.
(6)	Any person, including a banking company or any officer thereof	Information in relation to such points or matters, or statements of accounts and affairs verified in the manner specified by the Assessing Officer, the Joint Commissioner or the Joint Commissioner (Appeals) or the Commissioner (Appeals), giving information in relation to such points or matters as, in the opinion of the Assessing Officer, the Joint Commissioner or the Joint Commissioner (Appeals) or the Commissioner (Appeals), will be useful for, or relevant to, any enquiry or proceeding under this Act.

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(ii) **Exercise of power by the Income-tax authorities u/s. 133(6):** Although section 133 empowers only the Assessing Officer, Joint Commissioner, the Joint Commissioner (Appeals) or and Commissioner of Income tax (Appeals) to call for any information from any person which will be useful for or relevant to any proceedings under the Act as mentioned in point (6) of (i) above, such powers may also be exercised by the Principal Director General or Director-General, the Principal Chief Commissioner or Chief Commissioner, the Principal Director or Director or the Principal Commissioner or Commissioner or the Joint Director or Deputy Director or Assistant Director.

(iii) **Exercise of power of inquiry where no proceeding pending:** The power in respect of an inquiry, in a case where no proceeding is pending, shall not be exercised by any income-tax authority below the rank of Principal Director or Director or Principal Commissioner or Commissioner without the prior approval of the Principal Director or Director or as the case may be, the Principal Commissioner or Commissioner. However, the Joint Director or Deputy Director or Assistant Director can exercise such power without prior approval from PDIT, DIT, PCIT or CIT.

(iv) **Exercise of power to call for information under section 90 or 90A:** For facilitating quick collection of information on request from tax authorities outside India, notified income-tax authorities (not below the rank of Assistant Commissioner of Income-tax) to have powers under section 131(1) for making an inquiry or investigation in respect of any person or class of persons relating to an agreement for exchange of information under section 90 or 90A, even if no proceeding is pending before it or any other income-tax authority with respect to the concerned person or class of persons. Such notified authorities are also empowered, for the purposes of an agreement referred to in section 90 or section 90A, to exercise the powers conferred under section 133 to call for information, irrespective of whether any proceedings are pending before it or any other income-tax authority.

(8) Power of Survey [Section 133A]

(i) **Power to enter a place within jurisdiction to inspect books of account, to verify cash, stock etc. [Section 133A(1)]:** An income-tax authority may enter any place:

(a) within the limits of the area assigned to him, or

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(b) occupied by any person in respect of whom he exercises jurisdiction, or

(c) in respect of which he is authorised for the purposes of this section by such income-tax authority, who is assigned the area within which such place is situated or who exercises jurisdiction in respect of any person occupying such place,

at which a business or profession or an activity for charitable purpose is carried on, whether such place be the principal place or not of such business or profession or of such activity for charitable purpose, and require any proprietor, trustee, employee or any other person who may at that time and place be attending in any manner to, or helping in, the carrying on of such business or profession or such activity for charitable purpose.

This power may be exercised:

(a) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place;

Power of survey

(b) to afford him the necessary facility to check or verify the cash, stock or other valuable articles or things which may be found therein; and

(c) to furnish such information as he may require as to any matter which may be useful for or relevant to any proceeding under the Income-tax Act, 1961.

This power may be exercised in respect of any place with which the assessee is connected, whether or not such place is the principal place of business or profession or activity for charitable purpose. It will also include any other place, whether any business or profession or activity for charitable purpose is carried on therein or not, in which the person carrying on the business or profession or activity for charitable purpose states that any of his books of account or other valuable article or thing relating to his business or profession or activity for charitable purpose are kept.

(ii) Permitted time for conduct of survey [Section 133A(2)]: The income-tax authority may enter any place of business or profession mentioned above only during the hours at which such place is open for the conduct of business or profession and in the case of any other place, only after sunrise and before sunset.

Business place - during office hours

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For example, if a place is open for business from 11 a.m. to 11 p.m., an income tax authority may enter at 10 p.m. for survey operations. The survey can, however, continue beyond 11 p.m.

(iii) Exercise of power of survey for verification of TDS/TCS [Section 133A(2A)]: An income-tax authority may, for the purpose of verifying that tax has been deducted or collected at source in accordance with the provisions of Chapter XVII-B or Chapter XVII-BB, as the case may be, enter-

(a) any office, or a place where business or profession is carried on, within the limits of the area assigned to him, or

(b) any such place in respect of which he is authorised for the purposes of this section by such income-tax authority who is assigned the area within which such place is situated, where books of account or documents are kept.

The income-tax authority may for this purpose enter an office, or a place where business or profession is carried on after sunrise and before sunset. Further, such income-tax authority may require the deductor or the collector or any other person who may at the time and place of survey be attending to such work,—

After sunrise before sunset

(a) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place, and

(b) to furnish such information as he may require in relation to such matter.

(iv) Permissible and impermissible acts while conducting survey [Section 133A(3)]:

An income-tax authority may -

(a) place marks of identification on the books of account or other documents inspected by him and take extracts and copies thereof;

(b) impound and retain in his custody for such period as he thinks fit any book of account or other documents inspected by him after recording reasons for doing so.

Cannot retain for >15 days without approval of higher authorities.

However, the income tax authority cannot retain in his custody such books of account etc. for a period exceeding 15 days (excluding holidays) without obtaining the approval of the Principal Chief Commissioner or Chief Commissioner or

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Principal Director General or Director General or the Principal Commissioner or Commissioner or Principal Director or Director, as the case may be.

(c) make an inventory of any cash, stock or valuable article or thing checked or verified by him; and

(d) record the statement of any person which may be useful for, or relevant to, any proceeding under the Act.

However, while acting under sub-section (2A), the income-tax authority shall not impound and retain in his custody, any books of account or documents inspected by him or make an inventory of any cash, stock or other valuable articles or thing checked or verified by him.

Any income-tax authority cannot remove or cause to be removed from the place where he has entered, any cash, stock or other valuable article or thing **[Section 133A(4)]**.

Income-tax Authority cannot remove cash, stock or other valuable thing

(v) Power to collect information and record statements in connection with any function, ceremony or event [Section 133A(5)]: The income-tax authorities would also have the power to collect information and record the statements of any of the persons concerned at any time after any function, ceremony or event but even before the stage of commencement of assessment proceedings for the following year for which the information may be relevant, if they are of the opinion that having due regard to the nature, scale and extent of the expenditure incurred, it is necessary or expedient to do so. This provision is intended to help in collecting evidence about ostentatious expenditure incurred for any function, etc., immediately after the event which may be used at the time of the assessment.

(vi) Power to enforce compliance [Section 133A(6)]: If any person who is required to provide facility to the income-tax authority to inspect the books of account or the other documents or to check or verify any cash, stock or other valuable articles or to furnish any information or to have his statement recorded, either refuses or evades do so, the income-tax authority would be entitled to use all the powers vested in it under section 131(1) for enforcing proper compliance with the requirements.

(vii) Meaning of 'proceeding' [Clause (b) of *Explanation* to Section 133A]: For the purpose of this section, "proceeding" means any proceeding under this Act in respect of any year which may be pending on the date on which the powers under this section are exercised or which may have been completed on or before such date and includes also all proceedings under this Act which may be commenced after such date in respect of any year.

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(viii) Meaning of "Income tax authority" and restriction to exercise the power under this section [Clause (a) of *Explanation* to section 133A]:

"Income tax authority", for the purpose of this section, means –

(i) a Principal Commissioner or Commissioner, a Principal Director or Director, a Joint Commissioner or Joint Director, an Assistant Director or Deputy Director or an Assessing Officer or a Tax Recovery Officer; and

(ii) includes an inspector of Income tax (only for the purpose of inspection of books of account or other documents, placing marks of identification on such books of account or other documents inspected by him and making or causing to be made extracts or copies therefrom and recording statements from any person in connection with any ceremony, function or event mentioned in section 133A(5) above).

who is subordinate to the Principal Director General or the Director General or the Principal Chief Commissioner or the Chief Commissioner, as may be specified by the Board.

All income-tax authorities have to take approval from Principal Director General or the Director General or Principal Chief Commissioner or the Chief Commissioner in all cases of survey.

(9) Power to collect certain information [Section 133B]

(i) Under this section, an income-tax authority may enter

- any building or place within its jurisdiction or
- any building or place which is occupied by any person in respect of whom the said authority exercises jurisdiction

at which a business or profession is carried on for the purpose of collecting any information which may be useful for or relevant for the purposes of the Act. It is not necessary that such a place should be the principal place of the business or profession.

(ii) The authority may require any proprietor, employee or any other person who may at the time and place be attending in any manner to or helping in carrying on such business or profession to furnish such information as may be prescribed.

(iii) An income-tax authority **may enter** any place of business or profession referred to above **only during the hours at which such place is open for business**.

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(iv) Such authority **shall on no account remove or cause to be removed** from the building or place wherein he has entered any books of account or other valuable articles or things.

(v) In this section, 'income-tax authority' means a Joint Commissioner, an Assistant Director or Deputy Director or an Assessing Officer, and includes an Inspector of Income-tax who has been authorised by the Assessing Officer to exercise the power conferred under this section in relation to the area in respect of which the Assessing Officer exercises jurisdiction or any part thereof.

(vi) **Penalty under section 272AA for failure to furnish the prescribed information:** Fail to furnish the prescribed information as required as per section 133B would attract penalty of upto ₹ 1000 under section 272AA. Such penalty is imposable by the joint Commissioner or Assistant Director or Deputy Director or the Assessing Officer after giving the person an opportunity of being heard in the matter.

(10) Prescribed income-tax authorities empowered to call for information [Section 133C]

(i) Section 133C enables the prescribed income-tax authority to verify the information in its possession relating to any person, which may be useful for or relevant to any inquiry or proceedings under this Act.

(ii) Under this section, for the purposes of verification of information in its possession relating to any person, prescribed income-tax authority, may, issue a notice to such person requiring him,

- on or before a date to be therein specified,
- to furnish information or documents,
- verified in the manner specified therein
- which may be useful for, or relevant to, any inquiry or proceeding under the Act.

(iii) The prescribed income-tax authority may process and utilise such information and document in accordance with the provisions of section 135A empowering the Central Government to make a scheme for faceless collection of information.

The Central Government has, vide Notification No. 137/2021 dated 13.12.2021 made e-Verification Scheme, 2021 as empowered under section 135A.

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The prescribed income-tax authority under section 133C shall be an income-tax authority not below the rank of Assistant Commissioner of Income-tax who has been authorised by the CBDT to act as such authority for the purposes of the section.

(iv) The term "proceeding" means any proceeding under the Act in respect of any year which may be pending on the date on which the powers under this section are exercised or which may have been completed on or before such date.

Meaning of Proceeding

The term "proceeding" also includes all proceedings under the Income-tax Act, 1961 which may be commenced after such date in respect of any year.

(11) **Power to inspect registers of companies [Section 134]:** The Assessing Officer, the Joint Commissioner or the Joint Commissioner (Appeals) or the Commissioner (Appeals), or any person subordinate to him authorised in writing in this behalf by the Assessing Officer, the Joint Commissioner or the Joint Commissioner (Appeals) or the Commissioner (Appeals), as the case may be, may inspect and if necessary, take copies, or cause copies to be taken, of any register of the members, debenture holders or mortgagees of any company or of any entry in such register.

(12) **Other powers [Sections 135 and 136]:** The Principal Director General or Director General or Principal Director or Director, the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner and the Joint Commissioner are competent to make any enquiry under this act and for all purposes they shall have the powers vested in an Assessing Officer in relation to the making of enquiries.

If the Investigating officer is denied entry into the premises, the said Officer shall have all the powers vested in him under sections 131(1) and (2). All the proceedings before Income-tax authorities are judicial proceedings for purposes of section 196 of the Indian Penal Code, 1860 ***(Bharatiya Nyaya Sanhita, 2023)***, and fall within the meaning of sections 193 and 228 of the Code.

An income-tax authority shall be deemed to be a Civil Court for the purposes of section 195 of the Criminal Procedure Code, 1973.

(13) **Faceless collection of information [Section 135A]:**

(i) Section 135A provides for faceless collection of information.

(ii) Section 135A(1) empowers the Central Government to make a scheme, by notification in the Official Gazette, for the following purposes –

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(iii) For the purpose of giving effect to the scheme, section 135A(2) empowers the Central Government to direct , by notification in the Official Gazette, that any of the provisions of the Income-tax Act, 1961 would not apply or would apply with specified exceptions, modifications and adaptations.

(iv) Section 135A(3) requires that every notification to be laid before each House of Parliament, as soon as may be after notification is issued.

Accordingly, the Central Government has, vide Notification No. 137/2021 dated 13.12.2021 made e-Verification Scheme, 2021[3].

[3] To know the scheme in detail, please refer - https://incometaxindia.gov.in/communications/notification/notification-137-2021.pdf.

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(14) Disclosure of information respecting assessees [Section 138]

(i) Under section 138(1)(a), the CBDT, or any other income-tax authority specified by it by a general or special order, may furnish or cause to be furnished, any information received or obtained by any income-tax authority, in the performance of his functions under the Act which may be necessary for the purpose of enabling any officer, or authority or body performing any function:

(a) under any law relating to the imposition of any tax, duty or cess or to dealings in foreign exchange

(b) under any other law as the Central Government may notify in the Official Gazette in the public interest.

As per section 138(1)(b), if a person makes an application in accordance with Rule 113 of the Income-tax Rules, 1962 to the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner of Income-tax in the prescribed form for obtaining any information relating to any assessee received or obtained by any income-tax authority in the performance of his functions under the Income-tax Act, 1961, the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, may, if he is satisfied that it is in the public interest, furnish or cause to be furnished the information asked for. His decision in this regard cannot be called in question in any court of law.

(ii) Nevertheless, section 138(2) empowers the Central Government to direct, having regard to practice and usage customary or otherwise, and any other relevant factors, that no information or documents shall be furnished or produced by a public servant in respect of such matters relating to a particular class of assessees or except to certain authorities which may be specified.

For instance, in exercise of the powers conferred by section 138(2), the Central Government having regard to all the relevant factors, has directed, vide *Notification No.56/2016 dated 6.7.2016,* that no public servant shall produce before any person or authority any such document or record or any information or computerised data or part thereof as comes into his possession during the discharge of official duties in respect of a valid declaration made under the Income Declaration Scheme, 2016', contained in Chapter IX of the Finance Act, 2016.

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SIGNIFICANT SELECT CASES

S. No.	Case Law	
1.	***CIT and Anr v. SV Gopala and Others (2017) 396 ITR 694 (SC)***	
	Issue	**Decision**
	Does the CBDT have the power to amend legislative provisions through a Circular?	The CBDT does not have the power to amend legislative provisions in exercise of its powers u/s 119 of the Income-tax Act, 1961 by issuing a Circular.
2.	***Hemant Kumar Sindhi & Another v. CIT (2014) 364 ITR 555 (All)***	
	Issue	**Analysis & Decision**
	Can the assessee's application, for adjustment of tax liability on income surrendered during search by sale of seized gold bars, be entertained where assessment has not been completed?	Consequent to a search in the premises of the assessee, some gold bars were seized from the locker. The assessee voluntarily disclosed some income during the course of search. The assessee filed an application for sale of the gold bars and **adjustment of tax liability on undisclosed income** out of the sale proceeds. This would obviate his liability to pay interest under sections 234B and 234C. Section 132B(1)(i) uses the expression "the amount of any existing liability" and "the amount of the liability determined". The words "existing liability" postulates a liability that is crystallized by adjudication; Likewise, "a liability is determined" only on completion of the assessment. **Until the assessment is complete, it cannot be postulated that a liability has been crystallized.** As per the first proviso to section 132B(1)(i), the assessee may make an application to the Assessing Officer for release of the assets seized. However, he has to explain the nature and source of acquisition of the asset to the satisfaction of the Assessing Officer. It is not the *ipse dixit* of the assessee but the satisfaction of the Assessing Officer on the basis of the explanation tendered by the assessee which is material. **Only when the liability is determined on the completion of assessment that it would stand crystallized and in pursuance of which a demand can be raised and recovery can be initiated.** Therefore, in the present case, the first proviso to section 132B(1)(i) would not be attracted.

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3.	***Kathiroor Service Co-operative Bank Ltd. v. CIT (CIB) (2014) 360 ITR 0243 (SC)***	
	Issue	**Analysis & Decision**
	Where no proceeding is pending against a person, can the Assessing Officer call for information under section 133(6), which is useful or relevant to any enquiry, with the permission of Director or Commissioner?	The Assessing Officer has been empowered to requisition information which will be useful for or relevant to **any enquiry** or proceeding under the Income-tax Act, 1961 in the case of any person. However, an income-tax authority below the rank of the Principal Director or Director or Principal Commissioner or Commissioner can exercise this power in respect of an **enquiry** in a case where no proceeding is pending, only with the prior approval of the Principal Director or Director or Principal Commissioner or Commissioner. ***Note*** *– The power in respect of an inquiry, in a case where no proceeding is pending, can, however, be exercised by the Joint Director, Deputy Director and Assistant Director, without the prior approval of the Principal Director/Director/Principal Commissioner/Commissioner.*

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TEST YOUR KNOWLEDGE

Questions

1. *ABC Ltd. regularly files its return of income electronically. While trying to upload return of income for assessment year 2025-26 on 31st October, 2025, ABC Ltd found it extremely difficult to do the same due to network problems and ultimately, became successful in making e-filing of its return only at 1 a.m. on 1st November,2025. The return contained a claim for carry forward of business loss of ₹ 3.10 crores. This circumstance was recorded in an e-mail addressed to the competent income-tax authority on 1st November, 2025. ABC Ltd. made a request to the Principal Chief Commissioner of Income-tax (PCCIT) for condonation of delay in filing return of income.*

   Discuss whether the PCCIT has the power to condone the delay in filing the return of income and permit carry forward of loss in the given circumstance.

2. *Examine the correctness of the statement "the jurisdiction of an Assessing Officer cannot be objected by the assessee".*

3. *The Director General of Income-tax after getting the information that Mr. Mogambo is in possession of unaccounted cash of ₹ 50 lakhs, issued orders by invoking powers vested in him as per section 131(1A), for its seizure. Is the order for seizure of cash issued by the Director General of Income-tax correct? If not, does the Director General of Income-tax have any other power to seize such cash?*

4. *The premises of Ganesh were subjected to a search under section 132 of the Act. The search was authorized and the warrant was signed by the Joint Commissioner of Income-tax having jurisdiction over the assessee, consequent to information in his possession. The assessee challenged the validity of search on the ground that section 132(1) does not empower Joint Commissioner to authorise a search under the Act. Decide the correctness of the contention raised by the assessee.*

5. *Examine whether the information regarding possession of unexplained assets and income received from the Central Bureau of Investigation, a Government agency, can constitute "information" for action under section 132. Discuss.*

6. *Cash of ₹ 25 lakhs was seized on 12.9.2025 in a search conducted as per section 132 of the Act. The assessee moved an application on 27.10.2025 to release such cash after explaining the sources thereof, which was turned down by the department. The assessee seeks your opinion on the following issues:*

   (i) Can the department withhold the explained money?

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(ii) If yes, then to what extent and upto what period?

7. *The business premises of Ram Bharose Ltd. and the residence of two of its directors at Delhi were searched under section 132 by the DDI, Delhi. The search was concluded on 9.8.2025 and following were also seized besides other papers and records:*

   (i) Papers found in the drawer of an accountant relating to Shri Krishna Ltd., Mumbai indicating details of various business transactions. However, Ram Bharose Ltd. is not having any direct or indirect connection of any nature with these transactions and Shri Krishna Ltd., Mumbai and its directors.

   (ii) Jewellery worth ₹ 5 lakhs from the bed room of one of the directors, which was claimed by him to be of his married daughter.

   (iii) Papers recording certain transactions of income and expenses having direct nexus with the business of the company for the period from 16.4.2020 to date of search. It was admitted by the director that the transactions recorded in such papers have not been incorporated in the books.

   You are required to answer on the basis of aforesaid and the provisions of Act, following questions:

   (a) What action the DDI shall be taking in respect of the seized papers relating to Shri Krishna Ltd., Mumbai?

   (b) Whether the contention raised by the director as to jewellery found from his bed-room will be acceptable?

   (c) What presumption shall be drawn in respect of the papers which indicate transactions not recorded in the books?

8. *In the course of search on 25.03.2026, assets were seized. Examine the procedure laid down to deal with such seized assets under the Act.*

Answers

1. Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or **any other relief under the Act** after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of late filing of a return is relatable to a claim arising under the category of "any other relief available under the Act". Therefore, CBDT has the power to condone delay in filing of such loss return due to genuine reasons.

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The facts of the case are similar to the case of *Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441*, where the Delhi High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown justifiable reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the assessee. Therefore, the Court held that the delay of one day in filing of the return had to be condoned.

The CBDT has, *vide* Circular No. 11/2024 dated 1.10.2024, specified the monetary limits along with following authorities to be approached for this purpose.

Quantum of claim	Concerned Income-tax Authority
Where the claim is upto ₹ 1 crore for one A.Y.	Principal CIT or CIT
Where the claim is above ₹ 1 crore but upto ₹ 3 crores for any one A.Y.	CCIT
Where the claim is above ₹ 3 crores for any one A.Y.	Principal CCIT

Applying the rationale of the above court ruling and the clarification given in CBDT Circular to the case on hand, the Principal CCIT has the power to condone the delay in filing the return of income of ABC Ltd. and permit carry forward of business loss of ₹ 3.10 crores, since the delay of one hour was due to a genuine and justifiable reason i.e., network problem while e-filing the return.

2. According to section 124(3), the assessee can raise a question as to the jurisdiction of an Assessing Officer within the prescribed time limit as under:

(i) **where a return has been filed** under section 139(1) then, within one month from the date of service of notice under section 142(1) or section 143(2) or before the completion of assessment, whichever is earlier.

(ii) **where no return has been filed,** then, within the expiry of time allowed by the notice under section 142(1) or section 148 for filing the return or within the time allowed in show cause notice issued seeking as to why a best judgment assessment under section 144 should not be made, whichever is earlier.

(iii) where search is initiated under section 132 or books of accounts, other documents or any assets are requisitioned under section 132A, within one month from the date on

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which he was served with a notice under section 153A(1) or 153C(2)[4] or before the completion of assessment, whichever is earlier.

Where the assessee calls in question the jurisdiction of an Assessing Officer and the Assessing Officer is not satisfied with such claim, he shall refer the matter for determination by the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner before the assessment is made.

Therefore, in view of the above provisions, the statement that "the jurisdiction of an Assessing Officer cannot be objected by the assessee" is not correct.

3. The powers under section 131(1A) deal with power of discovery and production of evidence. They do not confer the power of seizure of cash or any asset. The Director General, for the purposes of making an enquiry or investigation relating to any income concealed or likely to be concealed by any person or class of persons within his jurisdiction, shall be competent to exercise powers conferred under section 131(1), which confine to discovery and inspection, enforcing attendance, compelling the production of books of account and other documents and issuing commissions. Thus, the power of seizure of unaccounted cash is not one of the powers conferred on the Director General under section 131(1A).

However, under section 132(1), the Director General has the power to authorize any Additional Director or Additional Commissioner or Joint Director or Joint Commissioner etc. to seize money found as a result of search [Clause (iii) of section 132(1)], if he has reason to believe that any person is in possession of any money which represents wholly or partly income which has not been disclosed [Clause (c) of section 132(1)]. Therefore, the proper course open to the Director General is to exercise his power under section 132(1) and authorize the Officers concerned to enter the premises where the cash is kept by Mr. Mogambo and seize such unaccounted cash.

4. Under section 132(1), the income-tax authorities listed therein are empowered to authorise other income-tax authorities to conduct search and seizure operations. The authorities empowered to issue authorisation include such Additional Director, Additional Commissioner, Joint Director and Joint Commissioner as are empowered by the CBDT to do so.

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[4] *Section 153A deals with assessment in case of search, initiated under section 132 or books of accounts or other documents or any assets requisitioned under section 132A before 1.4.2021.*

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However, a Joint Commissioner can issue warrant of authorisation only if he has been specifically empowered to do so by the CBDT. Therefore, only if the Joint Commissioner has not been specifically empowered by the CBDT to do so, the contention of the assessee would hold good. If the Joint Commissioner has been duly empowered by the CBDT, then the contention raised by the assessee would not be valid.

5. As per section 132(1)(c), authorisation for search and seizure can take place if the authority, in consequence of information in his possession, has reason to believe that any person is in possession of money, bullion, jewellery or other valuable article or thing and these assets represent, either wholly or partly, income or property which has not been, or would not be disclosed by such person for the purposes of this Act. In the absence of such information, a search cannot be validly authorised.

The Apex Court in *UOI v Ajit Jain [2003] 260 ITR 80* has held that mere intimation by the CBI that money was found in the possession of the assessee, which according to the CBI was undisclosed, without something more, does not constitute "information" within the meaning of section 132, on the basis of which a search warrant could be issued. Consequently, the Supreme Court held that the search conducted on this basis and the assessment made pursuant to such search was not valid.

6. The proviso to section 132B(1)(i) provides that where the person concerned makes an application to the Assessing Officer, within 30 days from the end of the month in which the asset was seized, for release of the asset and the nature and source of acquisition of the asset is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, 1961, etc. out of such asset. 'Existing liability', however, does not include advance tax payable. Such asset or portion thereof has to be released within 120 days from the date on which the last of the authorisations for search under section 132 was executed.

In this case, since the application was made to the Assessing Officer within 30 days from the end of the month in which search was conducted, the department may retain only the amount of existing liability, if any, and the balance may have to be released within 120 days from the date on which the last of the authorisations for search under section 132 was executed.

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Note: *It may be noted that one of the conditions mentioned above for release of an asset is that the nature and source of acquisition of the asset should be explained to the satisfaction of the Assessing Officer. However, in this case, it has been given that the assessee's application for release of the asset, explaining the sources thereof, was turned down by the Department. If the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset, then, the asset (in this case, cash) cannot be released, since the condition mentioned above is not satisfied.*

7. **(a)** The authorised officer being DDI, Delhi is not having any jurisdiction over Shri Krishna Ltd., Mumbai, and therefore, as per section 132(9A), the papers seized relating to this company shall be handed over by him to the Assessing Officer having jurisdiction over Shri Krishna Ltd., Mumbai within a period of 60 days from the date on which the last of the authorisations for search was executed for taking further necessary action thereon.

(b) The contention raised by the Director will not be acceptable because as per the provisions of sub-section (4A)(i) of section 132, where any books of account, other documents, money, bullion, jewellery or other valuables are found in the possession or control of any person in the course of search, then, in respect thereof, it may be presumed that the same belongs to that person.

(c) As per section 132(4A), the presumptions in respect of the papers, indicating transactions not recorded in the books but having direct nexus with the business of the company, are that the same belong to the company, contents of such papers are true and the handwriting in which the same are written is/are of the persons(s) whose premises have been searched.

8. Section 132B of the Income-tax Act, 1961 deals with the application of assets seized under section 132. Such assets will be first applied towards the existing liability under the Income-tax Act, 1961, etc. 'Existing liability', however, does not include advance tax payable. Further, the amount of liability determined on completion of assessment or reassessment or recomputation pursuant to search or completion of the assessment under block assessment of search cases (including any penalty levied or interest payable in connection with such assessment) and in respect of which the assessee is in default or deemed to be in default, may be recovered out of such assets.

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Where the nature and source of acquisition of such seized assets is explained to the satisfaction of the Assessing Officer, the amount of any existing liability mentioned above may be recovered out of such asset and the remaining portion, if any, of the asset may be released, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, as the case may be. The release must be made within 120 days from the date on which the last of the authorisations for search under section 132 or for requisition under section 132A was executed. The assets would be released to the person from whose custody they were seized.

When the assets consist of solely of money, or partly of money and partly of other assets, the Assessing Officer may apply such money in the discharge of the liabilities referred to above and the assessee shall be discharged of such liability to the extent of the money so applied. However, the assets other than money may also be applied for the discharge of such liabilities if the complete recovery could not be made from the money seized or the money seized was not sufficient.

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CHAPTER 15

ASSESSMENT PROCEDURE

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** when return filing becomes mandatory for different persons;
- **identify and recall** the due dates for filing of return in case of such persons;
- **comprehend and apply** the provisions relating to belated return, revised return and defective return;
- **appreciate** the statutory provisions relating to special audit directed by the Assessing Officer;
- **appreciate** the procedure for assessment (including faceless assessment) – self-assessment, summary assessment, scrutiny assessment and best judgement assessment;
- **appreciate** the circumstances when the Assessing Officer can issue notice for reassessment of income and the time limit for issuance of such notice;
- **know and recall** the time limits for completion of assessments;
- **appreciate** the provisions for rectification of mistake apparent from the record.

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CHAPTER OVERVIEW

- Filing of return of income [Section 139]
  - ROI on or before due date [Section 139(1)]
  - Loss return [Section 139(3)]
  - Belated return [Section 139(4)]
  - Revised Return [Section 139(5)]
  - Updated Return [Section 139(8A)]
- Permanent Account Number [Section 139A]
- Quoting of Aadhaar Number [Section 139AA]
- Persons authorised to verify Return of Income [Section 140]
- Self-assessment [Section 140A]
- Provisions contained under section 142
- Assessment [Section 143]
- Best Judgement Assessment [Section 144]
- Faceless Assessment [Section 144B]
- Reference to Dispute Resolution Panel [Section 144C]
- Income Escaping Assessment [Sections 147 to 151]
- Assessment for Search Cases [Chapter XIV-B]
- Other Provisions [Section 152]
- Time limits for completion of assessments [Section 153]
- Rectification of Mistake [Section 154]
- Other amendments [Section 155]
- Notice of Demand [Section 156]
- Intimation of loss [Section 157]
- Faceless rectification, amendments and issuance of notice or intimation [Section 157A]

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15.1 RETURN OF INCOME

The Income-tax Act, 1961 contains provisions for filing of return of income. Return of income is the format in which the assessee furnishes information as to his total income and tax payable. The format for filing of returns by different assessees is notified by the CBDT. The particulars of income earned under different heads, gross total income, deductions from gross total income, total income and tax payable by the assessee are generally required to be furnished in a return of income. In short, a return of income is the declaration of income by the assessee in the prescribed format.

15.1.1 Compulsory filing of return of income [Section 139(1)]

(1) As per section 139(1), it is **compulsory for companies and firms to file a return** of income or loss for every previous year on or before the due date in the prescribed form.

All companies and firms to mandatorily file ROI by due date

(2) A return of income or loss for the previous year in the prescribed form and verified in the prescribed manner on or before the due date, has to be filed by every person, being a resident other than not ordinarily resident in India within the meaning of section 6(6), who is not required to furnish a return under section 139(1) if such person, at any time during the previous year –

(a) holds, as a beneficial owner or otherwise, any asset (including any financial interest in any entity) located outside India or has a signing authority in any account located outside India; or

(b) is a beneficiary of any asset (including any financial interest in any entity) located outside India.

However, an individual being a beneficiary of any asset (including any financial interest in any entity) located outside India would not be required to file return of income, where, income, if any, arising from such asset is includible in the income of the person referred to in (a) above in accordance with the provisions of the Income-tax Act, 1961.

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Meaning of "beneficial owner" and "beneficiary" in respect of an asset for the purpose of section 139:

<u>Requirement of filing of return of income as per the fourth and fifth proviso to section 139(1)</u>

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(3) Further, **every person, being an individual or a HUF or an AOP or BOI or an artificial juridical person** -

Cases where ROI mandatorily to be filed

– **whose total income** or the total income of any other person in respect of which he is assessable under this Act during the previous year

– **without giving effect** to the exemption provisions contained in sections 54/54B/54D/ 54EC/54F/54G/54GA in respect of capital gains or deductions under Chapter VI-A

– **exceeds the basic exemption limit**

Different BEL

is required to file a return of his income or income of such other person on or before the due date.

For the A.Y. 2026-27, the basic exemption limit is **₹ 4,00,000** for individuals/HUF/AOPs/BOIs and artificial juridical persons under the default regime under section 115BAC. These amounts denote the level of total income, which is arrived at after claiming the admissible deductions under Chapter VI-A, i.e., 80CCD(2), 80CCH(2) and 80JJAA under default regime and exemption under section 54/54B/54D/54EC/54F/54G/54GA in respect of capital gain. However, the level of total income to be considered for the purpose of filing a return of income is the income before claiming the admissible deductions under Chapter VI-A and exemption under section 54/54B/54D/54EC/54F/54G/54GA.

However, where the assessee being an individual/HUF/AOPs/BOIs and artificial juridical persons have exercised the option of shifting out of the default tax regime provided under section 115BAC(1A), the basic exemption limit would be ₹ 2,50,000 for individuals/HUFs/ AOPs/BOIs and artificial juridical persons, ₹ 3,00,000 for resident individuals of the age of 60 years or more but less than 80 years and ₹ 5,00,000 for resident individuals of the age of 80 years or more at any time during the previous year. These amounts denote the level of total income, which is arrived at after claiming exemption under sections 54/54B/54D/54EC/ 54F/54G/54GA in respect of capital gains and the admissible deductions under Chapter VI-A. However, the level of total income to be considered for the purpose of filing a return of income is the income before claiming exemption under sections 54/54B/54D/54EC/54F/54G/54GA in respect of capital gains and the admissible deductions under Chapter VI-A.

(4) Any **person other than a company or a firm**, who is **not required** to furnish a return under section 139(1), would have to file income-tax return in the prescribed form and manner on or before the due date if, during the previous year, such person –

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(a) has **deposited** an amount or aggregate of the amounts **exceeding ₹ 1 crore** in one or more current accounts maintained with a banking company or a co-operative bank; or

(b) has **incurred expenditure** of an amount or aggregate of the amounts **exceeding ₹ 2 lakh** for himself or any other person **for travel to a foreign country**; or

(c) has incurred **expenditure** of an amount or aggregate of the amounts **exceeding ₹ 1 lakh** towards **consumption of electricity**; or

(d) fulfils such other prescribed conditions.

Accordingly, CBDT, vide Notification No. 37/2022 dated 21.4.2022, inserted Rule 12AB stating the conditions wherein any person other than a company or a firm, who is not required to furnish a return under section 139(1), would have to file income-tax return in the prescribed form and manner on or before the due date if, during the previous year:

Prescribed Conditions where ROI mandatorily to be filed

(i) his total sales, turnover or gross receipts, as the case may be, in the business **exceed ₹ 60 lakh**; or

(ii) his total gross receipts in profession **exceed ₹ 10 lakh**; or

(iii) the aggregate of tax deducted at source and tax collected at source during the previous year, in the case of the person, is **₹ 25,000 or** more (in the case of a resident individual **who is aged ≥ 60 years** at any time during the relevant P.Y, the limit will be **₹ 50,000 or more**); or

(iv) the deposit in one or more savings bank accounts of the person, in aggregate, is **₹ 50 lakh or more.**

31st July or 31st Oct. or 30th Nov. of the A.Y

(5) **Meaning of due date**: 'Due date' means -

	Assessee	Due Date
(i)	Where the assessee, other than an assessee referred to in clause (ii), is - (a) a company, (b) a person (other than a company) whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force; or (c) a partner of a firm whose accounts are required to be audited under the	31st October of the assessment year

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	Income-tax Act, 1961 or any other law for the time being in force or the spouse of such partner if the provisions of section 5A applies to such spouse.	
(ii)	in the case of an assessee including the partners of the firm or the spouse of such partner (if the provisions of section 5A applies to such spouse), being such assessee who is required to furnish a report referred to in section 92E.	30th November of the assessment year
(iii)	in the case of any other assessee.	31st July of the assessment year

(6) 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 in the Union territories of Dadra and Nagar Haveli and Daman and Diu:

- **Income under the head "Salaries":** Where the husband or, as the case may be, the wife governed by the aforesaid system of community of property has any income under the head "Salaries", such income shall be included in the total income of the spouse who has actually earned it [Section 5A(2)]
- **Income under any head of income (other than under the head "Salaries"):** The income of the husband and of the wife under any head of income shall not be assessed as that of such community of property (whether treated as an association of persons or a body of individuals), but such income of the husband and of the wife under each head of income (other than under the head "Salaries") shall be apportioned equally between the husband and the wife and the income so apportioned shall be included separately in the total income of the husband and of the wife respectively, and the remaining provisions of this Act shall apply accordingly [Section 5A(1)]

15.1.2 Interest for default in furnishing return of income [Section 234A]

(1) Interest under section 234A is attracted for failure to file a return of income on or before the due date mentioned above, i.e. interest is payable where an assessee furnishes the return of income after the due date or does not furnish the return of income.

1% p.m after due date of ROI

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(2) Simple interest@1% per month or part of the month is payable for the period commencing from the date immediately following the due date and ending on the following dates -

Circumstances	Ending on the following dates
Where the return is furnished after the due date	the date of furnishing of the return
Where no return is furnished	the date of completion of assessment

(3) The interest has to be calculated on the amount of tax on total income as determined under section 143(1) or on regular assessment, as reduced by the advance tax paid, any tax deducted or collected at source, any relief of tax allowed under section 89/90/90A/91 and any tax credit allowed to be set-off in accordance with section 115JAA or 115JD.

Note – *For detailed understanding of section 234A, refer to Chapter 13: Tax deduction, collection and recovery of tax of this module.*

15.1.3 Specified class or classes of persons to be exempted from filing return of income [Section 139(1C)]

(1) **Persons required to furnish return of income:** Every person who falls within the ambit of the conditions mentioned under section 139 has to furnish a return of his income on or before the due date specified under section 139(1).

(2) **Exemption from filing return of income:** To reduce the compliance burden of certain types of taxpayers, the Central Government has been empowered to notify the class or classes of persons who will be exempted from the requirement of filing of return of income, subject to satisfying the prescribed conditions. Accordingly, the Central Government has, vide Notification No.55/2019 dated 26.7.2019 and ***Notification No. 49/2023 dated 14.7.2023***, **exempted non-corporate non-residents and foreign companies**, having **any income** chargeable under the Income-tax Act, 1961 during a previous year **from any investment fund set up in an International Financial Services Centre (IFSC) located in India**, from the requirement of furnishing a return of income under section 139(1) from A.Y.2019-20 onwards:

Exempted Persons

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Exemption from filing return of income **would be available** to such notified class of persons only if	Exemption from the requirement of furnishing a return of income **would not be** available to such notified class of persons
• any income-tax due on income of the said class of persons has been deducted at source and remitted to the Central Government by the investment fund at the tax-rate in force as per provisions of section 194LBB; and • there is no other income during the previous year for which the said class of persons, is otherwise liable to file the income-tax return.	• where a notice under section 142(1) or section 148 or section 153A or section 153C [relevant in respect of search initiated or books of accounts requistioned on or before 31.3.2021] has been issued for filing a return of income for the assessment year specified therein to such notified class of persons

Meaning of Investment fund

- any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or Category II Alternative Investment Fund (AIF) and is regulated under the SEBI (AIF) Regulations, 2012 or regulated under the IFSC Authority (Fund Management) Regulations, 2022.

The Central Government has, vide *Notification No. 119/2021 dated 11.10.2021,* also exempted the following class of persons mentioned in column (2) of the Table below, subject to the conditions specified in column (3) of the said Table, from the requirement of furnishing a return of income under section 139(1) from the assessment year 2021-22 onwards:

S. No.	Class of Persons	Conditions
(1)	(2)	(3)
1.	(i) Non-corporate non-resident; or (ii) a foreign company.	The said class of person should not earn any income in India, during the previous year, other than the income from investment in the specified fund referred to in sub-clause (i) of clause (c) of Explanation to section 10(4D). The provisions of section 139A are not applicable to the said class of persons subject to fulfillment of the conditions mentioned in Rule 114AAB(1) [Read discussion under section 139A in this chapter] [Refer Chapter 2: Non-resident Taxation in Module 4 for detailed reading of section 10(4D)]

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2.	a non-resident, being an eligible foreign investor.	(i)	The said class of persons, during the previous year, has made transaction only in capital asset referred to in section 47(viiab) (bonds or GDRs under section 115AC, rupee denominated bonds of an Indian company, derivative and other notified securities) which are listed on a recognised stock exchange located in any International Financial Services Centre and the consideration on transfer of such capital asset is paid or payable in foreign currency;
		(ii)	The said class of persons does not earn any income in India, during the previous year, other than the income from transfer of capital asset referred to in section 47(viiab) (bonds or GDRs under section 115AC, rupee denominated bonds of an Indian company, derivative and other notified securities); and
		(iii)	The provisions of section 139A are not applicable to the said class of persons subject to fulfillment of the conditions mentioned in Rule 114AAB(2A) (Read discussion under section 139A in this Chapter).

15.1.4 Return of Loss [Section 139(3)]

(1) **Return of loss:** This section requires the assessee to file a return of loss in the same manner as in the case of return of income within the time allowed under section 139(1).

(2) **Compulsory filing return of loss on or before the due date to carry forward and set-off certain losses:** Section 80 requires mandatory filing of return of loss under section 139(3) on or before the due date specified under section 139(1) for carry forward of the following losses -

(a) Business loss under section 72(1)

(b) Speculation business loss under section 73(2)

(c) Loss from specified business under section 73A(2)

(d) Loss under the head "Capital Gains" under section 74(1)

(e) Loss from the activity of owning and maintaining race horses under section 74A(3)

Consequently, section 139(3) requires the filing of a return of loss mandatorily within the time allowed under section 139(1) for claiming carry forward of the losses mentioned in (2) above.

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However, loss under the head "Income from house property" under section 71B and "unabsorbed depreciation" under section 32 can be carried forward for set-off even though return of loss has not been filed before the due date.

(3) **Non-receipt of a notice from the Assessing Officer to file a return not a valid excuse:** A return of loss has to be filed by the assessee in his own interest, and the non-receipt of a notice from the Assessing Officer requiring him to file the return cannot be a valid excuse under any circumstances for the non-filing of such return.

15.1.5 Belated Return [Section 139(4)]

(1) **Furnishing of belated return of income:** Any person who has not furnished a return within the time allowed to him under section 139(1), may furnish the return for any previous year at any time -

(i) before **three months prior to the end of the relevant assessment year (i.e., 31.12.2026 for P.Y. 2025-26)**; or

(ii) before the completion of the assessment,

whichever is earlier.

File ROI latest by 31st Dec. of RAY

Thus, a belated return can be filed only in case a person has not furnished his return within the time allowed under section 139(1).

(2) **Consequences of filing a belated return:**

(i) Certain losses computed under specified sections (refer to para (2) of 15.5 above) cannot be carried forward for set-off in the subsequent years.

(ii) Interest under section 234A for the delay in furnishing the return shall be leviable.

(iii) Fee of ₹ 5,000 under section 234F would be leviable where return is filed after the due date. However, the late fee shall not exceed ₹ 1,000 where the total income does not exceed ₹ 5,00,000.

(iv) Further, as per section 80AC, deductions in respect of certain incomes under Chapter VI-A [Heading C- Deduction in respect of certain incomes] would not be available.

(v) Additionally, no deduction under section 10AA shall be available to an eligible unit established in SEZ if it fails to furnish its return of income on or before the due date.

(vi) Assessee can not opt out of default tax regime under section 115BAC while filing a belated return, i.e., he/she/it has to file a belated return by paying taxes as per default tax regime only.

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15.1.6 Return of Income of Charitable Trusts and Institutions [Section 139(4A)]

(1) **Person required to furnish return under section 139(4A):** Every person in receipt of income -

(i) derived from property held under a trust or any other legal obligation wholly or partly for charitable or religious purposes; or

(ii) by way of voluntary contributions on behalf of such trust or institution

File ROI by due date for exemption u/s 11 and 12

must furnish a return of income if the total income in respect of which he is assessable as a representative assessee (computed before allowing any exemption under sections 11 and 12) exceeds the basic exemption limit.

Such persons should furnish the return in the prescribed form and verify in the prescribed manner, containing all the particulars prescribed for this purpose.

(2) **Return filed by the representative-assessee:** This return must be filed by the representative-assessee voluntarily within the time limit. Any failure on the part of the assessee would attract liability to pay interest, fees, and a penalty.

(3) **Due date for filing return of income in case books of account are required to be audited:** It may be noted that a charitable trust or other legal obligation is required to get its accounts audited when its income before claiming exemption under sections 11 and 12 exceeds basic exemption limit. In such a case, the due date would be **31st October** of the relevant assessment year.

15.1.7 Return of Income of Political Parties [Section 139(4B)]

(1) **Political party required to furnish return of income under section 139(4B):** Under this section, the Chief Executive Officer of the political party is statutorily required to file a return of income of the political party if, before claiming exemption under section 13A, the political party has income exceeding the basic exemption limit.

The return must be filed in the prescribed form and verified in the prescribed manner setting forth such other particulars as may be prescribed by the CBDT. The provisions of the Act would apply as if it were a return required to be furnished under section 139(1).

File ROI by due date for exemption u/s 13A

(2) **Furnishing of return mandatory to claim exemption under section 13A:** The grant of exemption from income-tax to any political party under section 13A is subject to the condition

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that the political party submits a return of its total income within the time limit prescribed under section 139(1) and gets the accounts audited.

(3) **Due date for filing return of income:** Since the audit of accounts is mandatory for the political party for claiming exemption under section 13A, the due date for filing of return of income would be **31st of October** of the relevant assessment year.

15.1.8 Mandatory filing of returns by research associations, news agency, trade unions, etc. [Section 139(4C)]

(1) It will be mandatory for the following institutions/associations/persons etc. to file the return of income if their total income without giving effect to exemption under respective clauses of section 10, exceeds the basic exemption limit –

	Institution/Association/Persons etc.	Applicable section
(a)	Research association	10(21)
(b)	News agency	10(22B)
(c)	Association or institution	10(23A)
(d)	Fund for the welfare of employees or their dependents	10(23AAA)
(e)	Institution	10(23B)
(f)	Fund or institution	10(23C)(iv)
(g)	Trust or institution	10(23C)(v)
(h)	University or other educational institution	10(23C)(vi)/(iiiad)/(iiiab)
(i)	Hospital or other medical institution	10(23C)(via)/(iiiae)/(iiiac)
(j)	Mutual Fund	10(23D)
(k)	Securitisation Trust	10(23DA)
(l)	Investor Protection Fund	10(23EC)/(23ED)
(m)	Core Settlement Guarantee Fund	10(23EE)
(n)	Venture Capital Company/Venture Capital Fund	10(23FB)
(o)	Trade Union/association	10(24)(a)/(b)
(p)	Board or Authority	10(29A)
(q)	Body or Authority or Board or Trust or Commission	10(46)
(r)	Infrastructure Debt Fund	10(47)

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(2) Such return of income should be in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

(3) Then, the provisions of the Act would apply as if it were a return required to be furnished under section 139(1).

15.1.9 Mandatory filing of returns by universities, colleges etc. [Section 139(4D)]

(1) It will be mandatory for every university, college or other institution referred to in clause (ii) and clause (iii) of section 35(1), which is not required to furnish its return of income or loss under any other provision of section 139, to furnish its return in respect of its income or loss in every previous year.

(2) All the provisions of the Income-tax Act, 1961 shall apply to such return as if it were a return under section 139(1).

15.1.10 Filing of return of income by a business trust [Section 139(4E)]

(1) Every business trust, which is not required to furnish return of income or loss under any other provisions of this section, has to furnish the return of its income in respect of its income or loss in every previous year.

(2) All the provisions of the Income-tax Act, 1961 shall apply as if it were a return required to be filed under section 139(1).

15.1.11 Filing of return of income by investment fund [Section 139(4F)]

(1) Every investment fund referred to in section 115UB, which is not required to furnish return of income or loss under any other provisions of this section, shall furnish the return of income in respect of income or loss in every previous year.

(2) All the provisions of the Income-tax Act, 1961 shall apply as if it were a return required to be filed under section 139(1).

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15.1.12 Revised return [Section 139(5)]

(1) If any person having furnished a return under section 139(1) or section 139(4), discovers any omission or any wrong statement therein, he may furnish a revised return

- **at any time before three months prior to the end of the relevant assessment year** (i.e., 31.12.2026 for P.Y. 2025-26) or
- before completion of assessment,

whichever is earlier.

File revised ROI latest by 31st Dec. of RAY

(2) The return can be revised for any number of times within the given time limit. In this case, the latest revised return filed replaces all other returns filed earlier.

(3) It may be noted that the returns filed under sub-sections (1A), (3), (4A) to (4F) of section 139 are treated as having been filed under section 139(1). Hence, these returns can also be revised subject to satisfying the conditions of section 139(5).

15.1.13 Particulars to be furnished with the return [Section 139(6)]

The return form prescribed under section 139(1)/ (3) and section 142(1)(i) in certain specified cases, require the assessee to furnish the particulars of -

(1) income exempt from tax.

(2) assets of the prescribed nature and value, held by him as a beneficial owner or otherwise or in which he is a beneficiary.

(3) his bank account and credit card held by him.

(4) expenditure exceeding the prescribed limits incurred by him under prescribed heads.

(5) such other outgoings as may be prescribed.

15.1.14 Particulars to be furnished with return of income in case of an assessee engaged in business or profession [Section 139(6A)]

The prescribed form of the return shall, in the case of an assessee engaged in any business or profession, also require him to furnish -

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(1) the report of any audit referred to in section 44AB [such tax audit report is required to be furnished one month prior to the due date of filing return of income u/s 139(1)].

(2) the particulars of the location and style of the principal place where he carries on the business or profession and all the branches thereof.

(3) the names and addresses of his partners, if any, in such business or profession.

(4) if he is a member of an association or body of individuals,

(a) the names of the other members of the association or the body of individuals; and

(b) the extent of the share of the assessee and the shares of all such partners or members, as the case may be, in the profits of the business or profession and any branches thereof.

15.1.15 Defective Return [Section 139(9)]

(1) Under this sub-section, the Assessing Officer has the power to call upon the assessee to rectify a defective return.

(2) Where the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation. The Assessing Officer has the discretion to extend the time period beyond 15 days, on an application made by the assessee.

Rectify defect within 15 days of intimation

(3) If the defect is not rectified within the period of 15 days or such further extended period, then the return would be treated as an invalid return. The consequential effect would be the same as if the assessee had failed to furnish the return.

(4) Where, however, the assessee rectifies the defect after the expiry of the period of 15 days or the further extended period, but before assessment is made, the Assessing Officer can condone the delay and treat the return as a valid return.

(5) A return of income shall be regarded as defective unless all the following conditions are fulfilled, namely:

(i) The annexures, statements and columns in the return of income relating to computation of income chargeable under each head of income, computations of gross total income and total income have been duly filled in.

(ii) The return of income is accompanied by the following, namely:

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(a) a statement showing the computation of the tax payable on the basis of the return.

(b) the report of the audit obtained under section 44AB [such tax audit report is required to be furnished one month prior to the due date of filing return of income u/s 139(1)].

(c) the proof regarding the tax, if any, claimed to have been deducted or collected at source and the advance tax and tax on self-assessment, if any, claimed to have been paid. (However, the return will not be regarded as defective if (i) a certificate for tax deducted or collected was not furnished under section 203 or section 206C to the person furnishing his return of income, (ii) such certificate is produced within a period of 2 years).

(d) the proof of payment of tax as required under section 140B, if the return of income is an updated return furnished under section 139(8A).

(iii) Where regular books of account are maintained by an assessee, the return of income is accompanied by the following -

(a) copies of manufacturing account, trading account, profit and loss account or income and expenditure account, or any other similar account and balance sheet;

(b) the personal accounts as detailed below -

(1)	Proprietary business or profession	The personal account of the proprietor
(2)	Firm, association of persons or body of individuals	Personal accounts of partners or members
(3)	Partner or member of a firm, association of persons or body of individuals	Partner's personal account in firm, member's personal account in the association of persons or body of individuals

(iv) Where the accounts of the assessee have been audited, the return should be accompanied by copies of the audited profit and loss account and balance sheet and the auditor's report.

(v) Where the cost accounts of an assessee have been audited under section 148 of the Companies Act, 2013, the return should be accompanied by such report (Cost Audit).

(vi) Where regular books of account are not maintained by the assessee, the return should be accompanied by -

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(a) a statement indicating the amount of turnover or gross receipts, gross profit, expenses and net profit of the business or profession;

(b) the basis on which such amounts mentioned in (1) above have been computed,

(c) the amounts of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year.

It may be noted that a return which is otherwise valid would not be treated as defective merely because self-assessment tax and interest payable in accordance with the provisions of section 140A has not been paid on or before the date of furnishing the return.

Notes:

(i) Many of these particulars are now required to be incorporated as part of the relevant return form, for example, details of tax deducted at source, advance tax paid, self-assessment tax paid, amount of turnover/gross receipts, etc.

(ii) Section 292B provides that no return of income, order of assessment, notice, summons or other proceedings furnished or made or taken or purported to have been furnished or made in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or shall be deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment, notice, summons or other proceeding, if they are in substance and effect in conformity with or according to the intent and purposes of the Income-tax Act, 1961. The provision, thus, enables tax authorities to accept returns and other documents and tax payers to accept orders, notice, etc., received from tax authorities even in cases where there are a few typographical, arithmetical or other mistakes which do not materially affect the objects with which the document was submitted by the assessee or order was issued by the department.

15.1.16 Return filed in pursuance of CBDT's order under section 119(2)(b) [Section 139(9A)]

Where any return of income is furnished in pursuance of an order under section 119(2)(b), then the provisions of section 139 shall apply. This amendment will help in reducing litigation, quick processing of returns, and selection of returns for scrutiny assessment just like for any other return under section 139.

Note: Students may refer Chapter 14 "Income Tax Authorities" for Sec 119(2)(b).

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15.1.17 Fee for default in furnishing return of income [Section 234F]

Fee ₹ 5,000; However, where TI ≤ ₹ 5 lakhs -Fee ₹ 1,000

Where a person, who is required to furnish a return of income under section 139, fails to do so within the prescribed time limit under section 139(1), he shall pay, by way of fee, a sum of ₹ 5,000. However, if the total income of the person does not exceed ₹ 5 lakhs, the fees payable shall not exceed ₹ 1,000.

15.1.18 Modified return - Effect of order of Tribunal or Court in respect of business reorganisaton [Section 170A]

(1) **Requirement and timeline to file Modified Return in ITR-A [Section 170A(1)]** - In a case of **business reorganisation**, where prior to the date of order of a High Court or Tribunal or an Adjudicating Authority as defined in section 5(1) of the Insolvency and Bankruptcy Code, 2016, as the case may be, any return of income has been furnished by an entity to which such order applies under the provisions of section 139 for any assessment year relevant to the previous year to which such order applies, such successor entity has to furnish, within a period of **six months from the end of the month in which the said order was issued**, **a modified return** in Form ITR-A in accordance with and limited to the said order. The said return of income has to be furnished electronically under digital signature.

This provision will apply notwithstanding anything contained in section 139.

(2) **Assessment on the basis of modified return [Section 170A(2)]**

	Status of Assessment or reassessment proceedings for an A.Y. relevant to a P.Y. to which the order of the business reorganisation applies	**Completion of Assessment by the A.O. on the basis of modified return**
(i)	**Completed proceedings** - If the proceedings have been completed on the date of furnishing of the modified return in accordance with the provisions of section 170A(1)	The A.O. has to **pass an order modifying the total income of the relevant A.Y.** determined in such assessment or reassessment proceedings in accordance with the order of the business reorganisation and the modified return so furnished.

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(ii)	**Pending proceedings** - If the proceedings are pending on the date of furnishing of the modified return in accordance with the provisions of section 170A(1)	The A.O. has to **proceed to complete the assessment or reassessment proceedings and pass an order assessing or reassessing the total income of the relevant assessment year in accordance with the order** of the business reorganisation and the modified return so furnished.

All other provisions of the Act shall apply to such assessment or reassessment made in respect of the assessment year to which the order of business reorganisation applies, and the tax shall be chargeable at the rate or rates applicable to such assessment year.

(3) **Meaning of "business reorganization"** – "Business reorganization" means the reorganization of business involving the amalgamation or demerger or merger of business or one or more persons.

(4) **Meaning of "successor"** – "Successor" means all resulting companies in a business reorganization, whether or not the company was in existence prior to such business reorganization.

Example: *If A Ltd. merges with B Ltd. with effect from 1.4.2024 vide order of the High Court dated 1.11.2025, and B Ltd. has already filed its return of income for the A.Y.2025-26 on 30th October, 2025, then, B Ltd. has to file a modified return for A.Y.2025-26 in accordance with and limited to the Order of the High Court on or before 31st May, 2026.*

15.2 PERMANENT ACCOUNT NUMBER (PAN) [SECTION 139A]

(1) **Persons mandatorily required to apply for allotment of PAN:** Section 139A(1) requires the following persons mentioned in column (2), who have not been allotted a permanent account number (PAN), to apply to the Assessing Officer within the time specified in column (3) for the allotment of a PAN –

(1)	(2)	(3)
	Persons required to apply for PAN	**Time limit for making such application**
(i)	Every person, if his total income or the total income of any other person in respect of which he is assessable under the Act during any	On or before 31st May of the assessment year for which such income is assessable

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	previous year exceeds the maximum amount which is not chargeable to income-tax	
(ii)	Every person carrying on any business or profession whose total sales, turnover or gross receipts are or is likely to exceed ₹ 5 lakhs in any previous year	Before the end of that financial year (previous year).
(iii)	Every person who is required to furnish a return of income under section 139(4A)	Before the end of the financial year
(iv)	Every person being a resident, other than an individual, which enters into a financial transaction of an amount aggregating to ₹ 2,50,000 or more in a financial year	On or before 31st May of the immediately following financial year in which financial transaction is made.
(v)	Every person who is a managing director, director, partner, trustee, author, founder, karta, chief executive officer, principal officer or office bearer of any person referred in (iv) above or any person competent to act on behalf of such person referred in (iv) above	On or before 31st May of the immediately following financial year in which the person referred in (v) enters into financial transaction specified therein.

Further, for widening the tax base, every person who has not been allotted a PAN **and intends to enter into such transaction** as prescribed by the CBDT is also required to apply to the Assessing Officer for allotment of PAN.

Accordingly, Rule 114BA prescribe the following transactions:

(i)	Every person, who intends to deposit cash in his one or more accounts with a banking company, co-operative bank or post office, if the aggregate amount of cash deposit in such accounts during a financial year is **₹ 20 lakh or more**	Atleast 7 days before the date on which he intends to deposit cash over the specified limit, i.e., ₹ 20 lakh or more.
(ii)	Every person, who intends to withdraw cash from his one or more accounts with a banking company, co-operative bank or post office, if the aggregate amount of cash withdrawal from such accounts during a financial year is **₹ 20 lakh or more**	Atleast 7 days before the date on which he intends to withdraw cash over the specified limit, i.e., ₹ 20 lakh or more.
(iii)	Any person, who intends to open a current account or cash credit account with a banking company or a co-operative bank, or a Post Office	Atleast 7 days before the date on which he intends to open such account.

(2) The Central Government is empowered to specify, by notification in the Official Gazette, any class or classes of persons by whom tax is payable under the Act or any tax or duty is payable under any other law for the time being in force. Such persons are required to apply within

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such time as may be mentioned in that notification to the Assessing Officer for the allotment of a PAN [Sub-section (1A)].

(3) For the purpose of collecting any information which may be useful for or relevant to the purposes of the Act, the Central Government may notify any class or classes of persons, and such persons shall within the prescribed time, apply to the Assessing Officer for allotment of a PAN [Sub-section (1B)].

(4) The Assessing Officer, having regard to the nature of transactions as may be prescribed, may also allot a PAN to any other person (whether any tax is payable by him or not) in the manner and in accordance with the procedure as may be prescribed [Sub-section (2)].

(5) Any person, other than the persons mentioned in (1) to (4) above, may apply to the Assessing Officer for the allotment of a PAN and the Assessing Officer shall allot a PAN to such person immediately.

Note – Rule 114(4) requires submission of application for allotment of PAN by the applicant in the prescribed form accompanied by the prescribed documents as proof of identity, address and date of birth of such applicant. Rule 114(1A) provides that any person, who has not been allotted a PAN but possesses the Aadhaar number and has furnished or intimated or quoted his Aadhaar number in lieu of the PAN in accordance with section 139A(5E), **shall be deemed to have applied for allotment of PAN and he shall not be required to apply or submit any documents under Rule 114**.

Further, Rule 114(1B) provides that any person, who has not been allotted a PAN but possesses the Aadhaar number may apply for allotment of the PAN under section 139A(1)/(1A)/(3) by intimating his Aadhaar number and he shall not be required to apply or submit any documents under Rule 114.

(6) **Quoting of PAN is mandatory for transactions prescribed under Rule 114B:** As per section 139A(5) quoting of PAN is mandatory in the following documents/prescribed transactions:

Quoting of PAN

(a) in all returns to, or correspondence with, any income-tax authority;

(b) in all challans for the payment of any sum due under the Act;

(c) in all documents pertaining to such transactions entered into by him, as may be prescribed by the CBDT in the interests of revenue. In this connection, CBDT has prescribed the following transactions *vide* Rule 114B, namely:

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S. No.	Nature of transaction	Value of transaction
1.	Sale or purchase of a motor vehicle or vehicle, as defined in the Motor Vehicles Act, 1988 which requires registration by a registering authority under that Act, other than two wheeled vehicles.	All such transactions
2.	Opening an account [other than a time-deposit referred to at Sl. No.12 and a Basic Savings Bank Deposit Account] with a banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act).	All such transactions
3.	Making an application to any banking company or a co-operative bank to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act) or to any other company or institution, for issue of a credit or debit card.	All such transactions
4.	Opening of a demat account with a depository, participant, custodian of securities or any other person registered under section 12(1A) of the SEBI Act, 1992.	All such transactions
5.	Payment to a hotel or restaurant against a bill or bills at any one time.	Payment in cash of an amount exceeding ₹ 50,000.
6.	Payment in connection with travel to any foreign country or payment for purchase of any foreign currency at any one time.	Payment in cash of an amount exceeding ₹ 50,000.
7.	Payment to a Mutual Fund for purchase of its units	Amount exceeding ₹ 50,000.
8.	Payment to a company or an institution for acquiring debentures or bonds issued by it.	Amount exceeding ₹ 50,000.
9.	Payment to the Reserve Bank of India for acquiring bonds issued by it.	Amount exceeding ₹ 50,000.

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10.	Deposit with - a banking company or a co-operative bank to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act); or - post office	Cash deposits exceeding ₹ 50,000 during any one day.
11.	Purchase of bank drafts or pay orders or banker's cheques from a banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act).	Payment in cash of an amount exceeding ₹ 50,000 during any one day.
12.	A time deposit with, - (i) a banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act); (ii) a Post Office; (iii) a Nidhi referred to in section 406 of the Companies Act, 2013; or (iv) a non-banking financial company which holds a certificate of registration under section 45-IA of the Reserve Bank of India Act, 1934, to hold or accept deposit from public.	Amount exceeding ₹ 50,000 or aggregating to more than ₹ 5 lakh during a financial year.
13.	Payment for one or more pre-paid payment instruments, as defined in the policy guidelines for issuance and operation of pre-paid payment instruments issued by Reserve Bank of India under the Payment and Settlement Systems Act, 2007, to a banking company or a co-operative bank to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to	Payment in cash or by way of a bank draft or pay order or banker's cheque of an amount aggregating to more than ₹ 50,000 in a financial year.

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	in section 51 of that Act) or to any other company or institution.	
14.	Payment as life insurance premium to an insurer as defined in the Insurance Act, 1938.	Amount aggregating to more than ₹ 50,000 in a financial year.
15.	A contract for sale or purchase of securities (other than shares) as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956.	Amount exceeding ₹ 1 lakh per transaction.
16.	Sale or purchase, by any person, of shares of a company not listed in a recognised stock exchange.	Amount exceeding ₹ 1 lakh per transaction.
17.	Sale or purchase of any immovable property.	Amount exceeding ₹ 10 lakh or valued by stamp valuation authority referred to in section 50C at an amount exceeding ₹ 10 lakh.
18.	Sale or purchase, by any person, of goods or services of any nature other than those specified at Sl. No. 1 to 17 of this Table, if any.	Amount exceeding ₹ 2 lakh per transaction.

Minor to quote PAN of the parent or guardian

Where a person, entering into any transaction referred to in this rule, is a minor and who does not have any income chargeable to income-tax, he shall quote the PAN of his father or mother or guardian, as the case may be, in the document pertaining to the said transaction.

Declaration by a person not having PAN

Further, any person not being a company or a firm who does not have a PAN and who enters into any transaction specified in the Table above, shall make a declaration in Form No.60 giving therein the particulars of such transaction.

However, a foreign company who,—

- does not have any income chargeable to tax in India; and
- does not have a permanent account number,

and enters into any transaction referred to at Sl. No. 2 or 12 of the Table (given in previous paras), in an IFSC banking unit, shall make a declaration in Form No. 60.

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Meaning of IFSC banking unit – A financial institution defined under section 3(1)(c) of the IFSC Authority Act, 2019, that is licensed or permitted by the IFSC to undertake permissible activities under the IFSC Authority (Banking) Regulations, 2020.

Non-applicability of Rule 114B

Also, the provisions of Rule 114B shall not apply to the following class or classes of persons, namely:-

(i) the Central Government, the State Governments and the Consular Offices;

(ii) the non-residents referred to in section 2(30) in respect of the transactions other than a transaction referred to at Sl. No. 1 or 2 or 4 or 7 or 8 or 10 or 12 or 14 or 15 or 16 or 17 of the Table.

Meaning of certain phrases:

	Phrase	Inclusion
(i)	Payment in connection with travel	Payment towards fare, or to a travel agent or a tour operator, or to an authorized person as defined in section 2(c) of the Foreign Exchange Management Act, 1999
(ii)	Travel agent or tour operator	A person who makes arrangements for air, surface or maritime travel or provides services relating to accommodation, tours, entertainment, passport, visa, foreign exchange, travel-related insurance or other travel-related services either severally or in package
(iii)	Time deposit	Any deposit which is repayable on the expiry of a fixed period.

(7) Every person who receives any document relating to any transaction cited above shall ensure that the PAN is duly quoted in the document.

(8) If there is a change in the address or in the name and nature of the business of a person, on the basis of which PAN was allotted to him, he should intimate such change to the Assessing Officer [Sub-section 5(d)]

(9) **Intimation of PAN to person deducting tax at source**

Every person who receives any amount from which tax has been deducted at source shall intimate his PAN to the person responsible for deducting such tax [Sub-section (5A)].

A person, however, shall intimate the General Index Register Number till such time PAN is allotted to him.

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(10) **Quoting of PAN in certain documents of tax deduction**

Where any amount has been paid after deducting tax at source, the person deducting tax shall quote the PAN of the person to whom the amount was paid in the following documents:

(i) in the statement furnished under section 192(2C) giving particulars of perquisites or profits in lieu of salary provided to any employee;

(ii) in all certificates for tax deducted issued to the person to whom payment is made u/s 203;

(iii) in all returns made to the prescribed income-tax authority under section 206;

(iv) in all statements prepared and delivered or caused to be delivered in accordance with the provisions of section 200(3) [Sub-section (5B)].

(11) **Requirement to intimate PAN and quote PAN not to apply to certain persons**

The above sub-sections (5A) and (5B) shall not apply to a person who –

(i) does not have taxable income or

(ii) who is not required to obtain PAN

if such person furnishes a declaration under section 197A in the prescribed form and manner that the tax on his estimated total income for that previous year will be nil.

(12) **Intimation of PAN to person collecting tax at source**

Likewise, every buyer or licensee or lessee referred to in section 206C shall intimate his PAN to the person responsible for collecting tax.

(13) **Quoting of PAN in certain documents of tax collection**

Every person collecting tax in accordance with section 206C shall quote PAN of every buyer or licensee or lessee referred to therein –

(i) in all certificates furnished in accordance with the provisions of section 206C(5);

(ii) in all returns prepared and delivered or caused to be delivered in accordance with the provisions of section 206C(5A) or section 206C(5B) to an income-tax authority;

(iii) in all statements prepared and delivered or caused to be delivered in accordance with the provisions of section 206C(3).

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(14) **Inter-changeability of PAN with the Aadhaar number**

Every person who is required to furnish or intimate or quote his PAN, may furnish or intimate or quote his Aadhaar Number in lieu of the PAN w.e.f. 1.9.2019, if he -

- has not been allotted a PAN but possesses the Aadhaar number
- has been allotted a PAN and has intimated his Aadhaar number to prescribed authority in accordance with the requirement contained in section 139AA(2)

PAN would be allotted in prescribed manner to a person who has not been allotted a PAN but possesses Aadhaar number [Sub-section (5E)]

(15) **Quoting and authentication of PAN or Aadhaar number**

(a) Every person entering into such prescribed transactions is required to quote his PAN or Aadhaar number, as the case may be, in the documents pertaining to such transactions. Such persons are also required to authenticate such PAN or Aadhaar number in the prescribed manner [Sub-section (6A)].

(b) Every person receiving such document relating to transactions referred to in (a) has to ensure that PAN or Aadhaar number has been duly quoted in such document. They also have to ensure that such PAN or Aadhaar number is so authenticated. [Sub-section (6B)].

Accordingly, Rule 114BB prescribe that every person has to, at the time of entering into a transaction specified in column (2) of the Table below, quote his permanent account number or Aadhaar number, as the case may be, in documents pertaining to such transaction, and every person specified in column (3) of the said Table, who receives such document, has to ensure that the said number has been duly quoted and authenticated:

(1)	(2)	(3)
S. No.	**Nature of transaction**	**Person**
1.	Cash deposit or deposits aggregating to ₹ 20 lakhs or more in a financial year, in one or more account of a person with a bank or a co-operative bank or Post Office.	A bank or a co-operative bank or Post Master General of a Post Office.

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2.	Cash withdrawal or withdrawals aggregating to ₹ 20 lakhs or more in a financial year, in one or more account of a person with a bank or a co-operative bank or Post Office	A bank or a co-operative bank or Post Master General of a Post Office.
3.	Opening of a current account or cash credit account by a person with a bank or a co-operative bank or Post Office	A bank or a co-operative bank or Post Master General of a Post Office.

Note – Quoting of PAN or Aadhaar number is, however, not required in case where the person depositing money as per Sl. No.1 or withdrawing money as per Sl. No.2 or opening a current account or cash credit account as per Sl. No.3 is the Central Government, the State Government or the Consular Office [Notification No. 105/2022 dated 1.9.2022]

Additionally, the CBDT has, vide Notification No. 88/2023 dated 10.10.2023 provide that a person is not required to apply for PAN or quote PAN, in a case –

(a) where the person, making the deposit or withdrawal of an amount otherwise than by way of cash as per (1) or (2) above, or opening a current account not being a cash credit account as per (3) above, is a non-resident (not being a company) or a foreign company;

(b) the transaction is entered into with an IFSC banking unit; and

(c) such non-resident (not being a company) or the foreign company does not have any income chargeable to tax in India.

(16) Power to make rules

The CBDT is empowered to make rules with regard to the following:

(a) the form and manner in which an application for PAN may be made and the particulars to be given therein;

(b) the categories of transactions in relation to which PAN or the Aadhaar number, as the case may be, is to be quoted on the related documents;

(c) the categories of documents pertaining to business or profession in which PAN or the Aadhaar number, as the case may be, shall be quoted by every person;

(d) the class or classes of persons to whom the provisions of this section shall not apply;

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Accordingly, Rule 114AAB provides that the provisions of section 139A shall not apply:

Exemption from obtaining PAN

- to a non-corporate non-resident, or a foreign company, who has made investment in a specified fund during the previous year;
- to a non-resident, being an **eligible foreign investor**, who has made transaction only in a capital asset referred to in section 47(viiab) (bonds or GDRs under section 115AC, rupee denominated bonds of an Indian company, derivative and other notified securities) which are listed on a recognised stock exchange located in any IFSC and the consideration on transfer of such capital asset is paid or payable in foreign currency, if the following conditions are satisfied:

  (i) the non-resident **does not earn any income in India, other than the income from investment in the specified fund** during the previous year. Similarly, the eligible foreign investor **does not earn any income in India, other than the income from transfer of a capital asset referred to in section 47(viiab)** (bonds or GDRs under section 115AC, rupee denominated bonds of an Indian company, derivative and other notified securities)

  (ii) any **income-tax due** on income of non-resident **has been deducted at source** and remitted to the Central Government by the specified fund at the rates specified in section 194LBB of the Act **(this condition is not applicable in case of eligible foreign investor)**; and

  (iii) the non-resident/eligible foreign investor **furnishes the following details and documents** respectively to the specified fund/stock broker through which the transaction is made, respectively:-

    (A) name, e-mail id, contact number;

    (B) address in the country or specified territory outside India of which he is a resident;

    (C) a declaration that he is a resident of a country or specified territory outside India; and

    (D) Tax Identification Number in the country or specified territory of his residence and in case no such number is available, then a unique number on the basis of which the non-resident is identified by the Government of that country or the specified territory of which he claims to be a resident.

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Specified Fund/Stock Broker to furnish such details received from non-resident: The specified fund/stock broker, as the case may be, has to electronically furnish a quarterly statement for the quarter of the financial year, in which the details and documents furnished by such non-resident/eligible foreign investor are received by it.

It also required to upload the declaration received from such non-resident/eligible foreign investor **within fifteen days from the end of the quarter of the financial year to which such statement relates**.

Meaning of Certain Terms:

Term	Meaning
Specified Fund	Any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a - - Category I or Category II Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 made under the Securities and Exchange Board of India Act, 1992 or International Financial Services Centres Authority Act, 2019 and which is located in any IFSC. - Category III Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012 or regulated under the International Financial Services Centres Authority (Fund Management) Regulations, 2022 - Specified fund referred in sub-clause (i) of clause (c) of *Explanation* to section 10(4D) [Refer Chapter 21 for detail definition].

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Eligible Foreign Investor	A non-resident who operates in accordance with the guidelines issued by SEBI in its Circular No. IMD/HO/FPIC/CIR/P/2017/003 dated 04th January, 2017.
Stock Broker	A person having trading rights in a recognised stock exchange located in any IFSC and the member of such exchange.

(e) the form and manner in which a person who has not been allotted a PAN shall make a declaration;

(f) the manner in which PAN/Aadhaar number shall be quoted for transactions cited in (b) above;

(g) the time and manner in which such transactions cited in (b) above shall be intimated to the prescribed authority.

(17) **Meaning of certain terms for the purpose of section 139A**

	Term	Definition
(i)	Aadhaar Number	An identification number issued to an individual by the Unique Identification Authority of India, after verification of the demographic information and biometric information submitted by the individual.
(ii)	Assessing Officer	Includes an income-tax authority who is assigned the duty of allotting PANs.
(iii)	Authentication	The process by which – (i) the PAN or Aadhaar number along with demographic information or biometric information of an individual is submitted to the income-tax authority or such other prescribed authority or agency for its verification; and (ii) Such authority or agency verifies the correctness or the lack thereof, on the basis of the information available with it.
(iv)	Permanent Account Number (PAN)	A number which the Assessing Officer may allot to any person for the purpose of identification and includes a PAN allotted under the new series i.e., PAN having 10 alphanumeric characters.

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(18) **Penalty for failure to comply with the provisions of section 139A [Section 272B]**

Section	Default	Penalty
272B(1)	Failure to comply with the provisions of section 139A	₹ 10,000
272B(2)	Failure to quote PAN/Aadhaar number in any document referred to in section 139A(5)(c)	₹ 10,000 for each such default
	Failure to intimate PAN/Aadhaar number to persons deducting or collecting tax at source	
	Knowingly quoting or intimating a number which is false	
272B(2A)	Failure to quote PAN/Aadhaar Number in documents referred to in section 139A(6A) or authenticate such number in accordance with the provisions contained therein	₹ 10,000 for each such default
272B(2B)	(i) Failure to **ensure** that PAN/Aadhaar Number is duly quoted in the documents relating to transactions referred to in section 139A(5)(c) or section 139A(6A)	₹ 10,000 for each such default
	(ii) Failure to ensure that PAN/Aadhaar Number has been duly authenticated in respect of transactions referred to under section 139A(6A)	
Note *– It is necessary to give an opportunity to be heard to the person on whom the penalty under section 272B is proposed to be imposed.*		

15.3 QUOTING OF AADHAAR NUMBER [SECTION 139AA]

(1) **Mandatory quoting of Aadhaar Number [Section 139AA(1)]**

Every person who is eligible to obtain Aadhaar Number is required to mandatorily quote Aadhaar Number, on or after 1st July, 2017:

(a) in the application form for allotment of Permanent Account Number (PAN)

(b) in the return of income [Sub-section (1)]

(2) **Mandatory quoting of Enrolment ID, where person does not have Aadhaar Number [Proviso to section 139AA(1)]**

Every person who has been allotted PAN before 01.10.2024 on the basis of Aadhaar Enrolment ID shall intimate his Aadhaar Number to the Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems) or the person authorised by the

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said authorities on or before 31st December, 2025 or such date as may be specified by the CBDT in this behalf. *[Notification No. 25/2025 and 26/2025 dated 03.04.2025]*.

(3) **Intimation of Aadhaar Number to prescribed Authority [Section 139AA(2)]**

Every person who has been allotted PAN as on 1st July, 2017, and who is eligible to obtain Aadhaar Number, shall intimate his Aadhaar Number to the Principal Director General of Income-tax (Systems) or Principal Director of Income-tax (Systems) **on or before 31.3.2022.**

Notwithstanding the last date of intimating/linking of Aadhaar Number with PAN being 31.3.2022, it is clarified that it is mandatory to quote and link Aadhaar number while filing the return of income, either manually or electronically, unless specifically exempted in cases referred to in para (5) below.

As per the proviso to section 139AA(2), in case of failure to intimate the Aadhaar Number, PAN would made inoperative after the date so notified i.e., 31.3.2022 in such manner as may be prescribed.

Manner of making PAN inoperative [Rule 114AAA]

Accordingly, Rule 114AAA specifies the manner of making PAN inoperative. Rule 114AAA(1) provides that where a person, who has been allotted PAN as on the 1.7.2017 and is required to intimate his Aadhaar number under section 139AA(2), has failed to intimate the same on or before 31.3.2022, the PAN of such person shall become inoperative, and he shall be liable for payment of fee specified under section 234H read with Rule 114(5A).

Where the person has intimated his Aadhaar number after 31.3.2022, after payment of fee specified under section 234H read with Rule 114(5A), his PAN would become operative within 30 days from the date of intimation of Aadhaar number.

Further consequences of failure to intimate Aadhaar Number: As per section 114AAA(3), a person, whose PAN has become inoperative, shall be liable for further consequences for the period commencing from 01.07.2023 till the date it becomes operative, namely –

(i) refund of any amount of tax or part thereof, due under the provisions of the Act shall not be made;

(ii) interest shall not be payable on such refund for the period, beginning with the date specified and ending with the date on which it becomes operative;

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(iii) where tax is deductible under Chapter XVIIB in case of such person, such tax shall be deducted at higher rate, in accordance with provisions of section 206AA;

(iv) where tax is collectible at source under Chapter XVII-BB in case of such person, such tax shall be collected at higher rate, in accordance with provisions of section 206CC.

It is hereby clarified vide Circular No. 9/2025 dated 21st July, 2025 that there shall be no liability on the deductor/collector to deduct/collect the tax at higher rates specified under section 206AA/206CC, as the case maybe, in the following cases:

- ***Where the amount is paid or credited from 01.04.2024 to 31.07.2025 and the PAN is made operative (as a result of linkage with Aadhaar) on or before 30.09.2025.***
- ***Where the amount is paid or credited on or after 01.08.2025 and the PAN is made operative (as a result of linkage with Aadhaar) within two months from the end of the month in which the amount is paid or credited.***

(4) **Fee for late intimation of Aadhaar Number i.e., after the notified date [Section 234H read with Rule 114(5A)]**

As per section 234H, where a person, who is required to intimate his Aadhaar Number under section 139AA(2), fails to do so on or before the notified date i.e., 31st March, 2022, he shall be liable to pay such fee, as may be prescribed, at the time of making intimation under section 139AA(2) after 31st March, 2022. However, such fee shall not exceed ₹ 1,000.

Accordingly, Rule 114(5A) provides that if such person fails to intimate his Aadhaar Number on or before the date notified in section 139AA(2) i.e., 31st March, 2022, then, at the time of subsequent intimation of his Aadhaar number to the prescribed authority, such person would be liable to pay, by way of fee, an amount equal to **₹ 1,000**. However, if a person fails to link Aadhaar with PAN on or before 31.3.2022, his PAN shall become inoperative after the said date in the prescribed manner [Proviso to section 139AA(2)].

(5) **Provision not to apply to certain person or class of persons**

The provisions of section 139AA relating to quoting of Aadhaar Number would, however, not apply to such person or class or classes of persons or any State or part of any State as may be notified by the Central Government [Sub-section (3)].

Accordingly, the Central Government has, vide Notification No. 37/2017, dated 11.05.2017, effective from 01.07.2017, notified that the provisions of section 139AA relating to quoting of Aadhaar Number would **not** apply to an individual who does not possess the Aadhaar number or Enrolment ID and is:

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(i) residing in Assam, Jammu & Kashmir and Meghalaya;

(ii) a non-resident as per Income-tax Act, 1961;

(iii) of the age of 80 years or more at any time during the previous year;

(v) not a citizen of India

Exemption from Quoting Aadhaar number

15.4 SCHEME FOR SUBMISSION OF RETURNS THROUGH TAX RETURN PREPARERS [SECTION 139B]

(1) This section provides that, for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income, the CBDT may notify a Scheme to provide that such persons may furnish their returns of income through a Tax Return Preparer authorised to act as such under the Scheme.

(2) The Tax Return Preparer shall assist the persons furnishing the return in a manner that will be specified in the Scheme and shall also affix his signature on such return.

(3) A **Tax Return Preparer** can be an individual, other than

Tax Return Preparer

(i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.

(ii) any legal practitioner who is entitled to practice in any civil court in India.

(iii) an accountant (being a chartered accountant).

(iv) an employee of the 'specified class or classes of persons'.

who has been authorised to act as a Tax Return Preparer under the Scheme.

(4) The **"specified class or classes of persons"** for this purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Income-tax Act, 1961.

(5) The Scheme notified under the said section may provide for the following -

(i) the manner in which and the period for which the Tax Return Preparers shall be authorised,

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(ii) the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer,

(iii) the code of conduct for the Tax Return Preparers,

(iv) the duties and obligations of the Tax Return Preparers,

(v) the circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and

(vi) any other relevant matter as may be specified by the Scheme.

(6) Accordingly, the CBDT has, in exercise of the powers conferred by this section, framed the Tax Return Preparer Scheme, 2006, which came into force from 1.12.2006.

Particulars	Contents
Applicability of the scheme	The scheme is applicable to all eligible persons.
Eligible person	Any person being an individual or a Hindu undivided family.
Tax Return Preparer	Any individual who has been issued a "Tax Return Preparer Certificate" and a "unique identification number" under this Scheme by the Partner Organisation to carry on the profession of preparing the returns of income in accordance with the Scheme. However, the following person are not entitled to act as Tax Return Preparer: (i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings. (ii) any legal practitioner who is entitled to practice in any civil court in India. (iii) an accountant.
Educational qualification for Tax Return Preparers	An individual, who holds a bachelor's degree from a recognised Indian University or institution, or has passed the intermediate level examination conducted by the Institute of Chartered Accountants of India or the Institute of Company Secretaries of India or the Institute of Certified Management Accountants of India, shall be eligible to act as Tax Return Preparer.
Preparation of and furnishing the Return of Income by the Tax Return Preparer	An eligible person may, at his option, furnish his return of income under section 139 for any assessment year after getting it prepared through a Tax Return Preparer:

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	However, the following eligible person (an individual or a HUF) cannot furnish a return of income for an assessment year through a Tax Return Preparer: (i) who is carrying out business or profession during the previous year and accounts of the business or profession for that previous year are required to be audited under section 44AB or under any other law for the time being in force; or (ii) who is not a resident in India during the previous year. An eligible person cannot furnish a revised return of income for any assessment year through a Tax Return Preparer unless he has furnished the original return of income for that assessment year through such or any other Tax Return Preparer. Also, a return of income which is required to be furnished in response to a notice under section 142(1)(i) or section 148 shall not be prepared and furnished through a Tax Return Preparer.

Note - *It may be noted that as per section 139B(3), an employee of the "specified class or classes of persons" is not authorised to act as a Tax Return Preparer. Therefore, it follows that employees of companies and persons whose accounts are required to be audited under section 44AB or any other law for the time being in force (since they do not fall in the category of specified class or classes of persons), are eligible to act as Tax Return Preparers.*

15.5 PERSONS AUTHORISED TO VERIFY RETURN OF INCOME [SECTION 140]

This section specifies the persons who are authorised to verify the return of income u/s 139.

	Assessee	Circumstance	Authorised Persons
1.	Individual	(i) In circumstances not covered under (ii), (iii) & (iv) below	- the individual himself
		(ii) where he is absent from India	- the individual himself; or - any person duly authorised by him in this behalf holding a valid power of attorney from the individual (Such power of attorney should be attached to the return of income)

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		(iii) Where he is mentally incapacitated from attending to his affairs	- his guardian; or - any other person competent to act on his behalf
		(iv) where, for any other reason, it is not possible for the individual to verify the return	- any person duly authorised by him in this behalf holding a valid power of attorney from the individual (Such power of attorney should be attached to the return of income)
2.	Hindu Undivided Family	(i) in circumstances not covered under (ii) and (iii) below	- the karta
		(ii) where the karta is absent from India	- any other adult member of the HUF
		(iii) where the karta is mentally incapacitated from attending to his affairs	- any other adult member of the HUF
3.	Company	(i) in circumstances not covered under (ii) to (vi) below	- the managing director of the company
		(ii) (a) where for any unavoidable reason such managing director is not able to verify the return; or (b) where there is no managing director	any director of the company or **any other person as may be prescribed for this purpose [See Note below]**
		(iii) Where the company is not resident in India	- the managing director of the company or a person who holds a valid power of attorney from such company to do so (such power of attorney should be attached to the return).
		(iv) (a) Where the company is being wound up (whether under the orders of a court or otherwise); or	- Liquidator
		(b) where any person has been appointed as the receiver of any assets of the company	- Liquidator
		(v) Where the management of the company has been taken over by the Central Government or any State Government under any law	- the principal officer of the company

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		(vi) Where an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under the Insolvency and Bankruptcy Code, 2016.	- insolvency professional appointed by such Adjudicating Authority
4.	Firm	(i) in circumstances not covered under (ii) below (ii) (a) where for any unavoidable reason such managing partner is not able to verify the return; or (b) where there is no managing partner.	- the managing partner of the firm - any partner of the firm, not being a minor - any partner of the firm, not being a minor
5.	LLP	(i) in circumstances not covered under (ii) below (ii) (a) where for any unavoidable reason such designated partner is not able to verify the return; or (b) where there is no designated partner.	- Designated partner any partner of the LLP or **any other person as may be prescribed for this purpose [See Note Below]**
6.	Local authority	-	- the principal officer
7.	Political party [referred to in section 139(4B)]	-	- the chief executive officer of such party (whether he is known as secretary or by any other designation)
8.	Any other association	-	- any member of the association or the principal officer of such association
9.	Any other person	-	- that person or some other person competent to act on his behalf.

Note – In case of a company and LLP, "any other person" as may be prescribed for the purpose of verification of return of income, shall be the person, appointed by the adjudicating authority i.e., National Company Law Tribunal constituted under Section 408 of the Companies Act, 2013 for discharging the duties and functions of an interim resolution professional, a resolution professional, or a liquidator, as the case may be, under the Insolvency and Bankruptcy Code, 2016 and the rules and regulations made thereunder [Rule 12AA].

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15.6 SELF ASSESSMENT [SECTION 140A]

(1) **Payment of tax, interest and fee before furnishing return of income**

Where any tax is payable on the basis of any return required to be furnished under section 139, or section 142 or section 148, after taking into account -

(i) the amount of tax, already paid, under any provision of the Income-tax Act, 1961

(ii) any tax deducted or collected at source;

Self Assessment tax

(iii) any relief of tax claimed under section 89;

(iv) relief of tax claimed under section 90 or 90A;

(v) deduction of tax claimed under section 91;

(vi) any tax credit claimed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

(vii) any tax or interest payable as per the provisions of section 191(2).

the assessee shall be liable to pay such tax together with interest and fee payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax before furnishing the return. The return shall be accompanied by the proof of payment of such tax, interest and fee.

(2) **Order of adjustment of amount paid by the assessee**

Where the amount paid by the assessee under section 140A(1) falls short of the aggregate of the tax, interest and fee as aforesaid, the amount so paid shall first be adjusted towards the fee payable and thereafter towards interest and the balance, if any, shall be adjusted towards the tax payable.

(3) **Interest under section 234A**

For the above purpose, interest payable under section 234A shall be computed on the amount of tax on the total income as declared in the return, as reduced by the amount of-

(i) advance tax paid, if any;

(ii) any tax deducted or collected at source;

(iii) any relief of tax claimed under section 89;

(iv) relief of tax claimed under section 90 or 90A;

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(v) deduction of tax claimed under section 91;

(vi) any tax credit claimed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

(4) **Interest under section 234B**

Interest payable under section 234B shall be computed on the assessed tax or on the amount by which the advance tax paid falls short of the assessed tax.

For this purpose, "assessed tax" means the tax on total income declared in the return as reduced by –

(i) the amount of tax deducted or collected at source;

(ii) any relief of tax claimed under section 89;

(iii) relief of tax claimed under section 90 or 90A

(iv) deduction of tax claimed under section 91

(v) any tax credit claimed to be set-off in accordance with the provisions of section 115JAA or section 115JD.

(5) **Self-assessment tax deemed to have been paid towards regular assessment**

After regular assessment under section 143 or section 144, any amount paid under section 140A shall be deemed to have been paid towards such regular assessment or assessment.

(6) **Consequence of failure to pay tax, interest or fee**

If any assessee fails to pay the whole or any part of such tax or interest or fees, he shall be deemed to be an assessee in default in respect of such tax or interest or fees remaining unpaid and all the provisions of this Act shall apply accordingly.

15.7 UPDATED RETURN OF INCOME [SECTION 139(8A)]

(1) **Option to furnish updated return:** Any person may furnish an updated return of his income or the income of any other person in respect of which he is assessable, for the previous year relevant to the assessment year at any time within 48 months from the end of the relevant assessment year.

This is irrespective of whether or not he has furnished a return under section 139(1) or belated return under section 139(4) or revised return under section 139(5) for that assessment year.

For example, an updated return for A.Y. 2026-27 can be filed till 31.3.2031.

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(2) Non-applicability of the provisions of updated return: The provisions of updated return would not apply, if the updated return of such person for that assessment year –

(i) is a loss return; or

(ii) has the effect of decreasing the total tax liability determined on the basis of return furnished under section 139(1) or section 139(4) or section 139(5); or

(iii) results in refund or increases the refund due on the basis of return furnished under section 139(1) or section 139(4) or section 139(5).

Additionally, no updated return shall be furnished in the following scenarios –

S. No.	Scenarios	Updated return can not be furnished
(i)	**In case of a person** • Where **a search has been initiated under section 132** or books of account or other documents or any **assets are requisitioned under section 132A**. • Where **a survey has been conducted under section 133A** (other than survey conducted in relation to TDS or TCS) • Where **a notice has been issued** to the effect that: - any money, bullion, jewellery or valuable article or thing, seized or requisitioned under section 132 or section 132A in case of any other person belongs to such person; or - any books of account or documents, seized or requisitioned under section 132 or section 132A in the case of any other person, pertain or pertains to, or any other information contained therein, relate to, such person.	- **for the Assessment Year** relevant to the Previous Year in which the search is initiated or survey is conducted, or requisition is made and - **for any A.Y. preceding such assessment year.**
(ii)	Where a person has furnished an updated return under this sub-section for the relevant assessment year.	

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(iii)	Where any proceeding for assessment, reassessment, recomputation, or revision of income under this Act is pending or has been completed for the relevant assessment year.	for such relevant Assessment Year
(iv)	Where the Assessing Officer has information in his possession for the relevant assessment year in respect of a person under - the Smugglers, and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 or - the Prohibition of Benami Property Transactions Act, 1988 or - the Prevention of Money laundering Act, 2002 or - the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 and the same has been communicated to him, prior to the date of furnishing of updated return.	for such relevant Assessment Year.
(v)	Where information for the relevant assessment year has been received under an agreement referred to in section 90 or section 90A in respect of such person and the same has been communicated to him, prior to the date of furnishing of updated return.	
(vi)	If any prosecution proceedings under the Chapter XXII have been initiated for the relevant assessment year in respect of a person prior to the date of furnishing of return under this sub-section.	

W.e.f. 01.04.2025, no updated return shall be furnished by any person where any notice to show-cause under section 148A has been issued in his case after 36 months from the end of the relevant assessment year.

However, where subsequently an order is passed under section 148A(3) determining that it is not a fit case to issue notice under section 148, updated return may be filed upto 48 months from the end of the relevant assessment year.

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(3) Updated return can be filed if the original return is a loss return and updated return is a return of income: If any person has a loss in any previous year and has furnished a return of loss on or before the due date of filing return of income under section 139(1), he shall be allowed to furnish an updated return if such updated return is a return of income.

For example, if Mr. X has furnished his return of loss for A.Y. 2025-26 on 31.5.2025 consisting of ₹ 5,00,000 as business loss, he can furnish an updated return for A.Y. 2025-26 upto 31.3.2030, if such updated return is a return of income.

(4) Updated return to be furnished for subsequent previous year in case (3) above - If the loss or any part thereof carried forward under Chapter VI or unabsorbed depreciation carried forward under section 32(2) or tax credit carried forward under section 115JD is to be reduced for any subsequent previous year as a result of furnishing of updated return of income for a previous year, an updated return is required to be furnished for each such subsequent previous year.

(5) Updated return for the relevant assessment year cannot be furnished by such person or belongs to such class of persons, as may be notified by the Board in this regard.

15.8 TAX ON UPDATED RETURN [SECTION 140B]

(1) Payment of tax, additional tax, interest and fee before furnishing an updated return of income

(a) In a case where no return is furnished earlier [Section 140B(1)]

(I) Tax to be paid along with interest and fee before furnishing of updating return:

Where no return of income under section 139(1) or 139(4) has been furnished by an assessee and tax is payable, on the basis of updated return to be furnished by such assessee under section 139(8A), the assessee would be liable to pay such tax together **with interest and fee payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax,** along with the payment of additional income-tax computed under section 140B(3), before furnishing the return.

No return filed earlier

The updated return shall be accompanied by proof of payment of such tax, additional income-tax, interest and fee.

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(II) Manner of computation of tax payable on the basis of updated return

The tax payable is to be computed after taking into account the following -

(i) the amount of tax, if any, already paid as advance tax;

(ii) any tax deducted or collected at source;

(iii) any relief of tax claimed under section 89;

(iv) 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;

(v) 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

(vi) any tax credit claimed to be set off in accordance with the provisions of section 115JAA or section 115JD.

(III) Interest under section 234A if no earlier return has been furnished

In a case, where no earlier return has been furnished, the interest payable under section 234A has to be computed on the amount of the tax on the total income as declared in the updated return under section 139(8A), in accordance with the provisions of section 140A(1A).

(b) In a case where return is furnished earlier [Section 140B(2)]

(I) Tax to be paid along with interest before furnishing updated return:

Where, return of income under section 139(1) or 139(4) or 139(5) has been furnished by an assessee and tax is payable, on the basis of updated return to be furnished by such assessee under section 139(8A), the assessee would be liable to pay such tax together with interest payable under any provision of this Act for any default or delay in payment of advance tax, along with the payment of additional income-tax computed under section 140B(3) **(as reduced by the amount of interest paid under the provisions of this Act in the earlier return)** before furnishing the return.

The updated return shall be accompanied by proof of payment of such tax, additional income-tax and interest.

(II) Manner of computation of tax payable on the basis of updated return:

The tax payable has to be computed after taking into account the following -

(i) the amount of relief or tax referred to in section 140A(1), the credit for which has been taken in the earlier return;

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(ii) **tax deducted or collected at source**, in accordance with the provisions of Chapter XVII-B, on any income which is subject to such deduction or collection and which is taken into account in computing total income and **which has not been included in the earlier return;**

(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 on such income **which has not been included in the earlier return**;

(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 on such income **which has not been included in the earlier return;**

(v) **any tax credit claimed**, to be set off following the provisions of section 115JAA or section 115JD, **which has not been claimed in the earlier return**; and

The aforesaid tax would be increased by the amount of refund, if any, issued in respect of such earlier return.

(III) Interest under section 234B where earlier return has been furnished [Section 140B(4)]

In a case where an earlier return has been furnished, **interest payable under section 234B has to be computed on the assessed tax.**

"Assessed tax" means the tax on the total income as declared in the updated return to be furnished under section 139(8A), after taking into account the following:

(i) the amount of relief or tax referred to in section 140A(1), the credit for which has been claimed in the earlier return, if any;

Assessed Tax

(ii) tax deducted or collected at source, in accordance with the provisions of Chapter XVII-B, on any income which is subject to such deduction or collection and which is taken into account in computing such total income, which has not been included in the earlier return;

(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 on such income which has not been included in the earlier return;

(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 on such income which has not been included in the earlier return;

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(v) any tax credit claimed, to be set off in accordance with the provisions of section 115JAA or section 115JD, which has not been claimed in the earlier return; and

The aforesaid tax would be increased by the amount of refund, if any, issued in respect of such earlier return.

(IV) Interest under section 234C if earlier return has been furnished

Interest payable under section 234C, where an earlier return has been furnished, has to be computed after taking into account the total income furnished in the updated return as returned income.

(2) Additional income-tax payable at the time of updated return [Section 140B(3)]

The additional income-tax payable at the time of furnishing the updated return under section 139(8A) would be –

S. No.	Time of furnishing updated return	Additional Income-tax Payable
(i)	If such return is furnished after expiry of the time available under section 139(4) or 139(5) of the assessment year and **before completion of the period of 12 months** from the end of the relevant assessment year;	**25% of aggregate** of tax and interest payable, as determined in (1) above
(ii)	If such return is furnished **after the expiry of 12 months** from the end of the relevant assessment year **but before completion of the period of 24 months** from the end of the relevant assessment year.	**50% of aggregate** of tax and interest payable, as determined in (1) above
(iii)	*If such return is furnished **after the expiry of 24 months** from the end of the relevant assessment year **but before completion of the period of 36 months** from the end of the relevant assessment year.*	***60% of aggregate** of tax and interest payable, as determined in (1) above*
(iv)	*If such return is furnished **after the expiry of 36 months** from the end of the relevant assessment year **but before completion of the period of 48 months** from the end of the relevant assessment year.*	***70% of aggregate** of tax and interest payable, as determined in (1) above*

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Computation of Additional income-tax

For the purpose of computation of Additional income-tax -

- tax would include surcharge and cess, by whatever name called, on such tax.
- the interest payable would be interest chargeable under any provision of the Act, on the income as per updated return furnished under section 139(8A), as reduced by interest paid in the earlier return, if any.

However, the interest paid in the earlier return would be considered to be nil, if no earlier return has been furnished.

Note - An updated return furnished under section 139(8A) would be regarded as defective return as referred u/s 139(9) unless such return of income is accompanied by the proof of payment of tax as required under section 140B.

(3) Power to CBDT to issue guidelines

In case of any difficulty arises in giving effect to the provisions of this section, the CBDT may issue guidelines for the purpose of removing the difficulty, with the approval of the Central Government. Every guideline issued shall be laid before each House of Parliament.

ILLUSTRATION

Mr. X would like to furnish his updated return for the A.Y. 2025-26. In case he furnished his updated return of income, he would be liable to pay ₹ 2,50,000 towards tax and ₹ 35,000 towards interest after adjusting tax and interest paid at the time filing earlier return. You are required to examine whether Mr. X can furnish updated return-

(i) as on 31.3.2027

(ii) as on 28.2.2028

(iii) as on 31.5.2028

If yes, compute the amount of additional income-tax payable by Mr. X at the time of filing his updated return.

Would your answer be different with respect to filing of the updated return in case of (ii) above, where he has received a notice under section 148 for the said A.Y. 2025-26 on 23.7.2027.

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SOLUTION

Mr. X may furnish an updated return of his income for A.Y. 2025-26 at any time within 48 months from the end of the relevant assessment year, i.e., 31.3.2030.

Accordingly, Mr. X can furnish updated return for A.Y. 2025-26 for all the above cases i.e. 31.3.2027, 28.2.2028 and 31.5.2028.

Mr. X would be liable to pay additional income-tax

- @25% of tax and interest payable, if updated return is furnished after the expiry of the time limit available under section 139(4) or 139(5), i.e., 31st December 2025 and before the expiry of 12 months from the end of relevant assessment year, i.e., 31.3.2027.
- @50% of tax and interest payable, if updated return is furnished after the expiry of 12 months from the end of relevant assessment year, i.e., after 31.3.2027 but before the expiry of 24 months from the end of relevant assessment year, i.e., 31.3.2028.
- @60% of tax and interest payable, if updated return is furnished after the expiry of 24 months from the end of the relevant assessment year, i.e., after 31.3.2028 but before the expiry of 36 months from the end of the relevant assessment year, i.e., 31.3.2029.

Accordingly, Mr. X is liable to pay additional income-tax in case he furnished his updated return as on

(i) 31.3.2027 - ₹ 71,250 [25% of 2,85,000, being tax of ₹ 2,50,000 plus interest of ₹ 35,000]

(ii) 28.2.2028 - ₹ 1,42,500 [50% of 2,85,000, being tax of ₹ 2,50,000 plus interest of ₹ 35,000]

(iii) 31.05.2028 - ₹ 1,71,000 [60% of 2,85,000, being tax of ₹ 2,50,000 plus interest of ₹ 35,000]

He cannot furnish an updated return where he has received notice u/s 148, since proceeding for income escaping assessment for the A.Y. 2025-26 are pending.

15.9 INQUIRY BEFORE ASSESSMENT [SECTION 142]

A. Issue of Notice to any person for making assessment [Section 142(1)]

For the purpose of making an assessment, the Assessing Officer may serve on any person who has made a return under section 139 or in whose case the time allowed under section 139(1) for furnishing the return has expired, a notice under section 142. The purposes for which such notice can be served are depicted in the following diagram:

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Notes – (1) *Notice to furnish return of income may also be served by the prescribed income-tax authority in addition to the Assessing Officer. Accordingly, Rule 12F provide that the prescribed income-tax authority shall be an income-tax authority not below the rank of Income-tax Officer who has been authorised by the CBDT to act as such authority for the purposes of this clause.*

(2) It may be noted that the time-limit provided under section 153(1) for completion of assessment is ***21 months/18 months/12 months/9 months*** *[Refer to table on time limits for completion of assessment given later in this chapter], as the case may be, from the end of the assessment year in which the income was first assessable. Therefore, since the assessment has to be completed within the said period, it appears that notice under section 142(1) should also be issued within that period.*

B. Inquiry by Assessing Officer [Section 142(2)]

For the purpose of obtaining full information in respect of income or loss of any person, the Assessing Officer may make such inquiry as he considers necessary.

15.10 SPECIAL AUDIT AND INVENTORY VALUATION UNDER SECTION 142

Sub-sections (2A), (2B), (2C), and (2D) of section 142 contain the statutory provisions relating to the conduct of audit.

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(1) **Basis for direction to get accounts audited or inventory valued:** If at any stage of the proceedings before him, the Assessing Officer, having regard

- to the nature and complexity of the accounts,
- volume of the accounts,
- doubts about the correctness of the accounts,
- multiplicity of transactions in the accounts or
- specialized nature of business activity of the assessee, and
- the interests of the revenue,

is of the opinion that it is necessary so to do, he may, with the previous approval of the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner, direct the assessee to get either or both of the following -

- the accounts audited by an accountant and furnish a report of such audit.
- the inventory valued by a cost accountant and furnish a report of such inventory valuation.

Opportunity of being heard is to be given to the assessee before directing to get the accounts audited or inventory valued.

'Accountant' means a 'chartered accountant' within the meaning of the Chartered Accountants Act, 1949.

"Cost Accountant" means a cost accountant as defined in the Cost and Works Accountants Act, 1959 and who holds a valid certificate of practice under the said Act.

(2) **Accountant and cost accountant nominated by the Principal Chief Commissioner/Chief Commissioner/Principal Commissioner/Commissioner** - The accountant by whom the audit should be carried out and the cost accountant by whom inventory should be valued are nominated by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner of Income-tax specifically for the purpose. The assessee is required to furnish an audit report and inventory valuation report in the prescribed form duly signed and verified by such accountant or cost accountant, respectively and setting forth such other particulars as may be prescribed and such other particulars as the Assessing Officer may require.

(3) **Special audit may be directed even if accounts are audited under any other law** - The Assessing Officer is empowered to direct the audit to be carried out in the case of any particular assessee even if the accounts of the assessee have already been audited under any other law for the time being in force or otherwise.

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(4) **Time limit** - The audit report or inventory valuation report, or both, must be furnished to the Assessing Officer by the assessee within the period specified by the Assessing Officer in his order.

The Assessing Officer is, however, entitled, *suo motu* or on receipt of an application made in this behalf by the assessee for any good any sufficient reason to extend the time-limit by such further period or periods as he deems fit. Further, the aggregate of the period originally fixed and the period or periods so extended **should not exceed 180 days** in any case. This time of 180 days must be reckoned from the date on which the Assessing Officer's direction is received by the assessee.

(5) **Expenses of special audit or inventory valuation to be paid by the Central Government** - Where the direction for special audit or inventory valuation is issued by the Assessing Officer, the expenses of, and incidental to, such **special audit or inventory valuation, including remuneration of the Accountant *or Cost Accountant,*** shall be determined by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner in accordance with the prescribed guidelines. **The expenses so determined shall be paid by the Central Government.**

Expenses paid by CG

Rule 14B lays down the guidelines for the purposes of determining expenses for audit under section 142(2A). Every Chief Commissioner would maintain a panel of

- Accountants, out of persons referred to in Explanation to section 288(2) or
- Cost accountants, out of the persons referred to in Explanation to section 142

for the purposes of section 142(2A). The expenses of, and incidental to, audit (including the remuneration of the accountant, cost accountants, qualified assistants, semi-qualified and other assistants who may be engaged by such Accountant or Cost Accountant) should not be

- less than ₹ 3,750 and
- not more than ₹ 7,500

for every hour of the period as specified by the Assessing Officer under section 142(2C). Such period shall be specified in terms of the number of hours required for completing the report.

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(6) **Assessee to be given an opportunity of being heard** - The assessee should, however, be given an opportunity of being heard in respect of any material gathered on the basis of –

(i) any inquiry under section 142(2); or

(ii) any audit or inventory valuation under section 142(2A)

which is proposed to be utilized for the purposes of the assessment. If, however, the assessment is in nature of a best judgment assessment under section 144, it is not obligatory for the Assessing Officer to give the assessee an opportunity to be heard, before passing the assessment order on the basis of the inquiry conducted under section 142(2) or audit report or inventory valuation report under section 142(2A).

(7) **Consequence of failure to get special audit done** - In any case, where the assessee is directed to get audit done or get inventory valued and the assessee fails to do so, the Assessing Officer is entitled to make a best judgment assessment under section 144 in addition to imposing penalty or taking such steps as may be necessary under the law.

Would the assessee be liable to consequences for failure to get the accounts audited if the nominated Chartered Accountant refused to audit the accounts of the assessee? *[Swadeshi Polytex Ltd. v. ITO [1983] 144 ITR 171 (SC)]*

In a case where a Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner issued instructions under section 142(2A) nominating a Chartered Accountant for auditing the assessee's accounts and though the concerned assessee was willing to produce the records, the concerned Chartered Accountant refused to audit the accounts, a question arose as to whether there was a failure on the assessee's part to comply with the directions under section 142(2A) and consequently the best judgement assessment could be made under section 144(b).

The Supreme Court held that if, for a frivolous reason, the Chartered Accountant **declined to undertake the audit of the assessee's accounts, the assessee could not be held responsible**. In such a case, there was no default or failure to comply with the direction issued under section 142(2A) on the assessee's part so as to attract the provisions of section 144(b). The best judgement made by the Assessing Officer was set aside with the directions to appoint another Chartered Accountant within one month to get the accounts audited.

Note - *The above ruling is with respect to a special audit refused by a nominated Chartered Accountant. The rationale of the said Apex Court ruling can also be applied in case inventory valuation is refused by the Cost Accountant.*

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15.11 POWER OF ASSESSING OFFICER TO MAKE A REFERENCE TO THE VALUATION OFFICER [SECTION 142A]

(1) **Reference to the Valuation Officer** - As per section 142A, the Assessing Officer may, for the purposes of assessment or reassessment, make a reference to a Valuation Officer to estimate the value, including fair market value, of any asset, property or investment and submit the report to him.

Section 142A further clarifies that the Assessing Officer may make a reference to the Valuation Officer whether or not he is satisfied about the correctness or completeness of the accounts of the assessee.

(2) **Estimation of value of asset, property or investment** - The Valuation Officer is required to estimate the value of the asset, property or investment after taking into account the evidence produced by the assessee and any other evidence in his possession gathered, after giving an opportunity of being heard to the assessee.

If the **assessee does not co-operate** or comply with the directions of the Valuation Officer he may, **estimate the value** of the asset, property or investment **to the best of his judgment**.

(3) **Time limit for submission of valuation report** - The Valuation Officer shall send a copy of his estimate to the Assessing Officer and the assessee **within a period of six months from the end of the month in which the reference is made**. Thus, a specific time limit has now been provided, within which the Valuation Officer has to send his report to the Assessing Officer.

(4) **Completion of assessment by taking into account valuation report** - On receipt of the report from the Valuation Officer, the Assessing Officer may, after giving the assessee an opportunity of being heard, take into account such report in making the assessment or reassessment.

15.12 FACELESS INQUIRY & VALUATION [SECTION 142B]

Section 142B empowers the Central Government to notify scheme for faceless processes for eliminating physical interface.

(1) **Faceless scheme [Section 142B(1)]** - The Central Government is empowered to make a scheme (faceless inquiry and valuation scheme) by notification in Official Gazette for the purpose of:

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a. issuing notice under section 142(1) or

b. making inquiry to obtain full information in respect of the income or loss of any person under section 142(2) or

c. directing the assessee to get the accounts audited by an accountant or inventory valuation by a cost accountant under section 142(2A) or

d. making a reference to the valuation officer to estimate the value of any asset, property or investment under section 142A.

The objective of the scheme is to impart greater efficiency, transparency and accountability by:

(i) eliminating the interface between the income-tax authority or Valuation Officer and the assessee or any person to the extent technologically feasible;

(ii) optimising utilisation of the resources through economies of scale and functional specialisation;

(iii) introducing a team-based issuance of notice or making of enquiries or issuance of directions or valuation with dynamic jurisdiction.

(2) **Applicability or non-applicability of other provisions of the Act [Section 142B(2)]** - The Central Government may, for the purpose of giving effect to the Faceless Inquiry and Valuation Scheme, by notification in the Official Gazette, direct that any provision of this Act shall not apply or shall apply with such modification, exceptions and adaptations as necessary.

(3) **Notification issued above to be laid before each House of Parliament [Section 142B(3)]** Every such notification issued by the Central Government either under sub section (1) or (2) of the section 142B has to be laid before each House of Parliament as soon as possible.

Accordingly, Central Government has issued Notification no. 19/2022 dated 30.3.2022, to provide that the Faceless Inquiry and Valuation for the purpose of -

a. issuing notice under section 142(1) or

b. making inquiry to obtain full information in respect of the income or loss of any person under section 142(2) or

c. directing the assessee to get the accounts audited by an accountant or inventory valuation by a cost accountant under section 142(2A) or

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d. making a reference to the valuation officer to estimate the value of any asset, property or investment under section 142A

shall be made in a faceless manner, through automated allocation, in accordance with and to the extent provided in section 144B with reference to making the faceless assessment of total income or loss of assessee.

"Automated allocation" means an algorithm for randomised allocation of cases by using suitable technological tools, including artificial intelligence and machine learning, with a view to optimise the use of resources.

15.13 ASSESSMENT [SECTION 143]

(1) **Summary assessment [Section 143(1)]**

Where a return has been made under section 139 or in response to a notice under section 142(1), such return shall be processed under section 143(1). Thus, summary assessment, commonly referred to as intimation, is a computerised preliminary assessment or processing of the return of income filed by an assessee.

(i) Section 143(1)(a) provides **for computation of the total income of an assessee after making the following adjustments** to the returned income:-

(a) any arithmetical error in the return;

(b) an incorrect claim, if such an incorrect claim is apparent from any information in the return;

Intimation

(c) *any such inconsistency in the return, with respect to the information in the return of any preceding previous year, as may be prescribed;*

(d) Disallowance of loss claimed, if return of the previous year for which set-off is claimed was filed beyond due date u/s 139(1);

(e) Disallowance of expenditure or increase in income indicated in the audit report but not taken into account in computing the total income in the return;

(f) Disallowance of deduction claimed under section 10AA or under any of the provisions of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes", if return is filed beyond due date u/s 139(1);

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However, before making any such adjustments, in the interest of natural justice, intimation has to be given to the assessee requiring him to respond to such adjustments. Such intimation may be in writing or through electronic mode. The response received, if any, has to be duly considered before effecting any adjustment. However, **if no response is received within 30 days of the issue of such intimation**, the processing shall be carried out incorporating the adjustments.

(ii) **The term "an incorrect claim apparent from any information in the return" shall mean** such claim on the basis of an entry, in the return, –

(a) of an item, which is inconsistent with another entry of the same or some other item in such return;

(b) in respect of which, information required to be furnished to substantiate such entry, has not been furnished in the return;

(c) in respect of a deduction, where such deduction exceeds specified statutory limit which may have been expressed as monetary amount or percentage or ratio or fraction.

(iii) **Tax, interest and fee should be computed** on the basis of the total income computed after making the adjustments in (i) above.

(iv) The sum payable by, or the amount of refund due to, the assessee shall be determined after adjustment of such tax, interest and fee, if any, so computed by any tax deducted at source, any tax collected at source, any advance tax paid, any relief allowable under section 89, any relief allowable under an agreement under section 90 or section 90A, or any relief allowable under section 91, any rebate under section 87A, any tax paid on self-assessment and any amount paid otherwise by way of tax, interest or fee.

(v) Based on the above adjustments, **an intimation** shall be prepared or generated and **sent to the assessee within a period of nine months from the end of the financial year in which the return was made**. The intimation shall specify the sum determined to be payable by, or the amount of refund due to, the assessee.

Intimation order can be issued within 9 months from the end of F.Y. in which return was furnished

(vi) If any amount is payable by the assessee, the communication sent to the assessee is considered a 'Notice of Demand'. The assessee must pay the tax liability within 30 days of receiving the intimation; otherwise, he will be treated as an assessee-in-

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default. Where any amount of refund is due to the assessee, the same shall be granted to the assessee.

(vii) An **intimation shall also be sent** to the assessee in a case where **the loss declared in the return by the assessee is adjusted** but **no tax, interest or fee is payable by, or no refund is due to, him**.

(viii) On the other hand, where there is neither any adjustment nor any tax due from or refund payable to the assessee, the acknowledgement of the return shall be deemed to be the intimation under section 143(1).

(ix) The scheme contemplates avoiding human interface and therefore, provides for computerised processing of returns for making the above adjustments, i.e., the software will be designed to detect arithmetical inaccuracies and internal inconsistencies and make appropriate adjustments in the computation of the total income.

(2) **Mandatory processing of return of income before issuance of assessment order [Section 143(1D)]**

(i) Section 143(1) requires processing of return of income filed under section 139(1) or in response to a notice issued under section 142(1).

(ii) An intimation has to be prepared or generated and sent to the assessee specifying the sum payable or the refund due, to the assessee.

(iii) No intimation can be sent after the expiry of ***nine months*** from the end of the financial year in which the return is made. This is provided in the second proviso to section 143(1).

(iv) In respect of returns furnished for A.Y.2017-18 or thereafter, processing of a return under section 143(1) is necessary even where a notice has been issued to the assessee under section 143(2).

(3) Regular assessment/Scrutiny assessment [Section 143(2)/(3)] - If the Assessing Officer or the prescribed income-tax authority [i.e., an income-tax authority not below the rank of an Income-tax Officer who has been authorised by the CBDT to act as income-tax authority] considers it necessary or expedient to ensure that the assessee has not understated his income or has not computed excessive loss or has not underpaid his tax in any manner he can **issue a notice for making the assessment** in the normal manner as at present. This will be a scrutiny assessment.

Notice for assessment u/s 143(2) to be issued within 3 months from the end of F.Y. in which ROI is furnished

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It may be noted that notice for detailed scrutiny under section 143(2) **cannot be served after the expiry of 3 months from the end of the financial year** in which the return of income is furnished.

On the day specified in the notice issued under section 143(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 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.

It is also obligatory for research associations, news agency, associations and other institutions exempt under clauses (21), (22B), (23A) and (23B) of section 10 to file their returns of income. In these cases, the Assessing Officer cannot make an assessment denying exemption under section 10 without intimating the Central Government or the prescribed authority of the contravention of the provisions of the relevant sections and till the approval granted to these research associations, news agency, associations and other institutions has been withdrawn or notification rescinded [First proviso to section 143(3)].

If any trust or institution or educational institution or hospital or medical institution referred in section 10(23C)(iv), (v), (vi) and (via) or any trust or institution referred to in section 11, has committed any "specified violation" as mentioned under section 10(23C) or under section 12AB(4), the Assessing Officer shall

- send a reference to the Principal Commissioner or Commissioner to withdraw the approval or registration, as the case may be, and
- no order making an assessment of the total income or loss of such fund or institution or trust or any university or other educational institution or any hospital or other medical institution shall be made by him without giving effect to the order passed by the Principal Commissioner or Commissioner either cancelling the approval or refusing to cancel the approval of such trust or institution or educational institution or hospital or medical institution under section 10(23C) or section 12AB(4) [Second proviso to section 143(3)].

The time period for completing the assessment in such cases will exclude the period between the date on which the Assessing Officer makes a reference to the Principal Commissioner or Commissioner and date on which copy of the order is received by the Assessing Officer [Clause (xiii) of Explanation 1 of section 153].

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Meaning of Specified Violation: The following are considered as Specified Violation

Specified Violation

(a) where any income derived from property held under trust, wholly or in part for charitable or religious purposes**, has been applied, other than for the objects of the trust or institution**; or

(b) the trust or institution has **income from profits and gains of business which is not incidental** to the attainment of its objectives **or separate books of account are not maintained** by such trust or institution in respect of the business which is incidental to the attainment of its objectives; or

(c) the trust or institution has **applied** any part of its income from the property held under a trust for **private religious purposes**, which does not enure for the benefit of the public; or

(d) the trust or institution established for charitable purpose created or established after the commencement of this Act, has **applied** any part of its income for the benefit of any **particular religious community or caste**; or

(e) any activity being carried out by the trust or institution—

(i) **is not genuine**; or

(ii) **is not being carried out in accordance with all or any of the conditions** subject to which it was registered; or

(f) the trust or institution **has not complied with the requirement of any other law**, and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality.

(g) where the registration application filed by the trust or institution is incomplete or contains false or incorrect information.

Note – *The situations mentioned in (c) and (d) are mentioned only in the case of a trust or institution registered under section 11.*

The Assessing Officer is empowered to send a proposal to the Central Government recommending withdrawal of approval of research association, university, college or other institution approved under section 35(1)(ii) and (iii), if the activities are not being carried out in accordance with all or any of the conditions subject to which any of the said entities had been approved. The Assessing Officer may, after giving a reasonable opportunity of showing cause to the concerned entity, send a proposal to the Central Government recommending withdrawal of approval.

The Central Government may, by order, withdraw the approval and forward a copy of the order to the concerned university, college or other institution and to the Assessing Officer.

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(4) **Best judgment assessment [Section 144]**

(i) **Best judgement assessment mandatory in all the three cases stated above** - It is mandatory for the Assessing Officer to make a best judgment assessment, and he has no discretion to make or not to make such assessment. These three cases are alternative and not cumulative for the purpose of making an *ex parte* assessment.

(ii) **Opportunity of being heard** - Before making the best judgement assessment, the Assessing Officer has to take into account all relevant material which he has gathered. The assessee must be given an opportunity of being heard. Such opportunity shall be given by an Assessing Officer by serving a notice calling upon the assessee to show cause on a date and time to be specified in the notice, why the assessment should not be completed to the best of his judgment. Thereafter, the Assessing Officer shall make the assessment of total income or loss to the best of his judgment and determine the sum payable on the basis of such assessment. It may be noted that no refund can be granted under section 144.

However, where a notice under section 142(1) has been issued prior to the making of an assessment under this section, it is not necessary to give such an opportunity.

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15.14 POWER OF JOINT COMMISSIONER TO ISSUE DIRECTIONS IN CERTAIN CASES [SECTION 144A]

(1) A Joint Commissioner may, on his own motion or on a reference being made to him by the Assessing Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending and, if he considers that, having regard to the nature of the case or the amount involved or for any other reason it is necessary so to do, he may issue such directions as he thinks fit for the guidance of the Assessing Officer to enable him to complete the assessment. Such directions shall be binding on the Assessing Officer.

(2) No directions which are prejudicial to the assessee shall be issued before an opportunity is given to the assessee to be heard. However, directions given as to the lines on which investigation is to be made shall not be construed as one prejudicial to the assessee.

15.15 FACELESS ASSESSMENT [SECTION 144B]

The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 has introduced faceless assessment under section 144B w.e.f. 1st April, 2021. "Faceless assessment" means the assessment proceedings conducted electronically in the 'e-Proceeding' facility through the assessee's registered account in the designated portal. CBDT has ordered www.incometax.gov.in as the "designated portal" for the purpose of Faceless Assessment.

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(1) Procedure for Faceless Assessment [Section 144B(1)] - Section 144B(1) provides that assessment under section 143(3) or best judgment assessment under section 144 **or income escaping assessment under section 147** in respect of such territorial area or persons or classes of persons or incomes or class of incomes or cases or class of cases, as specified by the CBDT under section 144B(2), has to be made in a faceless manner in accordance with the following procedure:

Faceless assessment u/s 14(3), 144 and 147

Clause	Provision
Assignment of the case to a Specific Assessment Unit	
(i)	The National Faceless Assessment Centre (NFAC) has **to assign** the case selected for the purposes of faceless assessment under this section **to a specific assessment unit** through an automated allocation system.
Intimation by NFAC to the assessee	
(ii)	The NFAC has to intimate the assessee that the assessment in his case would be completed following the procedure laid down under this section.
Serving of notice on the assessee	
(iii)	**Service of notice:** Notice shall be served on the assessee through the NFAC under section 143(2) or section 142(1).
(iii)	**Filing of response to the notice by the assessee:** The assessee may file his **response to the notice within the date specified therein** to the NFAC which shall forward the same to the assessment unit.
Request by Assessment Unit to NFAC for obtaining information/conducting enquiry	
(iv)	Where a case is assigned to the assessment unit, it may make a request to the NFAC for— (a) obtaining such further information, documents or evidence from the assessee or any other person, as it may specify; (b) conducting of enquiry or verification by verification unit; and (c) seeking technical assistance in respect of the determination of arm's length price, valuation of property, withdrawal of registration, approval, exemption or any other technical matter from the technical unit.
Course of Action when Assessment Unit requests for obtaining further information to NFAC as per sub-clause (a) of clause (iv)	

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(v)	Notice or requisition to the assessee or any other person for obtaining the information: The NFAC has to issue appropriate notice or requisition to the assessee or any other person for obtaining the information, documents or evidence requisitioned by the assessment unit.
	Assessee to file a response to the notice within the specified time: The assessee would be required to file a response to the notice within the time specified therein or such time as may be extended based on an application in this regard to the NFAC, which shall forward the reply to the assessment unit.
Course of Action when Assessment Unit makes request for conducting an enquiry or seeks technical assistance to NFAC as per sub-clauses (b) and (c) of clause (iv)	
(vi)	**Request for conducting inquiry or verification to be assigned to Verification Unit by NFAC:** Where a request for conducting of certain enquiry or verification by the verification unit has been made by the assessment unit, the request would be assigned by the NFAC to a verification unit through an automated allocation system.
	Request for seeking technical assistance to be assigned to Technical Unit by NFAC: Where a request for seeking technical assistance from the technical unit has been made by the assessment unit, the request would be assigned by the NFAC to a technical unit through an automated allocation system.
(vii)	**Report received from the Verification Unit/Technical Unit to be sent to Assessment Unit:** The NFAC has to send the report received from the verification unit or the technical unit to the concerned assessment unit.
Failure on the part of the assessee	
(viii)	**NFAC to intimate the failure to assessment unit:** Where the assessee fails to comply with the notice served for obtaining the information, documents or evidence or notice issued under section 142(1) or the terms of a notice issued under section 143(2), the NFAC shall intimate such failure to the assessment unit.
(ix)	**Serving notice u/s 144 for failure on the part of the assessee:** The assessment unit shall serve upon such assessee a notice, through the NFAC, under section 144, giving him an opportunity to show-cause on a date and time as specified in such notice as to why the assessment in his case should not be completed to the best of its judgment.
(x)	**Assessee to file response to a notice under section 144:** The assessee has to, within the time specified in the notice or such time as may be extended on the basis of an application in this regard, file his response to the NFAC which shall forward the same to the assessment unit.
(xi)	**Intimation to Assessment Unit, of failure on the part of the assessee to file response to notice issued u/s 144:** Where the assessee fails to file response

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	to the notice within the time specified therein or within the extended time, if any, the NFAC has to intimate such failure to the assessment unit.
Step to be taken by Assessment Unit after assessee files his response or fails to file his response	
(xii)	The assessment unit shall, after taking into account all the relevant material available on the record, prepare, in writing— (a) an income or loss determination proposal, where no variation prejudicial to the assessee is proposed and send a copy of such income or loss determination proposal to the NFAC; or (b) in any other case, a show cause notice stating the variations prejudicial to the interest of the assessee proposed to be made to the income of the assessee and calling upon him to submit as to why the proposed variation should not be made and serve such show cause notice, on the assessee, through the NFAC
Assessee to file reply of show cause notice served under sub-clause (b) of clause (xii)	
(xiii)	**Assessee to file a response to the notice within the specified time:** The assessee shall file his reply to the show-cause notice on a date and time as specified therein or such time as may be extended based on an application made in this regard, to the NFAC which shall forward the reply to the assessment unit.
(xiv)	**Intimation to Assessment Unit in case of no response from assessee:** Where the assessee fails to file a response to the notice served within the time specified therein or within the extended time, if any, the NFAC shall intimate such failure to the assessment unit.
Procedure to be followed after assessee files his response or fails to file his response to the show cause notice served under sub-clause (b) of clause (xii)	
(xv)	**Assessment unit to prepare an income or loss determination proposal:** The assessment unit shall, after considering the response received under clause (xiii) or after receipt of intimation under clause (xiv), as the case may be, and taking into account all relevant material available on record, prepare an income or loss determination proposal and send the same to the NFAC.
(xvi)	Upon receipt of the income or loss determination proposal, as referred to in sub-clause (a) of clause (xii) **[where no variations prejudicial to the assessee were proposed]** or clause (xv) **[where variations prejudicial to the assessee were proposed and then show cause notice was issued to him]**, as the case may be, the NFAC may, on the basis of guidelines issued by the Board - (a) convey to the assessment unit to prepare draft order in accordance with the income or loss determination proposal, which shall thereafter prepare a draft order; or (b) assign the income or loss determination proposal to a review unit through an automated allocation system, for conducting a review of such proposal.

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Where the proposal is assigned to a review unit	
(xvii)	Review Unit to prepare the review report: The review unit shall conduct a review of the income or loss determination proposal assigned to it by the NFAC, after that, it shall prepare a review report and send the same to the NFAC;
(xviii)	NFAC to forward the review report to the assessment unit, which has proposed the income or loss determination proposal.
Preparation of Draft Order	
(xix)	**Assessment Unit to prepare draft order:** The assessment unit shall, after considering such review report, accept or reject some or all of the modifications proposed therein and, after recording reasons in case of rejection of such modifications, prepare a draft order.
(xx)	**Draft order to be sent to NFAC:** The assessment unit shall send such draft order prepared under sub-clause (a) of clause (xvi) [where a proposal is not forwarded to review unit] or under clause (xix) [where a proposal is assigned to review unit] to the NFAC.
Preparation of final assessment order (other than cases in relation to eligible assessee)	
(xxii)	**Passing of final assessment order by Assessment Unit:** The NFAC shall convey to the assessment unit to pass the final assessment order in accordance with such draft order. After that, the assessment unit shall pass the final assessment order, initiate penalty proceedings, if any, and send it to the NFAC.
(xxiii)	**NFAC to serve a copy of such order to the assessee:** The NFAC shall serve a copy of the final assessment order and notice for initiating penalty proceedings, if any, on the assessee, along with the demand notice, specifying the sum payable by, or refund of any amount due to, the assessee on the basis of such assessment.
Procedure to be followed by NFAC in case of an eligible assessee (as defined under section 144C)	
(xxi)	**NFAC to serve draft order to the eligible assessee:** Where there is a proposal to make any variation which is prejudicial to the interest of an eligible assessee, as mentioned under section 144C(1), the NFAC shall serve the draft order referred to in clause (xx) on such assessee.
(xxiv)	**Procedure to be followed by the assessee:** Where a draft order is served on the assessee, he shall— (a) file his acceptance of the variations proposed in such draft order to the NFAC; or (b) file his objections, if any, to such variations, with— (I) the Dispute Resolution Panel, and

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	(II) the NFAC, within 30 days of the receipt by him of the draft order.
(xxv)	**Intimation by NFAC to Assessment Unit:** The NFAC shall intimate the assessment unit to complete the assessment based on the draft order: (a) upon receipt acceptance from of the eligible assessee; or (b) if no objections are received from the eligible assessee within 30 days of his receipt of the draft order.
(xxvi)	**Assessment Unit to pass the assessment order:** Upon receipt of intimation from NFAC under clause (xxv), the assessment unit shall pass the assessment order, in accordance with the relevant draft order within one month from the end of the month in which - the acceptance is received or - the period of 30 days for filing an objection expired and initiate penalty proceedings, if any, and send the order to the NFAC.
Procedure in case eligible assessee files objection with Dispute Resolution Panel (DRP)	
(xxvii)	**NFAC to intimate assessment unit about objections filed by assessee:** Where the eligible assessee files objections with the DRP, under sub-clause (b) of clause (xxiv), the NFAC shall send such intimation along with a copy of objections filed to the assessment unit.
(xxviii)	**NFAC to forward directions of Dispute Resolution Panel (DRP) to Assessment Unit:** Where the eligible assessee files his objections with the DRP, the NFAC has to, upon receipt of the directions issued by the DRP under section 144C(5), forward such directions to the Assessment Unit.
(xxix)	**Assessment Unit to prepare the assessment order:** In conformity with the directions issued by the DRP under section 144C(5), the Assessment Unit has to complete the assessment within the time allowed under section 144C(13) and initiate penalty proceedings, if any and send a copy of such order to the NFAC.
Serving a copy of the assessment order in case of an eligible assessee	
(xxx)	**NFAC to serve a copy of the order to the assessee:** The NFAC shall, upon receipt of the assessment order referred to in clause (xxvi) or clause (xxix), as the case may be, serve a copy of such order and notice for initiating penalty proceedings, if any, on the assessee, along with the demand notice, specifying the sum payable by, or the amount of refund due to, the assessee based on such assessment.
Procedure to be followed by NFAC on completion of the assessment	
(xxxi)	On completion of the assessment, the NFAC shall transfer all the electronic records of the case to the Assessing Officer having jurisdiction over the said case for such action as may be required under the provisions of this Act.

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(2) **NFAC/AUs/VUs/TUs/RUs to be set up for the purpose of faceless assessment [Section 144B(3)]-** For the purpose of faceless assessment, the CBDT, may set up the following Centers and Units and specify their function and jurisdiction –

National Faceless Assessment Center (NFAC)	To facilitate the conduct of faceless assessment proceedings in a centralised manner.
Assessment Units (AUs)	To conduct the faceless assessment, to perform the function of making assessment, which includes • identification of points or issues material for the determination of any liability (including refund) under the Act, • seeking information or clarification on points or issues so identified, • analysis of the material furnished by the assessee or any other person, and such other functions as may be required for making the faceless assessment. The term "assessment unit", shall refer to an Assessing Officer having powers assigned by the Board.
Verification Units (VUs)	To facilitate the conduct of faceless assessment, to perform the function of verification, which includes - enquiry, cross verification, examination of books of account, examination of witnesses and recording of statements, and such other functions as may be required for the purposes of verification. The term "verification unit", shall refer to an Assessing Officer having powers assigned by CBDT. The function of the verification unit under section 144B may also be performed by a verification unit located in any other faceless centre set up under the provisions of this Act or under any scheme notified under the provisions of this Act. The request for verification may also be assigned through the NFAC to such a verification unit.

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Technical Units (TUs)	To facilitate the conduct of faceless assessment, to perform the function of providing technical assistance which includes any assistance or advice on legal, accounting, forensic, information technology, valuation, transfer pricing, data analytics, management or any other technical matter under this Act or an agreement entered into under section 90 or 90A, which may be required in a particular case or a class of cases, under this section. The term "technical unit" shall refer to an Assessing Officer having powers assigned by CBDT.
Review Units (RUs)	To facilitate the conduct of faceless assessment, to perform the function of the review of the income determination proposal assigned to it by NFAC after receiving from the assessment unit under sub-clause (b) of clause (xvi) of sub-section (1). The function of review includes checking whether- • the relevant and material evidence has been brought on record, • the relevant points of fact and law have been duly incorporated, • the issues requiring addition or disallowance have been incorporated, and such other functions as may be required for the purposes of review. The term "review unit", shall refer to an Assessing Officer having powers assigned by CBDT.

(3) Authorities constituting AU/TU/VU/RU [Section 144B(4)]: The assessment unit, verification unit, technical unit and review unit will have the following authorities:

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(4) Communication among the units or with assessee [Section 144B(5)]:

(i) **Communication among units to be routed through NFAC:** All communication among the assessment unit, review unit, verification unit or technical unit or with the assessee or any other person with respect to the information or documents or evidence or any other details, as may be necessary for the purposes of making a faceless assessment has to be through the NFAC.

(ii) **Communication to be exchanged exclusively in electronic mode:** All communications between the NFAC, the assessee, his authorised representative, or any other person shall be exchanged exclusively in electronic mode. Similarly, all internal communications between the NFAC and various units must be exchanged exclusively in electronic mode.

However, in certain circumstances, enquiry or verification may be conducted by the verification unit otherwise than by electronic mode. Such circumstances may be specified by the CBDT.

(5) Authentication of electronic record through digital signature [Section 144B(6)]: For the purposes of faceless assessment, an electronic record has to be authenticated by—

(a) **NFAC:** by way of an electronic communication

(b) **Various Units:** by affixing digital signature

(c) **Assessee or any other person**: by affixing his digital signature or under electronic verification code (EVC), or by logging into his registered account in the designated portal.

(6) Delivery of notice/order electronically to the assessee or any other person [Section 144B(6)(ii)/(iii)/(iv)/(v)]: All notices, orders, and other electronic communication have to be delivered to the addressee, being the assessee, by way of—

(a) placing an authenticated copy thereof in the assessee's registered account; or

(b) sending an authenticated copy thereof to the registered email address of the assessee or his authorised representative; or

e-communication

(c) uploading an authenticated copy on the assessee's Mobile App and followed by a real-time alert.

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All notices, orders and other electronic communication have to be delivered to the addressee, being any other person, by sending an authenticated copy thereof to the registered e-mail address of such person, followed by a real-time alert.

The assessee has to file his response to any notice or order or any other electronic communication, through his registered account. Once an acknowledgement is sent by the NFAC containing the hash result generated upon successful submission of response, the response shall be deemed to be authenticated.

The time and place of dispatch and receipt of electronic record has to be determined in accordance with section 13 of the Information Technology Act, 2000.

(7) **No personal appearance required [Section 144B(6)(vi)]:** A person shall not be required to appear either personally or through an authorised representative in connection with any proceedings before any unit set up under this section.

(8) **Request by the assessee for a personal hearing in specific cases [Section 144B(6)(vii)]:** In a case where a variation is proposed in the income or loss determination proposal or the draft order, and an opportunity is provided to the assessee by serving a notice calling upon him to show cause as to why the assessment should not be completed as per such income or loss determination proposal, the assessee or his authorised representative, as the case may be, may request for personal hearing to make his oral submissions or present his case before the income-tax authority of the relevant unit.

(9) **Approval of request for personal hearing [Section 144B(6)(viii)]:** Where the request for a personal hearing has been received, the income-tax authority of relevant unit shall allow such hearing, through NFAC. Such hearing has to be conducted exclusively through video conferencing or video telephony, including the use of any telecommunication application software which supports video conferencing or video telephony, to the extent technologically feasible, in accordance with the procedure laid down by the CBDT.

(10) **Examination or recording of statement exclusively through video conferencing or video telephony [Section 144B(6)(ix)/(x)]:** Other than enquiry or verification conducted by the verification unit, otherwise than by electronic mode, in the circumstances specified by the CBDT, any examination or recording of the statement of the assessee or any other person (other than statement recorded in the course of survey under section 133A) has to be conducted by an income-tax authority in the relevant unit, exclusively through video

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conferencing or video telephony, including use of any telecommunication application software which supports video conferencing or video telephony, to the extent technologically feasible, in accordance with the procedure laid down by the CBDT.

For this purpose, suitable facilities for video conferencing or video telephony shall be established, including telecommunication application software which supports video conferencing or video telephony at such locations as may be necessary, so as to ensure that the assessee, or his authorized representative, or any other person is not denied the benefit of faceless assessment merely on the consideration that such assessee or his authorised representative, or any other person does not have access to video conferencing or video telephony at his end.

(11) Standards to be laid down for effective function of NFAC and other units [Section 144B(6)(xi)]: The Principal Chief Commissioner or the Principal Director General, as the case may be, in-charge of the NFAC shall, with the prior approval of CBDT, lay down the standards, procedures and processes for effective functioning of the NFAC and the units set up, in an automated and mechanised environment.

(12) Audit may be invoked under section 142(2A) during faceless assessment [Section 144B(1)(xxxii)]: If, at any stage of the proceedings before it, the assessment unit is of the opinion that it is necessary to do so,

- having regard to the nature and complexity of the accounts,
- volume of the accounts,
- doubts about the correctness of accounts,
- multiplicity of transactions in the accounts or
- specialised nature of the business activity of the assessee,

it may, upon recording its reasons in writing, refer the case to the NFAC stating that the provisions of section 142(2A) may be invoked. Such a case may be dealt with in accordance with section 144B(7).

NFAC's discretion to forward the reference of invoking audit or inventory valuation under section 142(2A) [Section 144B(7)]:

(a) The Principal Chief Commissioner or the Principal Director General, as the case may be, in-charge of the NFAC shall, in accordance with the procedure laid down by CBDT

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in this regard, if he considers appropriate that the provisions of section 142(2A) may be invoked in the case,—

(i) forward the reference received from an assessment unit to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner having jurisdiction over such case. The assessment unit shall be informed accordingly.

(ii) transfer the case to the Assessing Officer having jurisdiction over such case with the prior approval of CBDT.

(b) Once the reference has been received by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, he shall direct the Assessing Officer, having jurisdiction over the case, to invoke the provisions of section 142(2A).

(c) It can happen that NFAC may not consider appropriate to forward the reference to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, having jurisdiction over the case.

In such a case, the assessment unit has to proceed to complete the assessment in accordance with the procedure laid down in this section.

(13) Transfer of case to jurisdictional Assessing Officer [Section 144B(8)]: The Principal Chief Commissioner or the Principal Director General in charge of NFAC may, at any stage of the assessment, if considered necessary, transfer the case to the Assessing Officer having jurisdiction over such case. However, prior approval of the CBDT may be required in such cases.

15.16 REFERENCE TO PRINCIPAL COMMISSIONER OR COMMISSIONER IN CERTAIN CASES [SECTION 144BA]

The diagram given on the next page will give you an understanding of the procedure for declaring any arrangement as an impermissible avoidance arrangement. The short forms used in the diagram are:

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PC/C	Principal Commissioner/Commissioner	AP	Approving Panel
IAA	Impermissible Avoidance Arrangement	AO	Assessing Officer

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# The following period has to be excluded in computing the said period:	
(i)	The period commencing from the date on which the first direction is issued by the Approving Panel to the Principal Commissioner or the Commissioner for getting inquiries conducted through the authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information so requested is last received by the Approving Panel or one year, whichever is less.
(ii)	*The period commencing on the date on which stay on the proceeding of the Approving Panel was granted by an order or injunction of any court and ending on the date on which certified copy of the order vacating the stay was received by the Approving Panel.*
***Note** – If, immediately after the exclusion of the aforesaid time or period, the period available to the Approving Panel for issue of directions is less than 60 days, such remaining period shall be extended to 60 days. Consequently, the aforesaid period of six months shall be deemed to have been extended accordingly.*	

Approving Panel

	Particulars	Provisions	
(1)	Constitution	The Central Government may constitute one or more Approving Panels as may be necessary	
(2)	Composition	Each Approving Panel may shall consist of three members including a Chairperson	
(3)	Qualification of members	(i)	The Chairman shall be a person who is or has been a judge of a High Court
		(ii)	One member shall be a member of IRS not below the rank of PCCIT/CCIT
		(iii)	One member shall be an academic or scholar having special knowledge of matters, such as direct taxes, business accounts and international trade practices.
(4)	Term	Ordinarily for one year; May be extended from time to time upto a period of three years.	
(5)	Frequency of Meeting	The Chairperson and members of the Approving Panel shall meet, as and when required, to consider the references made to the Panel. They shall be paid the remuneration as may be prescribed.	
(6)	Powers	(i)	The Approving Panel has to issue such directions, as it deems fit, in respect of declaration of the arrangement as an impermissible avoidance arrangement in accordance with the provisions of Chapter X-A including specifying the previous year

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			or years to which such declaration of an arrangement as an impermissible avoidance arrangement shall apply.
		(ii)	The Approving Panel, may, before issuing any direction under section 144BA(6), if it is of the opinion that any further inquiry in the matter is necessary, direct the PC/C to make such inquiry or cause the inquiry to be made by any other IT authority and furnish a report containing the result of such inquiry to it.
		(iii)	Call for and examine such records relating to the matter as it deems fit.
		(iv)	Require the assessee to furnish such documents and evidence as it may direct
		(v)	All the powers which are the vested in the AAR u/s 245U
(7)	Officers	The CBDT shall provide to the Approving Panel such officials as may be necessary for the efficient exercise of powers and discharge of functions of the Approving Panel under the Income-tax Act, 1961.	
(8)	Rules	The CBDT may make rules for the purpose of the constitution and efficient functioning of the Approving Panel and expeditious disposal of the references received.	

15.17 REFERENCE TO DISPUTE RESOLUTION PANEL [SECTION 144C]

An alternate dispute resolution mechanism which will aid in speedy resolution of disputes on a fast-track basis are provided for under the Income-tax Act, 1961.

The provisions of this section shall not apply to any proceedings under Chapter XIV-B, i.e. for assessments of search cases.

The significant features of the alternate dispute resolution mechanism are briefed hereunder –

(1) In the case of assessment of an eligible assessee, the Assessing Officer shall, forward a draft proposed order of assessment to the eligible assessee if he proposes to make any variation which is prejudicial to the interest of such assessee.

Eligible Assessee

"Eligible assessee" means,-

(i) any person in whose case such variation arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 92CA; and

(ii) any non-corporate non-resident or any foreign company.

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Such eligible assessee shall not include person referred to in section 158BA(1) or other person referred to in section 158BD.

(2) The eligible assessee shall, within thirty days of the receipt by him of the draft order,-

(a) file his acceptance of the variations to the Assessing Officer; or

(b) file his objections, if any, to such variation with,—

(i) The Dispute Resolution Panel; and

(ii) The Assessing Officer.

File acceptance or objection within 30 days

"Dispute Resolution Panel" means a collegium comprising of three Principal Commissioners or Commissioners of Income-tax constituted by the CBDT for this purpose.

(3) The Assessing Officer has to complete the assessment on the basis of the draft order, if—

(a) the assessee intimates the acceptance of the variation to the Assessing Officer; or

(b) no objections are received within the period of 30 days specified in (2) above.

(4) The Assessing Officer shall, notwithstanding anything contained in section 153 or section 153B, pass the assessment order within one month from the end of the month in which -

(a) the acceptance is received; or

(b) the period of filing of objections expires.

(5) The Dispute Resolution Panel shall, in a case where any objections are received, issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

(6) The Dispute Resolution Panel shall issue such directions, after considering the following, namely -

(a) Draft order;

(b) Objections filed by the assessee;

(c) Evidence furnished by the assessee;

(d) Report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority;

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(e) Records relating to the draft order;

(f) Evidence collected by, or caused to be collected by, it; and

(g) Result of any enquiry made by, or caused to be made by it.

(7) The Dispute Resolution Panel may, before issuing any such directions -

(a) make such further enquiry, as it thinks fit; or

(b) cause any further enquiry to be made by any income tax authority and report the result of the same to it.

(8) The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order. However, it cannot set aside any proposed variation or issue any direction as mentioned in (5) above, for further enquiry and passing of the assessment order.

The power of the DRP to enhance the variation, as mentioned in section 144C(8), shall include and shall be deemed to have always included the power to consider any matter arising out of the assessment proceedings relating to the draft order. This power to consider any issue shall be irrespective of whether the matter was raised by the eligible assessee or not.

While exercising the aforesaid power for considering any matter arising out of the assessment proceedings relating to the draft order, the DRP can only enhance the variation. The power of reducing the variation is not accorded to DRP in respect of such matters.

(9) If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.

DRP direction binding on AO

(10) Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.

(11) If any direction is prejudicial to the interest of the assessee or the interest of the revenue, then, the same can be issued only after an opportunity of being heard is given to the assessee or the Assessing Officer, as the case may be.

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(12) Such direction has to be issued within **nine months** from the end of the month in which the draft order is forwarded to the eligible assessee.

Issue direction within 9 months from the end of month in which draft order is forwarded to eligible assessee

(13) Upon receipt of such direction, the Assessing Officer has to complete the assessment in accordance with the same, within one month from the end of the month in which the direction is received. This is notwithstanding anything contained in section 153 or section 153B. There is no requirement of providing any further opportunity of being heard to the assessee.

(14) The CBDT is empowered to make rules for the efficient functioning of the Dispute Resolution Panel and speedy resolution of the objections filed by the eligible assessee.

(15) The provisions of this section shall not apply to any assessment or reassessment order passed by the Assessing Officer with the prior approval of the Principal Commissioner or Commissioner as provided in 144BA(12) where GAAR has been invoked.

(16) Section 144C(14B)/(14C) and (14D) provide that the Central Government may make a scheme, by notification in the Official Gazette, for the purposes of issuance of directions by the dispute resolution panel, so as to impart greater efficiency, transparency and accountability by—

(a) eliminating the interface between the dispute resolution panel and the eligible assessee or any other person to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialisation;

(c) introducing a mechanism with dynamic jurisdiction for issuance of directions by dispute resolution panel.

For the purpose of giving effect to this faceless scheme for DRP, the Central Government may, by notification in the Official Gazette, direct that any of the provisions of the Income-tax Act, 1961 would not apply or would apply with such exceptions, modifications and adaptations as may be specified in the notification.

Every such notification issued has to be laid before each House of Parliament, as soon as may be after the notification is issued.

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15.18 INCOME ESCAPING ASSESSMENT [SECTIONS 147 TO 151]

The concept of block assessment under **Chapter XIV-BB** (section 158B-158BI) was introduced by the Finance (No. 2) Act, 2024 for the cases where a **search is initiated under section 132** or **requisition is made under section 132A** on or after **1st September 2024**. For **all other cases**, the provisions of **sections 147 to 151** will continue to apply.

(1) **Income escaping assessment [Section 147]** - If any income chargeable to tax, in the case of an assessee, has escaped assessment for any assessment year, the Assessing Officer may, subject to the provisions of sections 148 to 153, assess or reassess such income or recompute the loss or the depreciation allowance or any other allowance or deduction for such assessment year (i.e., relevant assessment year).

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The Assessing Officer may also, assess or reassess the income in respect of any issue, which has escaped assessment, and such issue comes to his notice subsequently in the course of the proceedings under this section, irrespective of the fact that the provisions of section 148A have not been complied with (*Explanation* to Section 147).

In other words, Assessing Officer may assess any income in respect of any issue that has escaped assessment which comes to his notice subsequently in the course of the proceeding, even if the steps prescribed in section 148A were not followed in relation thereto.

(2) Conducting inquiry, providing opportunity before issue of notice [Section 148A] -

(i) Where the Assessing Officer has information which suggests that income chargeable to tax has escaped assessment in the case of an assessee for the relevant assessment year, he shall, before issuing any notice under section 148 provide an opportunity of being heard to such assessee by serving upon him a notice to show cause as to why a notice under section 148 should not be issued in his case and such notice to show cause shall be accompanied by the information which suggests that income chargeable to tax has escaped assessment in his case for the relevant assessment year.

(ii) On receipt of the notice, the assessee may furnish his reply within such period, as may be specified in the notice.

(iii) The Assessing Officer shall, on the basis of material available on record and taking into account the reply of the assessee, if any, pass an order with the prior approval of the specified authority determining whether or not it is a fit case to issue notice under section 148.

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(iv) The provisions of this section shall not apply to income chargeable to tax escaping assessment for any assessment year in the case of an assessee where the Assessing Officer has received information under the scheme notified under section 135A.

Section 151- "Specified authority" for the purposes of sections 148 and 148A shall be the Additional Commissioner or the Additional Director or the Joint Commissioner or the Joint Director, as the case may be.

(3) **Issue of notice where income has escaped assessment [Section 148]** – Before making the assessment, reassessment or recomputation under section 147,

a) the Assessing Officer shall, subject to the provisions of section 148A, issue a notice under section 148 to the assessee, along with a copy of the order passed under section 148A.

b) requiring the assessee to furnish, within such period as may be specified in the notice, not exceeding three months from the end of the month in which such notice is issued, a return of his income or income of any other person in respect of whom he is assessable under this Act during the previous year corresponding to the relevant assessment year

Furnish return within 3 months from the end of month of issue of notice

c) The return of income shall be furnished 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 apply accordingly as if such return were a return required to be furnished under section 139.

However, where a return of income is furnished beyond the period allowed above, such return would not be deemed to be a return under section 139 and accordingly, the assessing officer can proceed with best judgment assessment in such a case.

Conditions: Notice under section 148 can be issued only if the following conditions are satisfied -

- There is **information** with the Assessing Officer which suggests that the income chargeable to tax has escaped assessment in the case of the assessee for the relevant assessment year.
- In case the Assessing Officer has received information under the scheme notified under section 135A, the prior approval of the specified authority is obtained.

For the purposes of this section and section 148A, **the 'information'** with the Assessing Officer which suggests that the income chargeable to tax has escaped assessment means—

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(i) any **information** in the case of the assessee for the relevant assessment year in accordance **with the risk management strategy** formulated by the Board from time to time; or

(ii) any **audit objection** to the effect that the assessment in the case of the assessee for the relevant assessment year has not been made in accordance with the provisions of this Act; or

(iii) any **information** received under **an agreement** referred to in section 90 or section 90A ; or

(iv) any **information made available** to the Assessing Officer under the scheme notified in respect of faceless collection of information **under section 135A**; or

(v) any information which requires action in consequence of the **order of a Tribunal or a Court.**

(vi) any **information** emanating from a **survey conducted under section 133A** (other than conducted under section 133A(2A) for verifying TDS and TCS) on or after 01.09.2024.

(4) Time limit for notices under sections 148 and 148A [Section 149]

(i) No notice under section 148 shall be issued for the relevant assessment year -

(a) if three years and three months have elapsed from the end of the relevant assessment year, unless the case falls under clause (b)

(b) if three years and three months, but not more than five years and three months, have elapsed from the end of the relevant assessment year unless the Assessing Officer has in his possession books of account or other documents or evidence related to any asset or expenditure or transaction or entries which show that the income chargeable to tax, which has escaped assessment, amounts to or is likely to amount to ₹ 50 lakhs or more.

(ii) No notice to show cause under section 148A shall be issued for the relevant assessment year -

(a) if three years have elapsed from the end of the relevant assessment year, unless the case falls under clause (b)

(b) if three years, but not more than five years, have elapsed from the end of the relevant assessment year unless the income chargeable to tax which has escaped assessment, as per the information with the Assessing Officer, amounts to or is likely to amount to ₹ 50 lakh or more.

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(5) **Time limit for notice [Section 149]** – Section 149(1) provides time limit upto which notice under section 148 can be issued for the relevant assessment year. However, section 149(2) provides time limit upto which notice under section 148A can be issued for the relevant assessment year.

(6) **Provision for cases where assessment is in pursuance of an order on appeal, etc. [Section 150]**

(i) Notwithstanding anything contained in section 149, the notice under section 148 may be issued at any time for the purpose of making an assessment or reassessment or recomputation in consequence of or to give effect to any finding or direction contained in an order passed by any authority in any proceeding under this Act by way of appeal, reference or revision or by a Court in any proceeding under any other law.

(ii) These provisions shall not apply in any case where any such assessment, reassessment or recomputation as is referred to in that sub-section relates to an assessment year in respect of which an assessment, reassessment or recomputation could not have been made at the time the order which was the subject-matter of the appeal, reference or revision, as the case may be, was made by reason of any other provision limiting the time within which any action for assessment, reassessment or recomputation may be taken.

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15.19 FACELESS ASSESSMENT OF INCOME ESCAPING ASSESSMENT [SECTION 151A]

Section 151A provide for faceless assessment of income escaping assessment.

(1) **Faceless assessment scheme for income escaping assessment:** Faceless assessment scheme for income escaping assessment **may be notified by** the Central Government, for the purposes of assessment, reassessment or re-computation under section 147 or issuance of notice under section 148 or issuance of show-cause notice or passing of order under section 148A or sanction for issue of such notice under section 151, so as to impart greater efficiency, transparency and accountability by—

(a) eliminating the interface between the income-tax authority and the assessee or any other person to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialisation;

(c) introducing a team-based assessment, reassessment, re-computation or issuance or sanction of notice with dynamic jurisdiction.

(2) **Notification to be laid before each House of Parliament:** Every notification issued has to be laid before each House of Parliament, as soon as may be after the issue.

Accordingly, the Central Government has, vide Notification no. 18/2022 dated 29.3.2022 specified that:

(a) assessment, reassessment or recomputation under section 147 or

(b) issuance of notice under section 148

would be through automated allocation, in accordance with risk management strategy formulated by the Board as referred to in section 148 for issuance of notice, and in a faceless manner, to the extent provided in section 144B with reference to making assessment or reassessment of total income or loss of assessee.

(3) **Applicability or non-applicability of any of the provisions of the Act as may be notified by the Central Government to give effect to the Scheme:** The Central Government may, for the purpose of giving effect to the scheme, direct that any of the provisions of the Income-tax Act, 1961 shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in the notification. However, no direction shall be issued after 31st March, 2022.

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15.20 OTHER PROVISIONS [SECTION 152]

(1) Income escaping assessment to be charged to tax at rates applicable for respective years [Section 152(1)]

In the case of any assessment or reassessment or recomputation made under section 147, the income escaping assessment would be chargeable to tax at the rate applicable to the respective years in which such income is liable to be taxed.

(2) Assessee entitled to claim dropping of proceedings under section 147 in certain cases [Section 152(2)]

Where an assessment is reopened under section 147, the assessee may claim that the proceedings under section 147 shall be dropped on his showing that he had been assessed on an amount not lower than what he would be rightly liable for, even if the income alleged to have escaped assessment had been taken into account. Alternatively, he can make such a claim on showing that the assessment or computation had been properly made. An assessee can avail of this benefit only if he had not challenged any part of the original assessment order either by filing an appeal or filing a revision petition.

The assessee, while making such claim, shall not be entitled to reopen matters concluded by an order under sections 154,155, 260, 262 or 263.

15.21 TIME LIMIT FOR COMPLETION OF ASSESSMENTS AND REASSESSMENTS [SECTION 153]

(1) **Time limits in different cases/circumstances** –

Section	Proceeding	Case/Circumstance	Time limit for completion of assessment or reassessment
153(1)	Order of assessment u/s 143 or 144	In respect of an order relating to: A.Y.2017-18 or any earlier A.Y. and made on or after 1.6.2016	21 months from the end of the assessment year in which the income was first assessable
		A.Y.2018-19	18 months from the end of the assessment year in which the income was first assessable

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		A.Y.2019-20	12 months from the end of the assessment year in which the income was first assessable
		A.Y. 2020-21	18 months from the end of the assessment year in which the income was first assessable
		A.Y.2021-22	9 months from the end of the assessment year in which the income was first assessable
		A.Y. 2022-23 and thereafter	12 months from the end of the assessment year in which the income was first assessable
	Where an updated return under section 139(8A) is furnished, an order of assessment under section 143 or section 144 may be made at any time before the expiry of **12 months** from the end of the financial year in which such return was furnished. Where a return is furnished in consequence of an order under section 119(2)(b), an order of assessment under section 143 or section 144 may be made at any time before the expiry of **12 months** from the end of the financial year in which such return was furnished.		
153(2)	Order of assessment, reassessment or recomputation u/s 147	Where notice u/s 148 is served before 1.4.2019	9 months from the end of the financial year in which the notice was served
		Where notice u/s 148 is served on or after 1.4.2019	12 months from the end of the financial year in which the notice was served
153(3)	Fresh assessment u/s 143/144/ 147 or an fresh order u/s 92CA (reference to TPO), as the case may be, where the original assessment or order u/s	If order u/s 250 or 254 is received or order u/s 263/264 is passed before 01.04.2019	9 months from the end of the financial year in which the said order u/s 250 or 254 is received by the PCC/CC/PC/CIT[1] or the order u/s 263 or u/s 264 is passed by the PCC/CC/ PC/CIT
		If order u/s 250 or 254 is received or order u/s 263/264 is passed on or after 01.04.2019	12 months from the end of the financial year in which the said order u/s 250 or 254 is received by the PCC/CC/PC/CIT or the order u/s 263 or u/s 264 is passed by the PCC/ CC/ PC/CIT

[1]Principal Chief Commissioner (PCC) / Chief Commissioner (CC) / Principal Commissioner (PC) / Commissioner of Income-tax (CIT).

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	92CA, has been set aside, cancelled and referred back to the Assessing Officer by an order u/s 250 / 254/ 263/264		
153(3A)	Where an assessment or reassessment is pending on the date of initiation of search u/s 132 or making of requisition u/s 132A.		Period available for completion of assessment or reassessment referred under section 153(1)/(1A)/(2)/(3) shall be extended by 12 months in - - a case where such search is initiated u/s 132 or such requisition is made u/s 132A; - the case of an assessee, to whom any money, bullion, jewellery or other valuable article or thing seized or requisitioned belongs to; - the case of an assessee, to whom any books of account or documents seized or requisitioned pertains or pertain to, or any information contained therein, relates to.
153(4)	Where a reference is made to the TPO u/s 92CA(1) during the course of proceeding for assessment or reassessment :		An additional time period of 12 months is available for completion of assessment/ reassessment in such cases. Thus, the revised time limit shall be as follows:
	Completion of assessment u/s 143 or u/s 144.	In relation to A.Y.2017-18 or earlier A.Y.	33 months from the end of the assessment year in which the income was first assessable.
		In relation to A.Y. 2018-19	30 months from the end of the assessment year in which the income is first assessable
		In relation to A.Y. 2019-20	24 months from the end of the assessment year in which the income is first assessable

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		In relation to A.Y. 2020-21	30 months from the end of the assessment year in which the income is first assessable
		A.Y.2021-22	21 months from the end of the assessment year in which the income was first assessable
		A.Y.2022-23 and thereafter	24 months from the end of the assessment year in which the income was first assessable
	Where an updated return under section 139(8A) is furnished, an order of assessment under section 143 or section 144 may be made at any time before the expiry of 24 months from the end of the financial year in which such return was furnished.		
	Completion of assessment/ reassessment /re-computation u/s 147	Where notice u/s 148 is served before 1.4.2019	21 months from the end of the financial year in which notice u/s 148 is served.
		Where notice u/s 148 is served on or after 1.4.2019	24 months from the end of the financial year in which the notice u/s 148 is served
	Completion of fresh assessment or fresh order u/s 92CA in pursuance of an order u/s 250 or 254 or an order passed u/s 263 or u/s 264	Where order u/s 250 or 254 is received or order u/s 263/264 is passed before 01.04.2019	21 months from the end of the financial year in which such order u/s 250 or 254 is received by the PCC or CC/PC or CIT or such order u/s 263 or 264 is passed by the PCC or CC or PC or CIT, as the case may be.
		Where order u/s 250 or 254 is received or order u/s 263/264 is passed on or after 01.04.2019	24 months from the end of the F.Y. in which the said order u/s 250 or 254 is received by the PCC/CC/PC/CIT or the order u/s 263 or u/s 264 is passed by the PCC/CC/PC/CIT
	Completion of pending assessment or reassessment on the date of initiation of search u/s 132 or making of requisition u/s 132A.		An additional time period of 12 months is available for completion of assessment/ reassessment referred under section 153(1)/(1A)/(2)/(3)/(3A).
153(5)	Effect to be given by the Assessing	Where order u/s 250/ 254/ 260/ 262/ 263/264 requires	The order u/s 250/254/ 260/262/263/264 shall be made within time specified in section 153(3) i.e., within 9 months in

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	Officer or the Transfer Pricing officer, as the case may be, to an order u/s 250/ 254/ 260/ 262/ 263/ 264, wholly or partly, otherwise than by making a fresh assessment or reassessment or fresh order u/s 92CA, as the case may be	verification of issue by submission of any document by assessee or any other person or where opportunity of being heard is to be provided to the assessee.	respect of order passed on or before 31.03.2019 and 12 months in respect of an order passed on or after 1.4.2019.
		In any other case	3 months from the end of the month in which the order u/s 250/254/ 260/262 is received by the PCC/CC/PC/CIT or the order u/s 263/264 is passed by the PCC/CC/PC/CIT. **Note** – Additional period of 6 months may be allowed to the A.O./T.P.O. to give effect to order if the PC/CIT is satisfied, on an application from the A.O. /T.P.O., that the order could not be given effect to within 3 months due to reasons beyond the control of the A.O./T.P.O.
153(5A)	Where the Transfer Pricing Officer gives effect to an order or direction u/s 263 by an order u/s 92CA and forwards such order to the Assessing Officer		The Assessing Officer shall proceed to modify the order of assessment or reassessment or recomputation, in conformity with such order of the Transfer Pricing Officer, within 2 months from the end of the month in which such order of the Transfer Pricing Officer is received by him.

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153(6)(i)	Where the assessment, reassessment or recomputation is made on the assessee or any person in consequence of or to give effect to any finding or direction contained in an order u/s 250/254/260/262/ 263/264 or in an order of any court in a proceeding otherwise than by way of appeal or reference.		12 months from the end of the month in which the order is received or passed by the PCC or CC or PC or CIT.
153(6)(ii)	Where, in the case of a firm, an assessment is made on a partner of the firm in consequence of an assessment made on the firm under section 147		12 months from the end of the month in which the assessment order in the case of the firm is passed.

Notwithstanding anything contained in the above provisions of this section or section 158BE, the order of assessment or reassessment, relating to any assessment year, which stands revived under section 158BA(5), shall be made within a period of one year from the end of the month of such revival or within the period specified in this section or section 158BE, whichever is later. [Section 153(8)].

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(2) **Exclusion of period [*Explanation 1* to section 153]** - In computing the period of limitation for the purposes of section 153, the following time periods shall be excluded:

	Case	Exclusion of Period	
		Commencing from	**Ending with**
(i)	Contravention of the provisions of section 10(21)/(22B)/ (23A)/ (23B)	the date on which the A.O. intimates the Central Government or the prescribed authority, the said contravention as required under clause (i) of the first proviso to section 143(3)	the date on which the copy of the order withdrawing the approval or rescinding the notification, as the case may be, is received by the A.O.
(ii)	Direction to get accounts audited or inventory valued under section 142(2A)	the date on which the A.O. directs the assessee to get his accounts audited or inventory valued under section 142(2A)	the last date on which the assessee is required to furnish a report of such audit or inventory valuation (or) the date on which the order setting aside such direction is received by the PC/CIT, if such direction is challenged before a Court.
(iii)	Reference to the Valuation Officer under section 142A(1)	the date on which the Assessing Officer makes a reference to the Valuation Officer	the date on which the report of the Valuation Officer is received by the Assessing Officer.
(iv)	Where the assessee furnishes declaration claiming that any question of law arising in his case for an assessment year which is pending before the A.O. or any appellate authority is identical with a question of law arising in his case for another A.Y. which is pending	the date on which the Assessing Officer received the declaration under section 158A(1)	the date on which the order under section 158A(3) is made by him **Note** – However, such period cannot exceed 60 days.

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	before the High Court or Supreme Court.		
(v)	Where an application is made before the Board for Advance Rulings u/s 245Q(1)	the date on which an application is made before the Board for Advance Rulings u/s 245Q(1)	the date on which the order rejecting the application is received by the PC/CIT u/s 245R(3) **(or)** the date on which the advance ruling pronounced by it is received by the PC/CIT u/s 245R(7)
(vi)	Where reference(s) for exchange of information is made by a competent authority	the date on which a reference or first of the references for exchange of information is made by an authority competent under an agreement referred to in section 90 or section 90A	the date on which the information requested is last received by the PC/CIT **(or)** a period of one year, **whichever is less**
(vii)	Where a reference is made by A.O. u/s 144BA(1) to PC/CIT at any stage of assessment or reassessment proceedings, on the basis of material & evidence available to declare an arrangement as IAA and determine its consequence	the date on which a reference for declaration of an arrangement to be an IAA is received by the PC/CIT under section 144BA(1)	the date on which a direction under section 144BA(3) is issued by PC/CIT, if no objections are filed by the assessee **(or)** the date on which Approving Panel issue directions in respect of the declaration of the arrangement as an IAA under section 144BA(6) **(or)** the date on which order of PC/CIT not invoking the provisions of Chapter X-A, under section 144BA(5), is received by the A.O.
(viii)	Where the books of account or other documents, or any money, bullion, jewellery or other valuable article or thing seized under section 132 or	the date on which a search is initiated under section 132 or a requisition is made under section 132A	on the date on which the books of account or other documents, or any money, bullion, jewellery or other valuable article or thing seized under section 132 or requisitioned under section 132A, as the case may be, are

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	requisitioned under section 132A, as the case may be, are handed over by the Authorising Officer to the Assessing Officer having jurisdiction over the assessee		handed over to the Assessing Officer having jurisdiction over the assessee— (a) in whose case such search is initiated under section 132 or such requisition is made under section 132A; or (b) to whom any money, bullion, jewellery or other valuable article or thing seized or requisitioned belongs to; or (c) to whom any books of account or documents seized or requisitioned pertains or pertain to, or any information contained therein, relates to (However, such period should not be more than 180 days) Where after exclusion of this period, the period of limitation for making an order of assessment, reassessment or recomputation, as the case may be, ends before the end of the month, such period shall be extended to the end of such month.
(ix)	Where the Assessing Officer is satisfied that any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C)(iv)/(v)/(vi)/(via) or any trust or institution referred to in section 11, has	the date on which the Assessing Officer makes a reference to the Principal Commissioner or Commissioner under section 143(3)	the date on which the copy of the order either cancelling the approval/ registration, as the case may be or refusing to cancel the approval/ registration under section 10(23C) or section 12AB(4), as the case may be, is received by the Assessing Officer

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	committed any specified violation under section 10(23C) or section 12AB(4), as the case may be		
(x)	the time taken in reopening the whole or any part of the proceeding or in giving an opportunity to the assessee to be re-heard under the proviso to section 129; or		
(xi)	***the period commencing on the date on which the stay on the assessment proceeding was granted by an order or injunction of any court and ending on the date on which a certified copy of the order vacating the stay was received by the jurisdictional Principal Commissioner or Commissioner.***		

(3) **Period of limitation in certain cases**

	Case	Period of limitation
(i)	Where immediately after the exclusion of the aforesaid period, the period of limitation referred to in section 153(1)/(1A)/(2)/(3)/(8) available to the Assessing Officer for making an order of assessment, reassessment or re-computation, as the case may be, is less than 60 days	Such remaining period shall be extended to **60 days** and the aforesaid period of limitation shall be deemed to be extended accordingly.
(ii)	Where the period available to the Transfer Pricing Officer is extended to 60 days in accordance with the proviso to section 92CA(3A), and the period of limitation available to the Assessing Officer for making an order of assessment, reassessment or re-computation, as the case may be, is less than 60 days	Such remaining period shall be extended to **60 days** and the aforesaid period of limitation shall be deemed to be accordingly extended.

(4) **Deeming provisions in respect of assessment of excluded income for another assessment year or on another person**

	Case	Consequence
(a)	Where, by an order referred to in section 153(6)(i), any income is excluded from the total income of the assessee for an assessment year	An assessment of such income for another assessment year shall, for the purposes of sections 150 and 153, be deemed to be one made in consequence of or to give effect to any finding or direction contained in the said order.

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(b)	Where, by an order referred to in section 153(6)(i), any income is excluded from the total income of one person and held to be the income of another person	An assessment of such income on such other person shall, for the purposes of section 150 and section 153, be deemed to be one made in consequence of or to give effect to any finding or direction contained in the said order, provided such other person was given an opportunity of being heard before the said order was passed.

15.22 RECTIFICATION OF MISTAKES [SECTION 154]

(1) **Manner of rectification of a mistake apparent from the record** - With a view to rectifying any mistake apparent from the record, an income tax authority referred to in section 116 may:

(2) **Mistake apparent from the record** - The jurisdiction of any authority under the Act to make an order under section 154 depends upon the existence of a mistake apparent on the face of the record.

(i) **Mistake apparent from the record may be a mistake of fact as well as a mistake of law** - For instance, the treatment of non-agricultural income as agricultural income and granting exemption in respect of such income is an obvious mistake of law, which could be rectified under section 154.

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(ii) **Mere change of opinion cannot be a basis for rectification** - A mere change of opinion, however, cannot be the basis on which the same or the successor Assessing Officer can treat a case as one of rectification of mistake. A mistake is one apparent from the record in case, where it is a glaring, obvious, patent or self-evident. Mistake, which has to be discovered by a long-drawn process of reasoning or examination or arguments on points, where there may be two opinions, cannot be said to be a mistake or error apparent from the record.

(iii) **Subsequent decision of Supreme Court** - A mistake arising as a result of subsequent interpretation of law by the Supreme Court would also constitute an error apparent from the record.

Mistake apparent from record

(iv) **Retrospective amendment of law** - could also lead to rectification if an order is plainly and obviously inconsistent with the specific and clear provision, as amended retrospectively.

(3) **Doctrine of Partial Merger** - Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to a rectifiable order, the authority passing such order may, amend the order in relation to any matter other than the matter which has been so considered and decided.

(4) **Amendment may be *suo motu* or the same may be brought to notice by the assessee or deductor or collector** - The concerned authority may make an amendment on its own motion. However, he should mandatorily make the amendment for rectifying any such mistake which has been brought to its notice by the assessee or the deductor or the collector. Where the authority concerned is the Joint Commissioner (Appeals) or Commissioner (Appeals), the mistake can be pointed out by the Assessing Officer also.

(5) **Opportunity of being heard to be given to the assessee or deductor or collector before enhancing an assessment or reducing a refund**- An amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee or the deductor or the collector, shall not be made unless the authority concerned has given notice to the assessee or the deductor or the collector of its intention so to do and has allowed the assessee or the deductor or the collector a reasonable opportunity of being heard.

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(6) **Action to be taken by the Assessing Officer depending upon the effect of the amendment made**

	Case	Action to be taken by A.O.
(i)	Where an amendment is made under this section	An order shall be passed in writing by the authority concerned
(ii)	Where any such amendment has the effect of reducing the assessment, or otherwise reducing the liability of the assessee or the deductor or the collector	The Assessing Officer shall make any refund due to such assessee or the deductor or the collector
(iii)	Where any such amendment has the effect of enhancing the assessment or reducing the refund already made or otherwise increasing the liability of the assessee or the deductor or the collector	The Assessing Officer shall serve on the assessee or the deductor or the collector, as the case may be a notice of demand in the prescribed form specifying the sum payable

(7) **Time limit for rectification** - Except in cases which are specifically covered by section 155, no amendment under this section shall be made after the expiry of **four years from end of the financial year in which the order sought to be amended was passed**.

Where an application for amendment is made by the assessee or by the deductor or by the collector, the income-tax 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**, either making the amendment or refusing the claim.

It may be noted that the time limit of 6 months from the end of the month in which the application is received from the assessee or deductor or collector cannot exceed the outer time limit of 4 years from the end of the financial year in which the order sought to be rectified was passed.

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15.23 OTHER AMENDMENTS [SECTION 155]

Where any assessment made in respect of any assessment year is required to be amended on account of any specific provisions in the Act mentioned hereunder, such an order can be passed within the time mentioned below and in these cases, the time limit of 4 years would not be reckoned from the end of the year in which the order sought to be amended was passed but would be reckoned from the end of the financial year mentioned in column (4) in the table below -

Sub-section	Circumstances – head note	Circumstances – details	Time limit
(1)	(2)	(3)	(4)
(1A)	Rectification of order of assessment of partners consequence to disallowance of the remuneration in the hands of the firm	Where a partner is assessed in respect of any remuneration from a firm under section 28(v) and later in the assessment or reassessment of the firm or reduction or enhancement made in the income of the firm under sections 154/250/254/263/264, such remuneration is found not deductible under section 40(b), the assessment order of the partner shall be amended to exclude such remuneration which is not deductible in the firm's case. This is in view of the proviso to section 28(v) which states that the remuneration disallowed in the firm's case cannot be charged to tax in the partner's hands.	The four years period for making the amendment in the assessment of partners would be reckoned from the end of the financial year in which the final order was passed in the case of the firm.
(2)	Rectification of member's assessment consequent to enhancement or reduction of income of the AOP/BOI	Where a member is assessed in respect of any income from the AOP/BOI and later in the assessment of such AOP/BOI, an addition or disallowance is made resulting in variation of the income of the AOP/BOI, or where there is any	The four years period for making the amendment in the case of member would be reckoned from the end of the financial year in which the final order was passed in the case of the AOP/BOI.

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		enhancement or reduction in the income of the AOP/BOI as a result of an order in appeal, reference, revision or rectification, consequential amendment in the assessment of a member of an AOP/BOI is to be made.	
(4)	Rectification of assessment consequent to disallowance of excess loss or depreciation allowed as a result of proceedings initiated under section 147	Losses incurred in one year is claimed by the assessee in the subsequent year(s). However, the year of incurring loss may be subject to reassessment proceedings u/s 147 leading re-computation of total income, where excessive loss or depreciation allowance had been allowed. This would result in amending the order/intimation/deemed intimation of the subsequent years in which the loss/allowance (computed as per return/intimation or original assessment) was claimed. The order / intimation / deemed intimation of the subsequent years may need to be amended to give effect to the reduced loss or allowance in consequence of any proceedings initiated u/s 147.	The four year period for making the amendment of the subsequent years' order or intimation or deemed intimation would be reckoned from the end of the financial year in which the order was passed under section 147.
(7B)	Rectification necessitated on account of capital gains, which were not charged to tax by virtue of section 47(iv) or 47(v),	Under the provisions of section 47A, capital gains which were not charged to tax by virtue of section 47(iv) or (v) may be deemed to be chargeable to tax, if, before	Four years from the end of the previous year in which the relevant capital asset was converted into or treated as stock-in-trade or, as the case may be,

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	becoming chargeable under section 47A	the expiry of 8 years from the date of transfer. (i) the relevant capital asset was converted into or treated as stock-in-trade or, as the case may be, (ii) the parent company ceases to hold the entire share capital of the subsidiary company In such circumstances, the Assessing Officer, may, accordingly, make an order amending the original order for withdrawal of the exemption granted under section 47(iv)/(v).	the parent company ceases to hold the entire share capital of the subsidiary company.
(11A)	Rectification to give effect to deduction under section 10AA which was not allowed earlier.	Deduction u/s 10AA has not been allowed on the ground that such income has not been received in convertible foreign exchange in India or has not been brought into India, and subsequently such income or part thereof has been or is received in, or brought into, India. In such case, the AO shall amend the order of assessment so as to allow deduction u/s 10AA in respect of such income or part thereof as is so received in, or brought into, India.	The period of four years shall be reckoned from the end of the previous year in which such income is so received in, or brought into, India.
(14)	Rectification to give effect to TDS/TCS not deducted while computing tax liability	Where credit for TDS/TCS has not been given owing to TDS/TCS certificates not being furnished along with the return of income and such certificates are produced subsequently before the Assessing Officer within two years from the	The law does not explicitly state that the time limit of 4 years for the purpose of section 154(7) would get extended from the end of the year in which the TDS/TCS certificates are produced before the Assessing Officer.

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		end of the assessment year in which such income is assessable, the Assessing Officer can amend the order of assessment or intimation or deemed intimation under section 143(1). However, such rectification under section 155(14) is possible only if the income from which tax has been deducted or the income on which tax has been collected has been disclosed in the return of income filed by the assessee for the relevant assessment year.	All that it says is that the provisions of section 154 shall apply in all such cases. Therefore, one view would be that the time limit of 4 years would be reckoned from the end of the year in which the order /intimation/ deemed intimation was passed. The second view could be that the time limit of 4 years should be reckoned from the end of the year in which the TDS/TCS certificates are produced before the Assessing Officer. Going by the purpose of introduction of section 155, it appears that the second view seems more reasonable.
(14A)	Rectification to give effect to credit for income-tax paid outside India	The assessee may claim rebate or relief u/s 90, 90A or 91 in respect of tax paid outside India on income which was subject matter of double taxation. The credit shall be allowed in India based on the proof of payment of such tax outside India. Sometimes the levy of tax outside India on the assessee may be in dispute and therefore, the assessee might not have paid the same. In the absence of the proof of payment, the credit for the same cannot be given in Indian Income tax proceedings. When the dispute is finally settled, the assessee may pay the tax	The law does not explicitly state that the time limit of 4 years for the purpose of section 154(7) would get extended from the end of the year in which the application is made by the assessee after the settlement of the dispute. All that it says is that the provisions of section 154 shall apply in all such cases. Therefore, one view would be that the time limit of 4 years would be reckoned from the end of the year in which the order / intimation / deemed intimation was passed.

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		outside India and seek to claim the same u/s. 90, 90A or 91, to the extent permissible. In such cases, the assessee is required to make the claim within a period of six months from the end of the month in which the dispute is settled with a) evidence of settlement of dispute b) evidence of payment of such tax c) undertaking that no credit for such tax has been directly or indirectly claimed or shall be claimed in any other assessment year. In such cases, the Assessing Officer shall amend the order of assessment or any intimation or deemed intimation under section 143(1), as the case may be, and the provisions of section 154 shall, so far as may be, apply thereto. However, the credit of tax which was under dispute shall be allowed for the year in which such income is offered to tax or assessed to tax in India.	The second view could be that the time limit of 4 years should be reckoned from the end of the year in which the assessee files the application after the dispute in the other country got settled. Going by the purpose of introduction of section 155, it appears that the second view seems more reasonable.
(15)	Rectification consequent to revision of full value of consideration in appeal or revision	Where the Assessing Officer adopts stamp duty value as full value of consideration under section 50C and later, such value is revised in any appeal or revision, the Assessing Officer shall amend the assessment	The period of four years shall be reckoned from the end of the previous year in which the order revising the value was passed in that appeal or revision.

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		order to compute the capital gain by taking the full value of consideration to be the value so revised in such appeal or revision.	
(16)	Recomputation of capital gains on account of reduction of any compensation in a compulsory acquisition by any Court, Tribunal or any other authority	Where capital gains are computed u/s 45(5) based on the original or enhanced compensation in a compulsory acquisition and the same is required to be recomputed on account of any reduction of any compensation by any Court, Tribunal, or any other authority, the Assessing Officer shall amend the assessment order so as to re-compute the capital gain by taking the compensation or consideration as reduced by any Court, Tribunal or other authority.	The four years time period shall be reckoned from the end of the previous year in which the order reducing the compensation was passed by the Court, Tribunal or other authority.
(17)	Rectification consequent to revoking of patent or exclusion of name of the assessee from patents register as patentee	Where deduction under section 80RRB is allowed and subsequent to the allowance of such deduction in respect of any patent, the Controller or the High Court passes an order under the Patents Act, 1970 revoking the patent or excluding the name of the assessee from the Patents Register as patentee in respect of that patent, the Assessing Officer shall recompute the total income of assessee for the relevant previous year and make necessary amendments	For the purpose of amending the order (in which deduction under section 80RRB was originally granted), the period of 4 years is to be reckoned from the end of the previous year in which such order of the Controller or High Court, as the case may be, is passed.
(18)	Where any deduction in respect of any	Explanation 3 to Section 40(a)(ii), inserted by Finance	Four year period will begin from the end of the

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	surcharge or cess, which is not allowable as deduction under section 40, has been claimed and allowed in the case of an assessee in any previous year	Act, 2022 with retrospective effect from A.Y. 2005-06, provides that the term 'tax' shall include and be deemed to have always included 'surcharge' or 'cess' and hence shall be an inadmissible deduction under section 40(a)(ii). If an assessee has claimed the deduction on account of 'surcharge' or 'cess' in any previous year, it shall be deemed that the assessee has under-reported income for such previous years for the purpose of Section 270A(3) and the Assessing Officer shall recompute the total income of the assessee for such previous year and make necessary amendment.	previous year commencing on 1.4.2021. (i.e., from 31.3.2022). **Note:** If the assessee makes an application to the Assessing Officer in the prescribed form and within the prescribed time (on or before 31.3.2023), requesting for recomputation of the total income of the previous year without allowing the claim for deduction of surcharge or cess and pays the amount due thereon within the specified time, such claim shall not be deemed to be under-reported income for the purposes of section 270A(3). The A.O., on receipt of such application, has to recompute the total income by amending the relevant order and issuing notice u/s 156 specifying the time period within which amount of tax payable, if any, is to be paid – (i) for the A.Y. relevant to the P.Y. for which the assessee has made an application for recomputation of total income; and (ii) for the A.Y.s subsequent to such A.Y. referred to in (i) above, if the order for such A.Y. results in variation in carry forward of loss or

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			allowance or unabsorbed depreciation or credit for tax u/s 115JAA or 115JD [Rule 132 of Income-tax Rules, 1962] After paying the tax determined, the assessee has to furnish the details of payment of tax to the Assessing Officer within 30 days from the date of making the payment.
(20)	Where any income has been included in the return of income furnished by an assessee u/s 139 for any assessment year (being the relevant assessment year) and tax on such income has been deducted at source and paid to the credit of the Central Government in accordance with the provisions of Chapter XVII-B in a subsequent financial year.	The Assessing Officer shall, on an application made by the assessee in such prescribed form, within a period of 2 years from the end of the financial year in which such tax was deducted at source, amend the order of assessment or any intimation allowing credit of such tax deducted at source in the relevant assessment year. The credit of such tax deducted at source shall not be allowed in any other assessment year.	The period of four years shall be reckoned from the end of the financial year in which such tax has been deducted.
(21)	*Where the TPO determines the ALP and has validated the assessee's option for a block TP assessment covering the next two previous years*	*Where the arm's length price is determined in relation to an international transaction or a specified domestic transaction under* section 92CA*(3) for any previous year and the Transfer Pricing Officer has declared that an option exercised by the assessee is valid under section 92CA(3B) in respect of such transaction for two consecutive previous years immediately following such previous year, the Assessing*	***(a) If assessment, intimation or deemed intimation of consecutive two years is made:*** *The Assessing Officer is required to recompute within 3 months from the end of the month in which the assessment is completed in the case of the assessee for such previous year (i.e. year for which the TPO determines the ALP).*

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		Officer shall proceed to recompute the total income of the assessee for the said two consecutive previous years, by amending the order of assessment or any intimation or deemed intimation under section 143*(1), as the case may be,—* *(a) in conformity with the arm's length price so determined by TPO under section 92CA(4A) in respect of such transaction; and* *(b) taking into account the directions issued by DRP under section 144C(5), if any, for such previous year,*	***(b) If assessment, intimation or deemed intimation of such consecutive two years is not made within said 3 months period:*** *The Assessing Officer is required to recompute within 3 months from the end of the month in which such order of assessment or any intimation or deemed intimation under* section 143*(1) for such consecutive two years, as the case may be, is made.*

15.24 NOTICE OF DEMAND [SECTION 156]

(1) When any tax, interest, penalty or fine or any other sum is payable consequent to any order passed under this Act, the Assessing Officer shall serve upon the assessee, a notice of demand in the prescribed form, specifying the sum so payable.

An intimation under section 143(1) or section 200A(1) or section 206CB(1) would be deemed to be a notice of demand for the purpose of section 156, where any sum is determined to be payable by the assessee under section 143(1) or by the deductor under section 200A(1) or by the collector under section 206CB(1).

Notice of Demand

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The Apex Court has, in *Sri Mohan Wahi v. CIT (2001) 248 ITR 799,* held that failure to serve notice of demand renders the recovery proceedings invalid.

Note - *As per section 292BB, where an assessee had appeared in any proceedings or co-operated in any enquiry relating to an assessment or reassessment, it shall be deemed that any notice required to be served upon him, has been duly served upon him in time in accordance with the provisions of the Act and such assessee shall be precluded from raising any objection in any proceeding or enquiry that the notice was (a) not served upon him or (b) not served upon him in time or (c) served upon him in an improper manner. However, the above provision shall not be applicable where the assessee has raised such objection before the completion of such assessment or reassessment.*

(2) Tax on perquisite of specified securities and sweat equity shares must be paid in the year of exercising of option. However, where such shares or securities are allotted by the current employer, being an eligible start-up referred to in section 80-IAC, the perquisite is taxable in the year -

- after the expiry of 48 months from the end of the relevant assessment year
- in which sale of such security or share are made by the assessee
- in which the assessee ceases to be the employee of the employer,

whichever is earliest.

In such cases, tax or interest on such income included in the notice of demand referred to in (1) above shall be payable by the assessee within 14 days –

- after the expiry of 48 months from the end of the relevant assessment year
- from the date of sale of such security or share are made by the assessee
- from the date when the assessee ceases to be the employee of the employer,

whichever is earliest.

15.25 MODIFICATION AND REVISION OF NOTICE IN CERTAIN CASES [SECTION 156A]

Where any tax, interest, penalty, fine or any other sum in respect of which a notice of demand has been issued under section 156, is reduced as a result of an order of the Adjudicating Authority as defined in section 5(1) of the Insolvency and Bankruptcy Code, 2016, the Assessing Officer shall

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modify the demand payable in conformity with such order and shall thereafter serve on the assessee a notice of demand specifying the sum payable, if any. Such notice of demand shall be deemed to be a notice under section 156 and the provisions of this Act shall accordingly, apply in relation to such notice.

Where the order referred to above is modified by the National Company Law Appellate Tribunal or the Supreme Court, as the case may be, the modified notice of demand issued by the Assessing Officer earlier shall be revised accordingly.

15.26 INTIMATION OF LOSS [SECTION 157]

When, in the course of the assessment of total income of any assessee, it is established that a loss has taken place which the assessee is entitled to have carried forward and set-off business loss under section 72(1), speculation business loss under section 73(2), losses under the head "Capital Gains" under section 74 and loss from activity of owning and maintain race horses under section 74A(3), the Assessing Officer shall notify the assessee by an order in writing the amount of the loss as computed by him for this purpose.

15.27 FACELESS RECTIFICATION, AMENDMENTS AND ISSUANCE OF NOTICE OR INTIMATION [SECTION 157A]

Section 157A provide for faceless rectification, amendments and issuance of notice or intimation.

(1) **Faceless rectification, amendments and issuance scheme for income escaping assessment:** The Central Government may make a scheme, by notification in the Official Gazette, for the purposes of rectification of any mistake apparent from record under section 154 or other amendments under section 155 or issue of notice of demand under section 156, or intimation of loss under section 157, so as to impart greater efficiency, transparency and accountability by—

(a) eliminating the interface between the income-tax authority and the assessee or any other person to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialisation;

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(c) introducing a team-based rectification of mistakes, amendment of orders, issuance of notice of demand or intimation of loss, with dynamic jurisdiction.

(2) Applicability or non-applicability of any of the provisions of the Act as may be notified by the Central Government to give effect to the Scheme: The Central Government may, direct that any of the provisions of this Act would not apply or would apply with such exceptions, modifications and adaptations as may be specified in the notification. However, no direction shall be issued after 31.03.2022.

(3) **Notification to be laid before each House of Parliament:** Every notification issued has to be laid before each House of Parliament, as soon as may be after the notification is issued.

15.28 BLOCK ASSESSMENT IN SEARCH AND REQUISITION CASES

The Finance Act, 2021, amended search and reassessment provisions, abolishing separate search assessments and streamlining processes under sections 147 to 151A. Challenges like staggered assessments, prolonged litigation, and inconsistent outcomes were identified, emphasizing the need for consolidated assessments to reduce taxpayer burden, improve efficiency, and ensure coordinated investigations in search cases.

Accordingly, in order to make the procedure of assessment of search cases cost effective, efficient and meaningful, the Finance (No. 2) Act, 2024 reintroduced the scheme of block assessment by substituting Chapter XIV-B (Sections 158B to 158BI) in cases where a search under section 132 or a requisition under section 132A has been made on or after 01.09.2024. The main objectives for the introduction of this scheme are early finalisation of search assessments, coordinated investigation during search assessments and reduction in multiplicity of proceedings.

(1) **Definitions of certain terms**

Before we proceed to the procedure of block assessment, let's understand crucial terms defined under section 158B:

Term	Meaning
Block Period	The period comprising previous years relevant to **six** assessment years preceding the previous year in which the search was initiated under section 132 or any requisition was made under section 132A. It also includes the period starting from 1st April of the previous year in which the search was initiated, or requisition was made and ending on

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<table>
<tr><td></td><td>the date of the execution of the last of the authorizations for such search or such requisition.
The last of the authorisations shall be deemed to have been executed,—
<table>
<tr><td>(a)</td><td>in the case of search</td><td>on the conclusion of search as recorded in the last panchnama drawn in relation to any person in whose case the warrant of authorisation has been issued</td></tr>
<tr><td>(b)</td><td>in the case of requisition under section 132A</td><td>on the actual receipt of the books of account or other documents or assets by the Authorised Officer</td></tr>
</table></td></tr>
<tr><td colspan="2">For example, if the search was initiated on 10-12-2025 and last of authorization executed on 18.12.2025, the block period will comprise of assessment years relevant to previous years 2024-25, 2023-24, 2022-23, 2021-22, 2020-21 and 2019-20 including period from 01.04.2025 to 18.12.25.</td></tr>
<tr><td>Undisclosed Income</td><td>It includes:
- any money, bullion, jewellery, virtual digital assets or other valuable article or thing or any expenditure or any income based on any entry in the books of account or other documents or transactions, where such money, bullion, jewellery, virtual digital assets, valuable article, thing, entry in the books of account or other document or transaction represents wholly or partly income or property which has not been or would not have been disclosed for the purposes of this Act, or
- any expense, exemption, deduction or allowance claimed under this Act which is found to be incorrect, in respect of the block period.</td></tr>
</table>

(2) **Assessment of *total undisclosed income* as a result of search [Section 158BA]**

(i) **Assess or reassess the *total undisclosed income* of the block period:** Where on or after 1.9.2024, a search is initiated under section 132, or books of account, other documents or any assets are requisitioned under section 132A, in the case of any person, then, the Assessing Officer shall proceed to assess or reassess ***the total undisclosed income*** of the block period in accordance with the provisions of this Chapter XIV-B.

(ii) **Abatement of pending assessment or reassessment or re-computation:** The assessment or reassessment or re-computation under any other provisions of this Act

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(other than this Chapter), if any, pertaining to any assessment year falling in the block period, **pending** on the date of initiation of the search under section 132, or making of requisition under section 132A, as the case may be, shall **abate** and shall be deemed to have abated on the date of initiation of search or making of requisition.

(iii) **Abatement of pending assessment or reassessment or re-computation even if notice is issue during search:** Any proceeding for assessment or reassessment or recomputation under any provision of this Act (other than this Chapter) pertaining to any assessment year falling in the block period (other than the assessment year in which the last of the authorisations for a search is executed or requisition is made), for which a notice has been issued during the period commencing on the date of initiation of search under section 132 or making of requisition under section 132A and ending on the date of making of order under section 158BC(1)(c), shall abate and shall be deemed to have been abated on the date of issue of such notice.

(iv) **Abatement of pending assessment or reassessment or re-computation on reference or order passed under section 92CA:** Where during the course of any pending proceeding for the assessment or reassessment or recomputation under the provisions of this Act (other than this Chapter), a reference under section 92CA(1) has been made, or an order under section 92CA(3) has been passed, such assessment or reassessment or recomputation, along with such reference made or order passed, as the case may be, shall also **abate** and shall be deemed to have abated on the date of initiation of search or making of requisition.

(v) **Completion of assessment in case of subsequent search:** Where any assessment under the provisions of this Chapter ***is required to be made*** in the case of an assessee in whose case a subsequent search is initiated or a requisition is made, such assessment shall be duly completed, and thereafter, the assessment in respect of such subsequent search or requisition shall be made under the provisions of this Chapter, i.e. the AO must complete the initial assessment before starting the new one.

Where the period of completing the assessment with respect to the subsequent search is less than 3 months, such period shall be extended to 3 months from the end of the month in which the assessment with respect to the earlier search was completed.

(vi) **Revival of assessment orders due to annulment of block assessment:** If any proceeding initiated under this Chapter or any order of assessment or reassessment made under section 158BC(1)(c) has been annulled in appeal or any other legal

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proceeding, then, notwithstanding anything in this Chapter or section 153, ***the assessment or reassessment or recomputation or reference (to TPO under Section 92CA(1)) or order relating to any assessment year*** which has abated above, shall revive with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner. It is to be noted that such revival shall cease to have effect, if such order of annulment is set aside.

The consequential impacts have been made under section 153 to provide the time limit to complete such revived assessment or reassessment.

(vii) **Separate assessment of Total Income (other than undisclosed income) of the year of Search/Requisition:** The total income (other than undisclosed income) of the assessment year relevant to the previous year in which the last of the authorisations for a search is executed or a requisition is made shall be assessed separately in accordance with the other provisions of this Act. Thereby, only undisclosed income of the block period of six years shall be subject to the provisions of this chapter.

(viii) **Taxation of total undisclosed income of block period:** The ***total undisclosed income*** relating to the block period shall be charged to tax, at the rate specified in section 113, as income of the block period irrespective of the previous year or years to which such income relates.

As per section 113, the total undisclosed income of the block period, determined under section 158BC, shall be chargeable to tax @60% as increased by the surcharge, if any, and Health and Education Cess.

(3) **Computation of total undisclosed income of block period [Section 158BB]**

(i) ***Determination of Undisclosed Income for Block Period:*** *The total undisclosed income of the block period shall be an* ***aggregate*** *of the following:*

(a) Undisclosed income declared in the return furnished under section 158BC.

(b) Undisclosed income determined by the AO on the basis of evidence found as a result of search or survey or requisition of books of account or other documents and any other material or information as are either available with the Assessing Officer or come to his notice during the course of proceedings under this Chapter.

(ii) ***Income not included in Total Undisclosed Income****: The following income shall not be included in the total undisclosed income of the block period:*

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(a) The total income determined under section 143(1) or assessed under section 143 or section 144 or section 147 or section 153A or section 153C or assessed earlier under section 158BC(1)(c) or section 245D(4), prior to the date of initiation of the search or the date of requisition, in respect of any of the previous year comprising the block period;

(b) The total income declared in the return of income filed under section 139 or in response to a notice under section 142(1), prior to the date of initiation of the search or the date of requisition, in respect of any of the previous year comprising the block period and not covered in (a) above

(c) the income computed by the assessee, in respect of-

(i) a previous year, where such previous year has ended and the due date for furnishing the return for such year has not expired prior to the date of initiation of the search or the date of requisition, on the basis of entries relating to such income or transactions as recorded in the books of account and other documents maintained in the normal course before the date of initiation of search or the date of requisition

(ii) the period commencing from the 1st April of the previous year in which the search is initiated or requisition is made and ending on the day immediately preceding the date of initiation of search or requisition, on the basis of entries relating to such income or transactions as recorded in the books of account and other documents maintained in the normal course for such period on or before the day immediately preceding the date of initiation of search or the date of requisition;

(iii) the period commencing from the date of initiation of the search or the date of requisition and ending on the date of the execution of the last of the authorisations for search or requisition, on the basis of entries relating to such income or transactions as recorded in the books of account and other documents maintained in the normal course for such period on or before the date of the execution of the last of the authorisations.

However, where the Assessing Officer is of the opinion that any part of the income as computed by the assessee is undisclosed, he may recompute such income.

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(d) the total income computed under the provisions where return filing is not mandatory and tax on such income is paid by TDS under section 115A(5) or section 115G or section 194P(1).

Note - *Losses brought forward from the previous year (prior to the first previous year comprising the block period) or unabsorbed depreciation under section 32(2) shall not be set off against the undisclosed income determined in the block assessment under this Chapter. However, it may be carried forward for being set off in the previous year subsequent to the assessment year in which the block period ends, for the remaining period, taking into account the block period and such assessment year, and in accordance with the provisions of this Act [Section 158BB(7)].*

(iii) ***Treatment of Income Relating to International and Specified Domestic Transactions during Search Proceedings****: Where any income required to be determined as a result of search or requisition of books of account or other documents and any other material or information as are either available with the Assessing Officer or come to his notice during the course of proceedings under this Chapter, or*

- *determined on the basis of entries relating to such income or transactions as recorded in books of account and other documents maintained in the normal course on or before the date of the execution of the last of the authorisations,*
- *relates to any international transaction or specified domestic transaction referred to in* section 92CA*, pertaining to the period beginning from the 1st April of the previous year in which last of the authorisations was executed and ending with the date on which last of the authorisations was executed,*
- *such income shall not be considered for the purposes of determining the total undisclosed income of the block period and*
- *such income shall be considered in the assessment made under the other provisions of this Act.*

(iv) Special provision for the determination of the undisclosed income:

- **For a firm** - such income assessed for each of the previous years falling within the block period shall be the income determined before allowing deduction of salary, interest, commission, bonus or remuneration by whatever name called to any partner not being a working partner;

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- The provisions of sections 68, 69, 69A, 69B, and 69C shall, so far as may be, apply and references to "financial year" in those sections shall be construed as references to the relevant previous year falling in the block period;
- The provisions of section 92CA shall, so far as may be, apply and references to "previous year" in that section shall be construed as reference to the relevant previous year falling in the block period excluding the period beginning from the April 1st of the previous year in which last of the authorisations was executed and ending with the date on which last of the authorisations was executed .

(4) **Procedure for block assessment [Section 158BC]**

Where any search has been initiated under section 132 or books of account, other documents or assets are requisitioned under section 132A, in the case of any person, then:

(i) The Assessing Officer shall, in respect of search initiated, or books of account or other documents or any assets requisitioned, **issue a notice** to such person, requiring him to furnish within such period, not exceeding a period of sixty days, as may be specified in the notice, a return in the form and verified in the manner, as may be prescribed, setting forth his undisclosed income for the block period:

- Such return shall be considered as if it was a return furnished under the provisions of section 139 and notice under section 143(2) shall thereafter be issued.
- Returns filed under this section and furnished beyond the period allowed in the notice are not deemed to be a return under section 139.
- No notice under section 148 is required to be issued for the purpose of proceeding under this Chapter:
- A person who has furnished a return under this clause shall not be entitled to furnish a revised return.
- *The time allowed for furnishing a return under this clause may be extended by a further period of thirty days by AO, where:*
  - *The due date for furnishing the return of the previous year immediately preceding the year of search or requisition has not expired before the date of initiation of the search or the date of requisition;*
  - *the assessee was liable for audit under section 44AB for such previous year;*

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- *The accounts (maintained in the normal course) of such previous year have not been audited on the date of issuance of such notice; and*
- *The assessee requests in writing for an extension of time for furnishing such a return so that he may get such accounts audited.*

(ii) The Assessing Officer shall proceed to **determine the total undisclosed income of the block period**, in the manner laid down in section 158BB and the provisions of section 142, 143(2), 143(3), 144, 145, 145A and 145B shall apply.

(iii) The Assessing Officer, on determination of the total undisclosed income of the block period in accordance with this Chapter, shall **pass an order of assessment or reassessment** and **determine the tax payable** by him on the basis of such assessment or reassessment.

However, the provisions of section 144C, which deals with the Dispute Resolution Panel, do not apply to orders made under this scheme.

(iv) The **assets seized** under section 132 or requisitioned under section 132A shall be dealt with in accordance with the provisions of section 132B.

(v) The computerised processing of returns under Section 143(1) does not apply to returns filed under this section.

(vi) The Assessing Officer must obtain **prior approval** from an Additional Commissioner, Additional Director, Joint Commissioner, or Joint Director before issuing a notice under this section 158BC.

(5) **Undisclosed income of any other person [Section 158BD]**

Where the Assessing Officer is satisfied that any undisclosed income belongs to or pertains to or relates to any person (referred as "other person"), other than the person (referred as "specified person") with respect to whom search was made under section 132 or whose books of account or other documents or any assets were requisitioned under section 132A, then, any money, bullion, jewellery, virtual digital assets or other valuable article or thing, or assets, or expenditure, or books of account, other documents, seized or requisitioned or any other material or information relating to the aforesaid undisclosed income ***shall be handed over to the Assessing Officer having jurisdiction over such other person*** *and that Assessing Officer shall proceed under section 158BC against such other person and the provisions of this Chapter shall apply accordingly.*

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Cases	*Block period of the other person*
*Where there is **one specified person** relevant to such other person*	*the block period for such other person shall be the same as that for the specified person.*
*Where there is **more than one specified persons** relevant to such other person*	*the block period for such other persons shall be the same as that for the specified person in whose case the block period ends on a later date.*

Additionally, in case of such other person, for the purposes of abatement under Section 158BA(2)/(3), the reference to the date of initiation of the search or making of requisition shall be construed as a reference to the date on which such money, bullion, jewellery, virtual digital asset or other valuable article or thing or any books of account or other documents seized or requisitioned or any other material or information relating to the aforesaid undisclosed income were received by the Assessing Officer having jurisdiction over such other person.

(6) **Time-limit for completion of block assessment [Section 158BE]**

Notwithstanding the provisions of section 153, the order under section 158BC shall be passed within **twelve months from the end of the *quarter* in which the last of the authorisations for search under section 132, or requisition under section 132A, was executed or made, as the case may be.** For example, the time limits for completing the block assessment where the last authorisation of a search is falling between 1st April and 30th June 2025 will be 30th June 2026.

The period of limitation for completion of assessment or reassessment for the block period in the case of the other person referred to in section 158BD shall be twelve months from the end of the quarter in which the notice under section 158BC in pursuance of section 158BD, was issued to such other person.

The Finance Act 2025, under section 158BC(1)(a), enabled the extension by AO in the time allowed to file the return by a further period of 30 days if certain conditions are fulfilled. The corresponding extension in the limitation period to complete the block assessment is inserted under section 158BE in such cases. The period of limitation shall be thirteen months from the end of the quarter in which the last authorisation for a search under or requisition is executed or made. A similar extension in the limitation period for the completion of block assessment in the case of other person is inserted.

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Where a reference is made under section 92CA(1) (to Transfer pricing officer) during the assessment or reassessment of the total undisclosed income for the relevant block period, the time limit for making the order is extended by an additional twelve months.

Exclusion from the limitation period

- The period (not exceeding 180 days) commencing from the date on which a search is initiated under section 132 or a requisition is made under section 132A and ending on the date on which the books of account, or other documents or money or bullion or jewellery or other valuable article or thing seized under section 132 or requisitioned under section 132A, as the case may be, are handed over to the Assessing Officer having jurisdiction over the assessee, in whose case such search is initiated under section 132 or such requisition is made under section 132A, as the case may be, shall be excluded.

  Where after exclusion of the period referred above, the period of limitation for making an order of assessment or reassessment, as the case may be, expires before the end of a month, such period shall be extended to the end of such month.

- the period commencing on the date on which stay on assessment proceedings was granted by an order or injunction of any court and ending on the date on which certified copy of the order vacating the stay was received by the jurisdictional Principal Commissioner or Commissioner: or

- the period commencing from the date on which a reference or first of the references for exchange of information is made by an authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information requested is last received by the Principal Commissioner or Commissioner or a period of one year, whichever is less; or

- the time taken in reopening the whole or any part of the proceeding or giving an opportunity to the assessee to be re-heard under the proviso to section 129; or

- the period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited or inventory valued under section 142(2A) and—

  (a) ending with the last date on which the assessee is required to furnish a report of such audit or inventory valuation; or

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(b) where such direction is challenged before a court, ending with the date on which the order setting aside such direction is received by the Principal Commissioner or Commissioner; or

- the period commencing from the date on which the Assessing Officer makes a reference to the Valuation Officer under section 142A(1A) and ending with the date on which the report of the Valuation Officer is received by the Assessing Officer; or
- the period commencing from the date on which the Assessing Officer intimates the Central Government or the prescribed authority, the contravention of the provisions of clause (21) or clause (22B) or clause (23A) or clause (23B) of section 10, under sub-clause (i) of the first proviso to section 143(3) and ending with the date on which the copy of the order withdrawing the approval or rescinding the notification, as the case may be, under those clauses is received by the Assessing Officer; or
- the period commencing from the date on which the Assessing Officer makes a reference to the Principal Commissioner or Commissioner under the second proviso to section 143(3) and ending with the date on which the copy of the order under clause (ii) or clause (iii) of the fifteenth proviso to section 10(23C) or clause (ii) or clause (iii) of section 12AB(4), as the case may be, is received by the Assessing Officer; or
- the period commencing from the date on which a reference for declaration of an arrangement to be an impermissible avoidance arrangement is received by the Principal Commissioner or Commissioner under section 144BA(1) and ending on the date on which a direction under section 144BA(3)/(6) or an order under section 144BA(5) is received by the Assessing Officer; or
- the period commencing from the date on which an application is made before the Board for Advance Rulings under section 245Q(1) and ending with the date on which the order rejecting the application is received by the Principal Commissioner or Commissioner under section 245R(3); or
- the period commencing from the date on which an application is made before the Board for Advance Rulings under section 245Q(1) and ending with the date on which the advance ruling pronounced by it is received by the Principal Commissioner or Commissioner under section 245R(7).

Where immediately after excluding the period specified above, the period of limitation available with the Assessing Officer for making the assessment is less than 60 days, then such period shall be extended to 60 days, and the period of limitation shall be deemed to be

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extended accordingly. Further, if the period of limitation expires before the end of a month after an extension, it is extended to the end of that month.

(7) **Certain interests and penalties not to be levied or imposed [Section 158BF]**

No interest under section 234A, 234B or 234C or penalty under section 270A shall be levied or imposed upon the assessee in respect of the undisclosed income assessed or reassessed for the block period.

(8) **Levy of interest and penalty in certain cases [Section 158BFA]**

(i) **Interest for delay in filing of return** - When the assessee fails to furnish the return of undisclosed income, within the specified time in the notice issued under section 158BC or does not file it at all, the assessee is liable to pay interest at the rate of **1.5% of the tax** on the undisclosed income. The interest shall be charged for each month or part thereof, and the period shall start from the day immediately following the expiry of the time specified in the notice and ending on the date of completion of the assessment under section 158BC.

(ii) **Penalty for undisclosed income** - The Assessing Officer or the Commissioner (Appeals) in the course of any proceedings under this Chapter, may direct that the person shall pay by way of penalty a sum which shall be equal to **50% of tax** so leviable in respect of the undisclosed income determined by the Assessing Officer under section 158BC.

(iii) **Immunity from Penalty -** No order imposing penalty under this section or section 271AAD(1) or section 271D or section 271DA or section 271E shall be made for the block period in respect of a person if—

- such person has furnished a return under section 158BC;
- the tax payable on the basis of such return has been paid or, if the assets seized consist of money, the assessee offers the money so seized to be adjusted against the tax payable;
- evidence of tax paid is furnished along with the return; and
- an appeal is not filed against the assessment of that part of income which is shown in the return.

However, no immunity shall be available where the undisclosed income determined by the Assessing Officer is in excess of the income shown in the return. In such cases,

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the penalty shall be imposed on that portion of undisclosed income determined which is in excess of the amount of income shown in the return.

(iv) **Procedure to impose the penalty:** No order imposing penalty shall be made -

(a) unless an assessee has been given a reasonable opportunity of being heard;

(b) by the Deputy Commissioner or Assistant Commissioner or the Deputy Director or Assistant Director, as the case may be, where the amount of penalty exceeds ₹ 2 lakhs except with the previous approval of the Additional Commissioner or the Additional Director or the Joint Commissioner or the Joint Director, as the case may be

(c) in a case where the assessment is the subject-matter of an appeal to the Commissioner (Appeals) under section 246A or an appeal to the Appellate Tribunal under section 253, **after the expiry of the financial year** in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or six months from the end of the financial year in which the order of the Commissioner (Appeals) or, as the case may be, the Appellate Tribunal is received by the Principal Commissioner or Commissioner, whichever period expires later.

(d) in a case where the assessment is the subject-matter of revision under section 263, after the expiry of six months from the end of the financial year in which such order of revision is passed.

(e) in any case other than those mentioned in clause (c) and clause (d), after the expiry of the financial year in which the proceedings, in the course of which notice for the imposition of penalty has been issued, are completed, or six months from the end of the financial year in which notice for imposition of penalty is issued, whichever period expires later.

In computing the period of limitation under this section, the following period shall be excluded:

- the time taken in giving an opportunity to the assessee to be reheard under the proviso to section 129 (change of incumbent of an office),
- *the period commencing on the date on which stay on the proceedings above, was granted by an order or injunction of any court and ending on the date on*

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which certified copy of the order vacating the stay was received by the jurisdictional Principal Commissioner or Commissioner.

If the remaining period after such exclusions is less than 60 days, it shall be extended to 60 days. Further, if the period of limitation expires before the end of a month after an extension, it is extended to the end of that month.

(v) A copy of the order imposing penalty shall be sent to an Assessing Officer unless such order is passed by Assessing Officer himself.

(9) **Authority competent to make assessment of block period [Section 158BG]**

The order of assessment for the block period shall be passed by an Assessing Officer not below the rank of a Deputy Commissioner or an Assistant Commissioner or a Deputy Director or an Assistant Director, as the case may be.

However, no such order shall be passed without the previous approval of the Additional Commissioner or the Additional Director or the Joint Commissioner or the Joint Director, as the case may be, in respect of search initiated under section 132, or books of account, other documents or any assets requisitioned under section 132A..

Save as otherwise provided in this Chapter, all other provisions of this Act shall apply to assessment made under this Chapter [Section 158BH].

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SIGNIFICANT SELECT CASES

S. No.	Case Law	
1.	*CIT v. Govind Nagar Sugar Ltd. (2011) 334 ITR 13 (Delhi)*	
	Issue	**Analysis & Decision**
	Can unabsorbed depreciation be allowed to be carried forward in case the return of income is not filed within the due date?	The provisions of section 80 and section 139(3), requiring the return of income claiming loss to be filed within the due date, applies to, *inter alia*, carry forward of business loss and not for the carrying forward of unabsorbed depreciation. As per the provisions of section 32(2), the unabsorbed depreciation becomes part of the next year's depreciation allowance and is allowed to be set-off as per the provisions of the Income-tax Act, 1961, irrespective of whether the return of earlier year was filed within due date or not.
2.	*Orissa Rural Housing Development Corpn. Ltd. v. ACIT (2012) 343 ITR 316 (Orissa)*	
	Issue	**Analysis & Decision**
	Can an assessee revise the particulars filed in the original return of income by filing a revised statement of income other than by way of filing revised return as contemplated u/s 139(5) of the Act?	The assessee can make a fresh claim before the Assessing Officer or make a change in the originally filed return of income only by filing revised return of income under section 139(5). There is no provision under the Income-tax Act, 1961 to enable an assessee to revise his income by filling a revised statement of income. Therefore, filling of revised statement of income is of no value and will not be considered by the Assessing Officer for assessment purposes. Therefore, the Assessing Officer has no power to entertain a fresh claim made by the assessee after filing of the original return except by way of filing a revised return. **Note:** *As per section 139(8A) an updated return of income by any person, whether he has filed a return previously for the relevant assessment year, or not, can be furnished within 24 months from the end of the relevant assessment year. However, an assessee cannot file a return of loss or decrease the tax liability determined or increase its refund based on return furnished under section 139(1) or 139(4) or*

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		139(5). For making a fresh claim, the assessee only has an option to file a revised return under section 139(5).
3.	***CIT v. Tony Electronics Limited (2010) 320 ITR 378 (Delhi)***	
	Issue	**Analysis & Decision**
	Whether the time limit of 4 years as per section 154(7) would apply from the date of original assessment order or the order of the Appellate Authority.	Once an appeal against the order passed by an authority is preferred and is decided by the appellate authority, the order of the Assessing Officer merges with the order of the appellate authority. After merger, the order of the original authority ceases to exist and the order of the appellate authority prevails. Thus, the period of limitation of 4 years for the purpose of section 154(7) has to be counted from the date of the order of the Appellate Authority.
4.	***DCIT vs Travel Designer India Pvt. Ltd. vs (2025) 482 ITR 283 (SC)***	
	Issue	**Facts, Relevant Provision of Law, Analysis and Decision**
	Whether, for the purpose of computing limitation period under section 143(2), the relevant date is the date of filing of the original return of income or the date of removal of defects in response to a notice issued under section 139(9)?	**Facts of the Case:** The assessee filed its return of income under section 139(1) on 29th November, 2024[2]. The return was found to be defective, and accordingly, the assessee received an intimation on 10th July, 2025[3] to correct the defects within a period 15 days from the receipt of the said notice. The defects were rectified on 19th July, 2025[4]. Subsequently, the Assessing Officer issued a notice under section 143(2) on 11th June, 2026[5]. The assessee contended that the notice u/s 143(2) can be issued within three months[6] from the end of the financial year in which return is furnished. Thus, the said notice was barred by limitation as per the provisions of the Act. **Relevant Provision:** Section 139(1) mandates the filing of a return of income by an assessee, while section 139(9) provides an opportunity to rectify defects in the return within a prescribed time frame without filing a fresh return. Section 143(2) requires the Assessing Officer to issue a notice for scrutiny assessment within

[2] 2016, was the original date in the case law
[3] 2017, was the original date in the case law
[4] 2017, was the original date in the case law
[5] 11th August 2018, was the original date in the case law
[6] Time limit for issue of notice was six months for the financial year 2016-17

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		three months from the end of the financial year in which the return was filed, and such notice is a prerequisite for assessment under section 143(3). **Analysis and Decision:** Since the return was defective, the assessee was called upon to remove such defects, which was removed on 19th July, 2025, which is within the time allowed by the Assessing Officer. Therefore, upon such defects being removed, the return would relate back to the date of filing original return i.e., 29th November, 2024. Consequently, the limitation for issuance of notice under section 143(2) would be 30th June, 2025 i.e., three months from the end of the financial year in which the return under section 139(1) was filed. In the present case, notice under section 143(2) has been issued on 11th June, 2026, which is much beyond the period of limitation. Therefore, such notice is barred by limitation and cannot be sustained. Accordingly, the Gujarat High Court held that the notice issued under section 143(2) and the assessment proceedings initiated based on such notice are quashed and set aside. The Apex Court dismissed the special leave petition in the present case.
5.	***IBS Software Services (P.) Ltd. v UOI (2025) 478 ITR (Ker.)***	
	Issue	**Facts, Analysis and Decision**
	Whether the Assessing Officer is bound to pass assessment order within one month from the end of the month in which directions of the Dispute Resolution Panel is issued in accordance with section 144C(13)?	**Facts of the Case:** The assessee filed a writ petition challenging the assessment orders issued by the competent authority mainly on the ground that they were issued beyond the time limit under section 144C(13). The Department contended that a breach of the time limit prescribed under section 144C(13) cannot be considered as a vitiating factor affecting the very validity of the assessment order. It was further submitted that the Assessing Officer is not vested with any discretion under section 144C when the DRP issues directions. Department contended that even if the Assessing Officer takes more time than that is provided, no prejudice is caused and the assessment need not be considered as vitiated.

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		Analysis and Decision: The High Court noted that section 144C was incorporated to the Act by an amendment. Amendments are thoughtful, purpose-driven changes made to an existing legislation by the legislature. When an amendment is made, it must be assumed that the legislature felt it was appropriate to alter the law as it existed prior to the amendment. Section 144C was incorporated with the objective of providing a speedy mechanism for assessments involving transfer pricing, to reduce the possibility of disputes and to avoid time consuming litigations. The High Court, thus, held that the Assessing Officer is bound to adhere to the time limit stipulated in section 144C(13), and assessment order issued in breach of it shall be invalid and was accordingly set aside.

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TEST YOUR KNOWLEDGE

Questions

1. *Teachwell Education is a trust approved under section 10(23C)(vi) which runs various educational institutions. During the course of assessment under section 143(3), the Assessing Officer finds that the trust has carried out its activities in contravention of the section under which it was approved for exemption. Hence, the Assessing Officer wants to pass an order without giving exemption under section 10, which the assessee objects. You are required to examine the following with respect to the provisions of Income-tax Act, 1961.*

   (a) *Whether the Assessing Officer can pass an order without giving exemption under section 10?*

   (b) *Can the Assessing Officer get any additional time limit in completing this assessment?*

2. *State with reasons whether return of income is to be filed in the following cases for the Assessment Year 2026-27:*

   (i) *Mr. X, a resident individual, aged 80 years, has a total income of ₹ 2,85,000. He has claimed deduction of ₹ 1,50,000 under section 80C. Long-term capital gains of ₹ 80,000 is not taxable by virtue of the exemption available upto specified threshold under section 112A. Assume that he has opted for the normal provisions of the Income-tax Act.*

   Would your answer change if Mr. X has incurred ₹ 1,05,000 towards payment of electricity bills for F.Y. 2025-26?

   (ii) *ABC, a partnership firm, has a loss of ₹ 10,000 during the previous year 2025-26.*

   (iii) *A registered association, eligible for exemption under section 10(23B), has income from house property of ₹ 6,60,000.*

   (iv) *Mr. Y, aged 45 years, an employee of ABC (P) Ltd, draws a salary of ₹ 5,90,000 and has income from fixed deposits with bank of ₹ 10,000.*

3. *The Assessing Officer issued a notice under section 142(1) on the assessee on 24th February, 2026 calling upon him to file return of income for Assessment Year 2025-26. In response to the said notice, the assessee furnished a return of loss and claimed carry forward of business loss and unabsorbed depreciation. State whether the assessee would be entitled to carry forward as claimed in the return.*

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4. *State whether the following assessees have to file return of income and if so, the due date for the assessment year 2026-27:*

   (i) *A registered trade union having income from let out property of ₹ 1,00,000.*

   (ii) *A public trust hospital having an aggregate annual receipt of ₹ 505 lacs and availing exemption of ₹ 3,10,000 under sec*tion 10(23C)(via) with total income of ₹ 2,40,000

5. *What will be the consequences when Mr. Raghav paid ₹ 75,000 in cash to a travel agent for his travel to Saudi Arabia to be undertaken for business purposes by intentionally quoting the wrong PAN? Would your answer be different if such cash payment was made for his travel to Nepal, instead of Saudi Arabia?*

6. *For facilitating expeditious resolution of disputes relating to international transactions involving transfer pricing and foreign companies, the Income-tax Act, 1961, has provided for "alternate dispute resolution mechanism". In this context, you are required to answer the following:*

   (i) *What meanings have been assigned to "dispute resolution panel" and the "eligible assessee" under this mechanism?*

   (ii) *When can a grievance for resolution be filed by an assessee?*

   (iii) *What evidences are being considered by the panel to redress the grievance of the assessee?*

7. *The Assessing Officer has the power to make an assessment to the best of his judgment, in certain situations. What are they?*

8. *Mr. Sanskar is engaged in the business of retail trade and has been declaring income of ₹ 10 lakhs to ₹ 15 lakhs every year in the last 10 years. A search was conducted under section 132 in the business premises of Sanskar on 5th July, 2025. The search was concluded by executing last of authorisation for search on 10thAugust, 2025. The A.O. has in his possession documents which revealed that Mr. Sanskar has incurred ₹ 5 crores in May 2019 for the marriage of his daughter. The A.O intends to issue notice under section 148 to Sanskar for the Assessment Year relevant to the previous year 2019-20. Can he do so?*

9. *Examine whether the Assessing Officer has the power to make any adjustment to income disclosed by the assessee in the return of income in course of processing the return under section 143(1)?*

10. *Tai Ltd. filed its return of income for assessment year 2025-26 on 26th September, 2025. The return is selected for regular assessment under section 143(3) for which notice under section 143(2) is served on the company on 3rd July, 2026. The company responded to the notice*

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under section 143(2). Examine whether the service of the notice is within time and if not, whether the assessment order can be challenged by the assessee.

11. *Discuss the correctness or otherwise of the following proposition in the context of the Income-tax Act, 1961:*

    "A fresh claim before the Assessing Officer can be made only by filing a revised return and not otherwise".

12. *The Assessing Officer within the powers vested in him under section 142(2A), while examining the accounts of PNF Ltd., had ordered to get the same audited. The company challenges this order on the ground "that the opportunity was not provided to them by the Assessing Officer prior to passing of such an order". Decide the correctness of the action of the Assessing Officer.*

13. *Smt. Kanti, aged 49 years engaged in the business of growing, curing, roasting and grounding of coffee in India after mixing chicory had income of ₹ 6,00,000 from this business which was her only source of income during the year ended on 31.3.2026. She consults you to have an opinion whether she is required to file return of income for the A.Y. 2026-27 as per provisions of section 139(1).*

    Would your answer change if she had travelled to the USA during the P.Y.2025-26 and incurred ₹ 2.20 lakhs for the same?

14. *Ram, an individual, filed his return of income for the assessment year 2026-27 on 15.6.2026. He later discovered that he had not claimed deduction under section 80C in the said return though he had opted for the normal provisions of the Act. He claimed the said deduction through a letter addressed to the Assessing Officer. The Assessing Officer completed the assessment without allowing the deduction claimed by Ram. Is the Assessing Officer justified in doing so?*

15. *Examine the correctness or otherwise of the following statements in the context of provisions contained in the Income-tax Act, 1961 and the decided case laws:*

    "The Assessing Officer is bound to allow the set-off of brought forward losses under section 72 even if the assessee has not claimed the same in the return filed".

16. *X, an individual, has got his books of account for the year ending 31.3.2026 audited under section 44AB. His total income for the assessment year 2026-27 is ₹ 5,20,000. He desires to know if he can furnish his return of income for the assessment year 2025-26 through a Tax Return Preparer.*

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Answers

1. **(a)** As per second proviso to section 143(3), if any educational institution referred to in section 10(23C)(iv) has committed any "specified violation" as mentioned under section 10(23C), the Assessing Officer shall send a reference to the Principal Commissioner or Commissioner to withdraw the approval or registration, as the case may be. Specified violation *inter alia* includes a case where income of the institution has been applied other than for the objects for which it is established.

No order making an assessment of the total income or loss of such educational institution shall be made by AO without giving effect to the order passed by the Principal Commissioner or Commissioner either cancelling the approval or refusing to cancel the approval of such educational institution[7].

Therefore, in the aforesaid case, the Assessing Officer can pass an assessment order without giving exemption under section 10 to Teachwell Education, which is an educational institution approved under section 10(23C)(vi), if he has referred the matter to Principal Commissioner or Commissioner and they have subsequently cancelled the approval of such educational institution under clause (ii) of fifteenth proviso section 10(23C).

(b) As per *Explanation 1* to section 153, the period commencing from the date on which the Assessing Officer makes a reference to the Principal Commissioner or Commissioner under section 143(3)[8] and ending with the date on which the copy of the order either cancelling the approval or refusing to cancel the approval under section 10(23C)[9] is received by the Assessing Officer, shall be excluded for computing the period of limitation for completing the assessment.

Further, in case the time limit available to the Assessing Officer for passing an assessment order, after such exclusion is less than 60 days, such remaining period of assessment shall be deemed to have been extended to 60 days.

Therefore, the Assessing Officer will get the above mentioned additional time for completing the assessment of Teachwell Education.

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[7] *under clause (ii) or clause (iii) of the fifteenth proviso to section 10(23C)*
[8] *second proviso to section 143(3)*
[9] *under clause (ii) or clause (iii) of the fifteenth proviso to section 10(23C)*

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2.

S. No.	Is filing of return required?	Reason
(i)	No	As per the provisions of section 139(1), every person, whose total income without giving effect to the provisions of Chapter VI-A exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. X before giving effect to the deduction of ₹ 1,50,000 under section 80C is ₹ 4,35,000, which is less than the basic exemption limit of ₹ 5,00,000 applicable to an individual aged 80 years or more. Therefore, Mr. X need not furnish his return of income for the A.Y. 2026-27. *Yes, the answer would change, since Mr. X has incurred expenditure of an amount exceeding ₹ 1 lakh towards the consumption of electricity and he is not liable to file a return of income under other provisions of section 139(1). In such a case, he would have to file his return for A.Y.2026-27 on or before the due date u/s 139(1).*
(ii)	Yes	As per section 139(1), it is mandatory for a firm to furnish its return of income or loss on or before the specified due date. Therefore, M/s ABC has to furnish its return of loss for the A.Y. 2026-27 on or before the due date under section 139(1), even if it has incurred a loss.
(iii)	Yes	As per section 139(4C), every institution referred to, *inter alia*, in section 10(23B), whose total income without giving effect to the provisions of section 10 exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date u/s 139(2). In the above case, the registered association has income from house property of ₹ 6,60,000 before exemption under section 10, which exceeds the basic exemption limit of ₹ 3,00,000. Therefore, it is under an obligation to furnish its return of income for the A.Y. 2026-27.
(iv)	Yes	As per the provisions of section 139(1), every person, whose gross total income exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. Mr. Y's salary income is ₹ 5,15,000 (i.e., ₹ 5,90,000 *less* standard deduction of ₹ 75,000). The gross total income of Mr. Y is ₹ 5,25,000 (₹ 5,15,000 + ₹ 10,000), which exceeds the basic exemption limit of ₹ 4,00,000 applicable to an individual as per default regime of section 115BAC. Therefore, Mr. Y has to furnish his return of income for the A.Y. 2026-27.

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3. As per the provisions of section 139(3), any person who has sustained loss under the head 'Profit and gains of business or profession' is allowed to carry forward such a loss under section 72(1) or section 73(2), only if he has filed the return of loss within the time allowed under section 139(1). Also, the provisions of section 80 specify that a loss which has not been determined as per the return filed under section 139(3) shall not be allowed to be carried forward and set-off under, inter alia, section 72(1) (relating to business loss) or section 73(2) (losses in speculation business) or section 74(1) (loss under the head "Capital gains") or section 74A(3) (loss from the activity or owning and maintaining race horses) or section 73A (loss relating to a "specified business"). However, there is no such condition for carry forward of loss from house property under section 71B or unabsorbed depreciation under section 32.

In the given case, the assessee has filed its return of loss in response to notice under section 142(1). As per the provisions stated above, assessee furnished return in response to notice under section 142(1) after the due date specified under section 139(1) and therefore, the benefit of carry forward of business loss under section 72(1) or section 73(2) or section 73A shall not be available. The assessee shall, however, be entitled to carry forward the unabsorbed depreciation as per provisions of section 32(2).

4. **(i)** A registered trade union is having income from house property, which is exempt under section 10(24). Section 139(4C) mandates filing of return only when the total income exceeds the maximum amount which is not chargeable to tax without giving effect to the provisions of section 10. In this case, even without giving effect to section 10(24), the total income of the registered trade union is below basic exemption limit and therefore, there is no mandatory requirement to file the return of income.

(ii) Since the total income without giving effect to the exemption under section 10(23C)(via) is ₹ 5,50,000, which exceeds ₹ 4,00,000, the trust has to file its return of income by 31st October 2026.

5. If a person who is required to quote his permanent account number in any document referred to in section 139A(5)(c), quotes a number which is false, and which he either knows or believes to be false or does not believe to be true, the Assessing Officer may direct that such a person shall pay by way of penalty a sum of ₹ 10,000 under section 272B(2).

In the given case, if Mr. Raghav travels to Saudi Arabia and pays his travel agent cash in excess of ₹ 50,000, such a transaction is covered by section 139A(5)(c) read with Rule 114B and therefore, Mr. Raghav has to quote his PAN. Since Mr. Raghav has misquoted his PAN, a penalty under section 272B(2) is leviable. Mr. Raghav has to be given an opportunity of being heard in the matter. If Mr. Raghav is not able to prove that there was a reasonable cause for the said failure, penalty under section 272B(2) would be imposable.

The answer would remain the same even if such cash payment was made for his travel to Nepal.

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6. **(i)** The term "Dispute Resolution Panel" has been defined to mean a collegium comprising of three Principal Commissioners or Commissioners of Income-tax constituted by the Board for this purpose.

The term "Eligible Assessee" means any person in whose case the variation referred to in section 144C(1) arises as a consequence of the order of the Transfer Pricing Officer passed under section 92CA(3) and any non-corporate non-resident or any foreign company.

However, an eligible assessee shall not include a persons referred under section 158BA(1) or any other person referred under section 158BD.

(ii) In case of an assessment of the eligible assessee, the Assessing Officer shall forward a draft of the proposed order of assessment. The eligible assessee shall file his objections to such variation within 30 days of receipt of such order, with the Dispute Resolution Panel and with the Assessing Officer.

(iii) The Dispute Resolution Panel shall, in a case where any objections are received, take into consideration:-

(a) the draft order

(b) the objections filed by the assessee

(e) the evidence furnished by the assessee

(d) the report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority

(e) the records relating to the draft order

(f) the evidence collected by, or caused to be collected by it

(g) the result of any enquiry made by or caused to be made by it.

7. Under section 144, the Assessing Officer, after taking into account all relevant material which he has gathered, is under an obligation to make an assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee in the following cases –

(1) Where any person fails to make the return under section 139(1) and has not filed a belated return under section 139(4) or a revised return under section 139(5) or an updated return under section 139(8A).

(2) Where any person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited.

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(3) Where any person, having made a return, fails to comply with all the terms of a notice issued under section 143(2).

Further, section 145(3) of the Income-tax Act, 1961 permits the Assessing Officer to make an assessment in the manner provided in section 144:

(i) where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee; or

(ii) where the method of accounting under section 145(1) has not been regularly followed by the assessee;

(iii) where the income has not been computed in accordance with "Income Computation and Disclosure Standards" notified by the Central Government under section 145(2).

Faceless assessment as per section 144B shall be applicable to best judgement assessment under section 144, i.e., the assessment proceedings shall be conducted electronically in e- Proceeding facility through assessee's registered account in the designated portal. The faceless assessment shall be made in respect of such territorial area, or persons or class of persons, or incomes or class of incomes, or cases or class of cases, as may be specified by the Board.

8. In the given case, Mr. Sanskar, a retail trader, has been regularly filing returns of income over the past ten years. A search under section 132 was initiated at his business premises on 5th July 2025 and was concluded by executing the last of the authorisations on 10th August 2025. During the course of the search, the Assessing Officer came into possession of documents evidencing that Mr. Sanskar had incurred an expenditure of ₹5 crores towards the marriage of his daughter in May 2019, which was not recorded in the books of account.

Pursuant to the amendments made by the Finance Act (No. 2), 2024 and Finance Act, 2025, the provisions of Chapter XIV-B (Sections 158B to 158BI) have been reintroduced and are applicable to search and requisition cases where the search is initiated under section 132 or requisition is made under section 132A on or after 1st September 2024. As the search in this case was initiated after the said date, the case falls within the ambit of the block assessment scheme as reintroduced and not under section 147.

As per section 158BA, the "block period" is defined to include the six assessment years immediately preceding the previous year in which the search is conducted, as well as the period commencing from the first day of the relevant previous year up to the date of conclusion of the search. Accordingly, for a search conducted in the previous year 2025–26, the block period would comprise PYs 2019–20 to 2024–25, along with the period from 1st

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April 2025 to 10th August 2025.

Given that the expenditure of ₹ 5 crores pertains to the previous year 2019–20 (relevant to Assessment Year 2020–21), the same falls within the block period. Once the provisions of Chapter XIV-B become applicable pursuant to a search initiated on or after 1st September 2024, the assessment of undisclosed income for the block period must be undertaken under section 158BC, and not under the regular assessment or reassessment provisions, including section 148.

Therefore, the Assessing Officer **cannot issue a notice under section 148** for Assessment Year 2020–21 in this case. Instead, he is required to proceed by issuing a notice under section 158BC, requiring the assessee to furnish a return of income in the prescribed Form for the block period. The undisclosed expenditure identified during the search would be assessed as undisclosed income in the block assessment in accordance with the procedure laid down under Chapter XIV-B.

9. The procedure to be followed for summary assessment is contained in section 143(1). As per section 143(1), the total income or loss of an assessee shall be computed after making the following adjustments to the returned income:

(i) any arithmetical error in the return

(ii) an incorrect claim, if such incorrect claim is apparent from any information in the return

(iii) any such inconsistency in the return, with respect to the information in the return of any preceding previous year, as may be prescribed.

(iv) disallowance of loss claimed, if return is filed beyond due date u/s 139(1)

(v) disallowance of expenditure or increase in income indicated in the audit report but not taken into account in computing the total income in the return

(v) disallowance of deduction claimed under *section 10AA or under any of the provisions of Chapter VI-A under the heading* "C.—Deductions in respect of certain incomes", if return is filed beyond due date u/s 139(1)

No such adjustment shall be made unless an intimation is given to the assessee of such adjustment either in writing or electronic mode. Further, Assessing Officer shall make any adjustment after considering the response received from the assessee, if any. Where no response is received within 30 days of the issue of such notice, the above adjustment can be made.

For the purpose of section 143(1), “an incorrect claim apparent from any information in the

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return" means such claim on the basis of an entry, in the return of income:

(i) of an item, which is inconsistent with another entry of the same or some other item in such return;

(ii) in respect of which, the information required to be furnished under the Income-tax Act, 1961 to substantiate such entry, has not been so furnished;

(iii) in respect of a deduction, where such deduction exceeds specified statutory limit which may be expressed as monetary amount or percentage or ratio or fraction.

10. The time limit for service of notice under section 143(2) is three months from the end of the financial year in which the return of income was furnished by the assessee. The return of income for assessment year 2025-26 was filed by the assessee on 26th September, 2025. Therefore, the notice under section 143(2) has to be served by 30th June, 2026. However, the notice was served on the assessee only on 3rd July, 2026. Hence, the notice issued under section 143(2) is time-barred.

However, as per section 292BB, where an assessee had appeared in any proceedings or co-operated in any enquiry relating to an assessment or reassessment, it shall be deemed that any notice required to be served upon him, has been duly served upon him in time in accordance with the provisions of the Act and such assessee shall be precluded from raising any objection in any proceeding or enquiry that the notice was (a) not served upon him or (b) not served upon him in time or (c) served upon him in an improper manner.

The above provision shall not be applicable where the assessee has raised such an objection before the completion of such assessment or reassessment. Therefore, in the instant case, if the assessee, Tai Limited, had raised an objection to the proceeding on the ground of non-service of the notice under section 143(2) upon it on time, then, the validity of the assessment order can be challenged. In the absence of such objection, the assessment order cannot be challenged.

11. This proposition is correct.

A return of income filed within the due date under section 139(1) or a belated return filed under section 139(4) may be revised by filing a revised return under section 139(5) where the assessee finds any omission or wrong statement in the original return subject to satisfying other conditions. There is no provision in the Income-tax Act, 1961, to make changes or modification in the return of income by filing a letter before the Assessing Officer. The revised return can be filed at any time before three months prior to the end of the relevant assessment year or before the completion of assessment, whichever is earlier. In a case where a return

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of income has been filed within the due date under section 139(1) or a belated return is filed under section 139(4), the only option available to the assessee to make an amendment to such return is by way of filing a revised return under section 139(5). Therefore, a fresh claim can be made before the Assessing Officer only by filing a revised return and not otherwise. The Supreme Court, in *Goetze (India) Ltd. vs. CIT (2006) 284 ITR 323,* has held that there is no power available under the provisions of the Income-tax Act, 1961 enabling the Assessing Officer to allow a claim made by the assessee except by way of filing a revised return.

Note – *Section 139(8A), provides an option to an assessee to file an updated return for an assessment year, at any time within* ***48 months*** *from the end of the relevant assessment year. But such updated return should not be a return of a loss or have the effect of decreasing the total tax liability determined on the basis of return furnished under section 139(1) or 139(4) or 139(5) or result in refund or increases the refund due on the basis of return furnished under section 139(1) or 139(4) or 139(5). Hence, for making a fresh claim, the only option available to the assessee is to file a revised return under section 139(5).*

12. As per the proviso to section 142(2A), the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.

Therefore, in this case, the order of the Assessing Officer is not valid, since the assessee was not given an opportunity of being heard prior to passing of such order.

13. The clarification regarding filing return of income by the coffee growers being individuals covered by Rule 7B of the Income-tax Rules, 1962 is given in *Circular No.10/2006 dated 16.10.2006*. According to the Circular, an individual deriving income from growing, curing, roasting and grounding of coffee with or without mixing chicory would not be required to file the return of income if the aggregate of 40% of his or her income from growing, curing, roasting and grounding of coffee with or without mixing chicory and income from all other sources liable to tax in accordance with the provisions of this Act, is equal to or less than the basic exemption limit prescribed in the First Schedule of the Finance Act of the relevant year.

In this case, Smt. Kanti has a total income of ₹ 6,00,000 from this business, which was her only source of income for P.Y. 2025-26. 40% of her income works out to ₹ 2,40,000, which is less than the basic exemption limit of ₹ 4,00,000 (under section 115BAC, being default regime) / ₹ 2,50,000 (if opting for normal provisions) in respect of an individual assessee. Therefore, Smt. Kanti is not required to file a return of income for the A.Y. 2026-27 as per the provisions of section 139(1).

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If Smt. Kanti had travelled to the USA during the P.Y. 2025-26 and incurred ₹ 2.20 lakhs on such travel, she would be required to mandatorily file a return of income for A.Y. 2026-27 on or before the due date u/s 139(1), even though her total income does not exceed the basic exemption limit.

14. The Supreme Court has, in *Goetze (India) Ltd. v. CIT (2006) 284 ITR 323,* ruled that the Assessing Officer has no power to entertain a claim for deduction made after filing of the return of income otherwise than by way of a revised return. In the instant case, Ram has claimed the deduction under section 80C, which he omitted to claim in the original return of income, through a letter addressed to the Assessing Officer and not by filing a revised return under section 139(5). In view of the decision of the Supreme Court cited above, the Assessing Officer was justified in completing the assessment without allowing the deduction under section 80C.

15. The statement is correct.

The Supreme Court has, in *CIT v. Mahalakshmi Sugar Mills Co. Ltd. (1986) 160 ITR 920,* held that it is the duty of the Assessing Officer to apply the relevant provisions of the Act for the purpose of determining the true figure of the assessee's total income and consequential tax liability. Merely because the assessee has not claimed the set-off in the return filed, it cannot relieve the Assessing Officer of his duty to apply section 72 in the appropriate case.

As per *CBDT Circular No.14 (XL-35) of 1955 dated 11.04.1955*, it is the duty of the Assessing Officer to assist a taxpayer in every reasonable way, particularly in the matter of claiming and securing reliefs and in this regard, they should take the initiative in guiding a taxpayer where proceedings or other particulars before them indicate that some refund or relief is due to him.

Therefore, on the basis of the above Supreme Court ruling and the CBDT Circular, the Assessing Officer is bound to allow the set-off of brought forward losses under section 72, even if the assessee has not claimed the same in the return filed, provided the loss was determined in pursuance of a return filed under section 139(3) in any earlier previous year.

Moreover, the wording used in section 72 is "shall", indicating that the provisions relating to set off of brought forward business loss are mandatory.

Therefore, the Assessing Officer is bound to allow the claim for set off of brought forward business losses even if the assessee has not claimed the same in the return filed.

16. Section 139B provides for submission of return of income through Tax Return Preparers. It empowers the Central Board of Direct Taxes (CBDT) to frame a scheme for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of

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income through Tax Return Preparers. Specified class or classes of persons have been defined to mean any person, other than a company or a person whose accounts are required to be audited under section 44AB or under any other existing law, who is required to furnish a return of income under the Act. Thus, companies and persons whose accounts are liable for tax audit under section 44AB do not fall within the definition of 'specified class or classes of persons' and consequently, cannot furnish their returns of income through Tax Return Preparers. In the instant case, the books of account of X for the year ending 31.3.2026 have been audited under section 44AB. As such, he **cannot** furnish his return of income for the A.Y. 2026-27 through a Tax Return Preparer.

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CHAPTER 16

APPEALS AND REVISION

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the orders appealable before different appellate authorities;
- **recall** the time limit for filing appeals before different appellate authorities;
- **appreciate** the powers of different appellate authorities;
- **comprehend and appreciate** the provision in law for avoiding repetitive appeals;
- **appreciate** the procedure for appeal by Revenue when an identical question of law is pending before Supreme Court;
- **identify** the circumstances when an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the Revenue, for initiation of revision proceedings under section 263;
- **appreciate** the procedure for revision of other orders under section 264;
- **recall** the time limit for revision of orders;
- **identify** the cases where doctrine of total merger and doctrine of partial merger are applicable;
- **analyse and apply** the above provisions to determine whether an order is appealable before a particular appellate authority, the time limit for filing of appeal and address other issues in non-complex to moderately complex scenarios.

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CHAPTER OVERVIEW

16.1 APPEALS BEFORE JOINT COMMISSIONER (APPEALS) OR COMMISSIONER (APPEALS)

(1) Appealable Orders before Joint Commissioner (Appeals) [Section 246(1)]: Any assessee aggrieved by any of the following orders of an Assessing Officer (below the rank of Joint Commissioner) may appeal to the Joint Commissioner (Appeals) against -

Intimation u/s 143(1) or assessment order u/s 143(3) or 144 or u/s 147

(a) an order being an intimation under section 143(1), where the assessee objects to the making of adjustments, or any order of assessment under section 143(3) or section 144, where the assessee objects to-

(i) the amount of income assessed, or

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(ii) the amount of tax determined, or

(iii) the amount of loss computed, or

(iv) the status under which he is assessed;

***Status** means the category under which the assessee is assessed as "individual", "Hindu undivided family" and so on.*

(b) an order of assessment, reassessment or recomputation under section 147;

(c) an order being an intimation under section 200A(1) where the deductor objects to the making of adjustments;

(d) an order under section 201 deeming a person to be an assessee-in-default for failure to deduct the whole or any part of the tax deductible at source;

(e) an order under section 206C(6A) deeming a person to be an assessee-in-default for failure to collect or pay tax;

(f) an order being an intimation under section 206CB(1) where the collector objects to the making of adjustments;

(g) an order imposing a penalty under Chapter XXI; and

(h) an order under section 154 or section 155 amending any of the orders mentioned in clauses (a) to (g):

Deeming a deductor or collector of tax to be an assessee-in default

or

an order of penalty or a rectification order

No appeal can, however, be filed before the Joint Commissioner (Appeals), if any of the above orders is passed by or with the prior approval of an income-tax authority above the rank of Deputy Commissioner.

(2) Appeal pending before Commissioner (Appeals) in respect of appealable orders mention in (1) above may be transferred to Joint Commissioner (Appeals): Where any appeal filed against an order referred in section 246(1) is pending before the Commissioner (Appeals), the Board or an income-tax authority so authorised by the Board in this regard, may transfer such appeal and any matter arising out of or connected with such appeal and which is so pending, to the Joint Commissioner (Appeals). The Joint Commissioner (Appeals) may then proceed with such appeal or matter from the stage at which it was before it was so transferred [Section 246(2)].

Transfer of appeal

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(3) **Appeal pending before Joint Commissioner (Appeals) may be transferred to the Commissioner (Appeals):** The Board or an income-tax authority so authorised by the Board in this regard, may transfer any appeal which is pending before a Joint Commissioner (Appeals) and any matter arising out of or connected with such appeal and which is so pending, to the Commissioner (Appeals). The Commissioner (Appeals) may then proceed with such appeal or matter from the stage at which it was before it was so transferred [Section 246(3)].

(4) **Opportunity of being reheard is to be given before transferring the pending appeals:** Where an appeal is transferred under the provisions of section 246(2)/(3), the appellant shall be given an opportunity of being reheard.

(5) **Central Government empowered to notify faceless appeal scheme:** For the purposes of disposal of appeal by the Joint Commissioner (Appeals), the Central Government may make a scheme, by notification in the Official Gazette. This scheme will facilitate disposal of appeals in an expedient manner with transparency and accountability, by eliminating the interface between the Joint Commissioner (Appeals) and the appellant, in the course of appellate proceedings to the extent technologically feasible. The Central government may direct that any of the provisions of this Act relating to jurisdiction and procedure for disposal of appeals by the Joint Commissioner (Appeals), shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in the notification.

Accordingly, in the exercise of powers under section 246(5), the Central Government has notified E-Appeals Scheme, 2023.[1]

(6) **Cases or Class of Cases where appeal cannot be made before Joint Commissioner (Appeals):** The Board may specify that the provisions of section 246(1) shall not apply to any case or any class of cases.

(7) **Appealable Orders before Commissioner (Appeals) [Section 246A]:** An assessee or any deductor or any collector aggrieved by any of the following orders may appeal to the Commissioner (Appeals) against the following orders under section 246A -

[1] For detailed reading of the E-Appeals Scheme, 2023, students are advised to visit https://incometaxindia.gov.in/communications/notification/notification-33-2023.pdf

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Appealable orders before CIT(A)

(i) an order passed by a Joint Commissioner under section 115VP(3)(ii) refusing to approve the option for tonnage tax scheme; or

(ii) an order against the assessee where the assessee denies his liability to be assessed under this Act; or

(iii) an intimation under section 143(1) or section 200A(1) or section 206CB(1), where the assessee or the deductor or the collector objects to the making of adjustments; or

(iv) any order of assessment under section 143(3) except an order passed in pursuance of the directions of Dispute Resolution Panel or an order of assessment or reassessment passed by the Assessing Officer with the prior approval of Principal Commissioner or Commissioner, where tax consequences have been determined in the order under the provisions of Chapter X-A relating to General Anti Avoidance Rules or a best judgement order under section 144, in relation to the income assessed, or to the amount of tax determined, or to the amount of loss computed, or to the status under which he is assessed;

(v) an order of assessment, reassessment or recomputation under section 147 except an order passed in pursuance of the directions of Dispute Resolution Panel or an order of assessment or reassessment passed by the Assessing Officer with the prior approval of Principal Commissioner or Commissioner, where tax consequences have been determined in the order under the provisions of Chapter X-A relating to General Anti Avoidance Rules or section 150 where assessment is in pursuance of an order on appeal;

(vi) an order made under section 92CD(3) modifying the total income of the relevant assessment year in accordance with the arm's length price (ALP) determined as per the Advance Pricing Agreement (APA) entered into.

(vii) a rectification order made under section 154 or section 155 having the effect of enhancing the assessment or reducing a refund or an order refusing to allow the claim made by the assessee under either of the said sections except an order of assessment or reassessment passed by the Assessing Officer with the prior approval of Principal Commissioner or Commissioner, where tax consequences have been determined in the order under the provisions of Chapter X-A relating to General Anti Avoidance Rules;

(viii) an order made under section 163 treating the assessee as the agent of a non-resident;

(ix) an order made under section 170(2)/(3) assessing income of business prior to succession in the hands of the successor;

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(x) an order made under section 171 relating to assessment after partition of HUF;

(xi) an order made under section 201 deeming a person to be an assessee-in-default for failure to deduct the whole or any part of the tax deductible at source;

(xii) an order made under section 206C(6A) deeming a person to be an assessee-in-default for failure to collect or pay tax;

(xiii) a refund order made under section 237;

(xiv) an order made under section 239A with respect to refund for denying liability to deduct tax at source.

(xv) an order imposing a penalty under section 221; or

(xvi) an order imposing a penalty under Chapter XXI of the Income-tax Act;

(xvii) an order of assessment made by an Assessing Officer under section 158BC(1)(c) in respect of search initiated under section 132 or books of account, other documents or any assets requisitioned under section 132A on or after 1.9.2024.

(xviii) an order made by an Assessing Officer other than a Deputy Commissioner under the provisions of this Act in the case of such person or class of persons, as the Board may, having regard to the nature of the cases, the complexities involved and other relevant considerations direct.

It is also provided that an appellant may demand that before proceeding further with the appeal and the matter, the previous proceedings or any part thereof be re-opened or the appellant be re-heard.

(8) Form of appeal and prescribed fees [Section 249(1)]: Every appeal shall be in the prescribed form and shall be verified in the prescribed manner.

Prescribed fees - In case of an appeal made to the Commissioner (Appeals) or to the Joint Commissioner (Appeals) irrespective of the date of initiation of the assessment proceedings, the appeal shall be accompanied by a fee of:

	Case	Prescribed fees
(i)	where the total income of the assessee as computed by the Assessing Officer is ₹ 1,00,000 or less	₹ 250
(ii)	where the total income of the assessee computed as above is more than ₹ 1,00,000 but not more than ₹ 2,00,000	₹ 500
(iii)	where the total income of the assessee computed as above is more than ₹ 2,00,000	₹ 1,000
(iv)	in any case other than (i), (ii) and (iii) above	₹ 250

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(9) **Time limit [Section 249(2) & (3)]:** An appeal to Joint Commissioner (Appeals) or to the Commissioner (Appeals) against any order which is appealable is to be presented within 30 days from the date specified below in the particular cases. However, Joint Commissioner (Appeals) or the Commissioner (Appeals) may admit an appeal even after the expiry of the said period of thirty days, if he is satisfied that the appellant had sufficient cause for not presenting the appeal within the specified time. The dates from which the limitation period of 30 days has to be reckoned are as follows:

Within 30 days

	Appeal relating to	30 days to be reckoned from
1.	Assessment/penalty	Date of service of notice of demand
2.	Any other case	Date on which intimation of the order sought to be appealed against is served.

Period to be excluded while computing 30 days in case of appeal relating to assessment/penalty

Application	Period to be excluded	
	From	To
Under section 270AA(1)	The date on which the application is made	The date on which the order rejecting the application is served on the assessee

(10) **Tax to be paid at the time of filing the appeal [Section 249(4)]:** No appeal to the Joint Commissioner (Appeals) or the Commissioner (Appeals) shall be admitted for consideration unless, at the time of filing the appeal,

Tax to be paid before filing appeal

- **In a case where return has been filed:** The assessee has paid the tax on the amount of income returned by him in a case where a return has been filed by the assessee.
- **In a case where no return has been filed:** If, however, no return has been filed by the assessee and an assessment has been made on him by the Assessing Officer, then, the assessee must pay an amount equal to the amount of advance tax which was payable by him before filing the appeal. In this case, the Joint Commissioner (Appeals) or the Commissioner (Appeals) is, however, empowered for good and sufficient reasons to be recorded in writing, to exempt an appellant from the requirement of payment of advance tax, on receipt of an application from the appellant made specifically for this purpose.

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(11) Procedure in appeal [Section 250]:

(i) The Joint Commissioner (Appeals) or the Commissioner (Appeals) shall fix a day and place for the hearing of the appeal and shall give notice of the same to the assessee and to the Assessing Officer, against whose order the appeal is made.

Fix a day and place for hearing appeal

(ii) Both the appellant and the Assessing Officer have the right to be heard at the hearing of the appeal either in person or by an authorised representative.

(iii) The Joint Commissioner (Appeals) or the Commissioner (Appeals) has the power to adjourn the hearing of the appeal from time to time.

(iv) The Joint Commissioner (Appeals) or the Commissioner (Appeals), before passing an order on an appeal, may make such further enquiries as he thinks fit or direct the Assessing Officer to make further enquiries and report the result of the same to him.

(v) The Joint Commissioner (Appeals) or the Commissioner (Appeals) may also allow the appellant to go into any grounds of appeal not specified previously by the appellant if he is satisfied that the omission of that ground was not wilful or unreasonable.

(vi) The order of the Joint Commissioner (Appeals) or the Commissioner (Appeals) disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reasons for the decision. On disposal of the appeal, the Joint Commissioner (Appeals) or the Commissioner (Appeals) must communicate the order passed by him to the assessee as well as to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

(vii) In every appeal, the Joint Commissioner (Appeals) or the Commissioner (Appeals), as the case may be, 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 under section 246(1) or transferred to him under section 246(2)/(3) or under section 246A(1), as the case may be.

May hear or decide appeal within 1 year from the end of F.Y. of filing appeal

(viii) Section 250(6B) empowers the Central Government to make a scheme, by notification in the Official Gazette, for the purposes of disposal of appeal by Commissioner (Appeals), so as to impart greater efficiency, transparency and accountability by—

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(a) eliminating the interface between the Commissioner (Appeals) and the appellant in the course of appellate proceedings to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialisation;

(c) introducing an appellate system with dynamic jurisdiction in which appeal shall be disposed of by one or more Commissioner (Appeals).

Accordingly, in the exercise of powers under section 250(6B), the Central Government has notified Faceless Appeal Scheme, 2021.[2]

(12) Powers of the Joint Commissioner (Appeals) or Commissioner (Appeals) [Section 251(1)/(1A)]: While disposing of an appeal the Joint Commissioner (Appeals) or Commissioner (Appeals) is vested with the following powers viz.,

[2] For detailed reading of the Faceless Appeal Scheme, 2021, students are advised to visit https://www.incometaxindia.gov.in/Pages/faceless-scheme.aspx

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(i) In an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment.

Confirm, reduce, enhance or annul the assessment order or enhance or reduce penalty

Where such appeal is against an order of assessment made under section 144, he may set aside the assessment and refer the case back to the Assessing Officer for making a fresh assessment.

(ii) In an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it in such a way as to enhance or reduce the penalty.

(iii) In any other case, he may pass such orders in the appeal as he deems fit.

The Joint Commissioner (Appeals) or Commissioner (Appeals), however, is not empowered to enhance an assessment or a penalty or to reduce a refund due to the assessee without giving the assessee a reasonable opportunity of showing cause against such an enhancement or reduction.

In disposing of an appeal, the Joint Commissioner (Appeals) or the Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed even if such matters were not raised before the Joint Commissioner (Appeals) or the Commissioner (Appeals), as the case may be by the appellant.

16.2 APPEALS TO THE APPELLATE TRIBUNAL [SECTIONS 252 TO 255]

(1) **Constitution [Section 252(1)]** - The Central Government shall constitute an Appellate Tribunal consisting of judicial and accountant members to exercise the powers and discharge the functions conferred on the Tribunal by the Act.

(2) **Orders appealable before the Appellate Tribunal [Section 253]:** Section 253(1) provides that an assessee aggrieved by any of the following orders may appeal to the Appellate Tribunal against such order –

Appealable Orders

Order passed by	Section	Particulars
Assessing Officer	115VZC(1)	Power of Assessing Officer to exclude a tonnage tax company from the tonnage tax scheme if such company is a party to any

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		transaction or arrangement which amounts to an abuse of such scheme.
	143(3)/147	An order of assessment passed by an Assessing Officer in pursuance of the directions of Dispute Resolution Panel or an order passed under section 154 in respect of such order.
	143(3)/147	An order of assessment passed by an Assessing Officer with the approval of Principal Commissioner or Commissioner as referred to in section 144BA(12), where tax consequences have been determined under the provisions of Chapter X-A relating to general anti-avoidance rules, or an order passed under section 154 or section 155 in respect of such order.
Joint commissioner (Appeals) or Commissioner (Appeals)	250	Order of the Joint Commissioner (Appeals) or Commissioner (Appeals) disposing of the appeal
	270A	Order levying penalty for under-reporting and misreporting of income.
	271A	Order imposing penalty for failure to keep, maintain or retain books of account, documents etc.
	271AAC	Order imposing penalty in a case where income determined includes income referred under section 68, 69, 69A, 69B, 69C or 69D.
	271AAD	Order imposing penalty if during any proceedings it is found that in the books of account maintained by any person there is a false entry or an omission of any entry which is relevant for computation of total income of such person to evade tax liability.
	271J	Order imposing penalty for furnishing incorrect information in any report or certificate by an accountant, merchant banker or registered valuer.
	154	Order rectifying a mistake

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Commissioner (Appeals)	158BFA	Order imposing levy of interest and penalty in certain cases.
	271AAB	Order imposing penalty in a case where search is initiated under section 132 before 1.9.2024.
	272A	Order imposing penalty for failure to answer questions, sign statements, furnish information returns or statements, allow inspections etc.
Principal Commissioner or Commissioner	12AA/12AB	Order refusing/canceling registration of trust or institution
	80G(5)(vi)	Refusal to grant approval to the Institutions or Fund
	263	Revision of erroneous order passed by Assessing Officer
	270A	Order imposing penalty for under-reporting of income and mis-reporting of income.
	272A	Order imposing penalty for failure to answer questions, sign statements, furnish information returns or statements, allow inspections etc.
	154	Amending any of the orders passed by him
Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Director or Director	263	Revision of erroneous order passed by Assessing Officer
	272A	Order imposing penalty for failure to answer questions, sign statements, furnish information returns or statements, allow inspections etc.
	154	Amending any of the orders passed by him
Principal Commissioner or Commissioner	10(23C)(iv)/(v)/(vi)/(via)	Order passed by the prescribed authority refusing approval of a fund/ institution for charitable purposes or trust or institution for public religious purposes or wholly for public religious and charitable purposes, university or other educational institution solely for educational purposes and not for purposes of profit or hospital or other institution solely for philanthropic purposes and not for purposes of profit under section 10(23C)(iv)/(v)/(vi)/(via).

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Section 253(2) provides that the Principal Commissioner or Commissioner may, if he objects to any order passed by the Joint Commissioner (Appeals) or the Commissioner (Appeals) under section 154 or section 250, direct the Assessing Officer to appeal to the Appellate Tribunal against such order.

(3) Time limit for filing appeal or memorandum of cross objection under section 253(1) & (2) [Section 253(3), (4) & (5)]

(i) Every appeal to the Appellate Tribunal has to be filed within two months from the end of the month in which the order sought to be appealed against is communicated to the assessee or the Principal Commissioner or Commissioner, as the case may be.

(ii) Further, on receipt of notice that appeal against an order has been preferred by the Assessing Officer or the assessee, as the case may be, the other party can file **memorandum of cross objections within 30 days of receipt of notice** against any part of such order. The Appellate Tribunal has to dispose of the memorandum of cross objections as if it were an appeal filed within the given time limit.

Memorandum of cross objection within 30 days

(iii) However, the Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross objection even after expiry of the prescribed time limit, if he is satisfied that there was sufficient cause for not presenting it within that period.

(4) Fees [Section 253(6) & (7)]

	Case	Prescribed fees
(i)	Where the total income of the assessee as computed by the Assessing Officer in the case to which the appeal relates is ₹ 1,00,000 or less	₹ 500
(ii)	Where the total income exceeds ₹ 1,00,000 but is not more than ₹ 2,00,000	₹ 1,500
(iii)	Where the total income is more than ₹ 2,00,000	1% of the assessed income, subject to a maximum of ₹ 10,000.
(iv)	In any other case	₹ 500

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(v)	Where appeal is filed to the Appellate Tribunal by an Assessing Officer on the direction of the Commissioner or Principal Commissioner, against the order of the Joint Commissioner (Appeals) or the Commissioner (Appeals) under section 154 or 250	No fees
(vi)	Filing of memorandum of cross-objections.	No fees
(vii)	Application for stay of demand	₹ 500

(5) Scheme for Appeal to Appellate Tribunal [Section 253(8), (9) & (10)]

Section 253(8) empowers the Central Government to make a scheme, by notification in the Official Gazette, for the purposes of appeal to the Appellate Tribunal, so as to impart greater efficiency, transparency and accountability by—

(a) optimising utilisation of the resources through economies of scale and functional specialisation;

(b) introducing a team-based mechanism for appeal to Appellate Tribunal, with dynamic Jurisdiction.

The Central Government may, for the purpose of giving effect to such scheme, by notification in the Official Gazette, direct that any of the provisions of the Income-tax Act, 1961 would not apply or would apply with such exceptions, modifications and adaptations as may be specified in the notification [Section 253(9)].

Every such notification issued under section 253(8) or section 253(9) has to be laid before each House of Parliament as soon as may be after issue of the notification.

(6) Order [Section 254 (1), (2), (3) & (4)]: The Appellate Tribunal may, after giving both the parties to the appeal a reasonable opportunity of being heard, pass such orders on any appeal as it thinks fit. The Tribunal must send a copy of any orders passed by it to the assessee and to the Principal Commissioner or Commissioner. Such orders passed by the Appellate Tribunal shall be final unless appeal is made to the High Court under section 260A.

(7) Rectification: The Appellate Tribunal may, at any time within **6 months from the end of the month in which order is passed**, with a view to rectifying any **mistake apparent from record**, amend any order passed by it. However, if the mistake is brought to its notice by the assessee or the Assessing Officer, the Tribunal is bound to rectify the same. In cases where the amendment has the effect of enhancing the assessment or

Rectify within 6 months from end of the month in which order is passed by it.

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reducing a refund or otherwise increasing the liability of the assessee, the Tribunal shall not pass any order of amendment unless it has given notice to the assessee of its intention to do so and has allowed him a reasonable opportunity of being heard.

(8) **Fees for rectification:** Any application for rectification filed by the assessee shall be accompanied by a fee of ₹ 50.

(9) **Time limit:** In every appeal, the Appellate Tribunal, where it is possible, may hear and decide such appeal **within a period of four years from the end of the financial year in which such appeal is filed** under sub-section (1)/(2) of section 253.

Pass order within 4 years from the end of F.Y. in which appeal filed

Under section 254(2A), the Appellate Tribunal can grant stay of demand of tax which can extend only up to 180 days from the date of granting such stay subject to the condition that the assessee deposits not less than 20% of the amount of tax, interest, fee, penalty, or any other sum payable under the provisions of this Act, or furnishes security of equal amount in respect thereof.

Stay of demand

No extension of stay shall be granted by the Appellate Tribunal, where such appeal is not so disposed of within the said period of stay as specified in the order of stay, **unless** –

(i) **the assessee** makes an application and has complied with the condition of **depositing 20%** of tax, interest, fee, penalty or funishes security of equal amount and

(ii) the Appellate Tribunal is satisfied that the delay in disposing of the appeal is not attributable to the assessee,

However, **the aggregate of the period of stay** originally allowed and the period of stay so extended **should not exceed 365 days** and the Appellate Tribunal has to dispose of the appeal within the period or periods of stay so extended or allowed.

Aggregate period of stay cannot exceed 365 days

If such **appeal is not so disposed** of within 180 day period or the period or periods extended not exceeding 365 days, the order of **stay shall stand vacated after the expiry of such period** or periods, even if the delay in disposing of the appeal is not attributable to the assessee.

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(10) Cost of appeal: The cost of any appeal to the Appellate Tribunal shall be at the discretion of that Tribunal [Section 254(2B)].

(11) Final authority on facts: On all questions of fact the orders passed by the Appellate Tribunal on appeal shall be final and binding on the assessee as well as the Department [Section 255].

(12) Benches:

(i) Section 255(1) provides that the powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of the Appellate Tribunal among the members thereof.

(ii) As per section 255(2), a Bench should normally consist of one judicial member and one accountant member.

Constitution of single member bench or special bench

(iii) However, section 255(3) provides for constitution of a single member bench and a Special Bench.

(iv) Section 255(3) provides that the President or any other member of the tribunal authorized by the Central Government in this behalf may dispose of any case which pertains to an assessee whose total income as computed by the Assessing Officer in the said case does not exceed **₹ 50 lakh**.

(v) The President may, for the disposal of any particular case constitute a special Bench consisting of three or more members, one of whom must necessarily be a judicial member and one an accountant member.

Where members differ [Section 255(4)] - If the members of a Bench differ in opinion on any point the point shall be decided according to the opinion of the majority, if there is a majority. However, if the members are equally divided, they should state the points on which they differ and the case shall be referred by the President of the Tribunal for hearing on such point by one or more of the other members of the Tribunal: then, such points shall be decided according to the opinion of the majority of the members of the Tribunal who have heard the case, including those who first heard it.

Decision according to opinion of majority

Regulating power [Section 255(5) & (6)] - The Appellate Tribunal is empowered to regulate its own procedure and the procedure of its Benches in all matters arising out of the exercise

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of its power or of the discharge of its functions, including the places at which the Benches shall hold their sittings. The Tribunal is vested with all the powers which are exercisable by Income-tax authorities under section 131 for the purpose of discharging its functions. Any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding for the purpose of the Income-tax Act, 1961 and the Indian Penal Code ***(Bharatiya Nyaya Sanhita, 2023)*** and that Appellate Tribunal shall be deemed to be a Civil Court for all the purposes of the Income-tax Act, 1961 and the Code of Criminal Procedure, 1898.

Scheme for disposing of appeal [Section 255(7), (8) & (9)] - Section 255(7) empowers the Central Government to make a scheme, by notification in the Official Gazette, for the purposes of disposal of appeals by the Appellate Tribunal, so as to impart greater efficiency, transparency and accountability by—

(a) eliminating the interface between the Appellate Tribunal and the parties to the appeal in the course of appellate proceedings to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialisation;

(c) introducing an appellate system with dynamic Jurisdiction.

The Central Government may, for the purpose of giving effect to such scheme, by notification in the Official Gazette, direct that any of the provisions of the Income-tax Act, 1961 would not apply or would apply with such exceptions, modifications and adaptations as may be specified in the notification. [Section 255(8)].

Every such notification issued under section 255(7) or section 255(8) has to be laid before each House of Parliament as soon as may be after issue of the notification.

16.3 APPEALS TO HIGH COURT [SECTIONS 260A & 260B]

Section 260A provides for direct appeal to the High Court against the orders of the Appellate Tribunal.

(1) Appeal - Section 260A(1) 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. If the High Court is so satisfied, it shall formulate that question.

Formulate Substantial question of law

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The Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner or an assessee aggrieved by any order passed by the Appellate Tribunal may file an appeal to the High Court under this section.

(2) **Form for appeal** - The appeal shall be in the form of a memorandum of appeal, precisely stating in it the substantial question of law involved.

(3) **Time limit for appeal** - The appeal shall be filed **within 120 days from the date on which the order** appealed against **is received** by the assessee, or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

The High Court has and always had the power to condone the delay and admit an appeal after the expiry of the period of 120 days, if it is satisfied that there was sufficient cause for not filing the appeal within that period.

(4) **Matters on which appeal can be heard** - The appeal shall be heard only on the question formulated. However, the respondent shall at the hearing of appeal, be allowed to argue that the case does not involve such question. Further, the Court shall also have power to hear the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question. However, such power shall be exercised by the Court only after recording the reasons for hearing such other question.

Further, the High Court may determine any issue which -

(a) has not been determined by the Appellate Tribunal; or

(b) has been wrongly determined by the Appellate Tribunal, by reason of a decision on such question of law as is referred to in section 260A(1).

(5) **Delivery of judgment** - After the appeal is heard, the High Court shall decide the question of law so formulated and deliver such judgment thereon, but such judgment should contain the grounds on which such decision is founded.

(6) **Award of costs** - The High Court is empowered to award such costs as it deems fit.

(7) **Code of Civil Procedure** - Unless otherwise provided in this Act, the Code of Civil Procedure, 1908, relating to appeals to the High Court, shall apply to appeals under this section.

(8) **Case before High Court to be heard by not less than two judges [Section 260B]**

Strength of the bench hearing the appeal - The appeal shall be heard by a bench of not less than 2 judges of the High Court.

Decision of the majority - The appeal shall be decided in accordance with the opinion of the judges or the majority, if any.

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Where there is no such majority, the point of law upon which the judges differ shall be referred to one or more of the other judges of the High Court and such point shall be decided according to the opinion of the majority of the Judges who have heard the case, including those who first heard it.

16.4 APPEAL TO THE SUPREME COURT [SECTION 261]

According to section 261, an appeal shall lie to the Supreme Court from any judgment of the High Court, in a case which the High Court certifies to be a fit one for appeal to the Supreme Court. The provisions of the Code of Civil Procedure, 1908 in regard to appeal shall apply in the case of all appeals to the Supreme Court in the same manner as in the case of all appeals from decrees of a High Court. The cost of appeal shall be decided at the discretion of the Supreme Court. Where the judgment of a High Court is varied in the appeal, effect should be given to the order of the Supreme Court in the same manner as provided in the case of a judgment of the High Court.

Time limit for filing appeals

Before Joint Commissioner (Appeals) u/s 246 or Commissioner (Appeals) u/s 246A

Within 30 days from	
Appeal related to	**Date of**
Assessment / Penalty	Service of Notice of Demand.
Any other case	Service of intimation of order sought to be appealed against.

Before Appellate Tribunal u/s 253

within **2 months** from the end of the month in which the order sought to be appealed against is communicated.

Before High Court u/s 260A

Within **120 days** from the date of receipt of order appealed against.

Note: The above time period can be extended by the Appellate Authority if the appellant shows sufficient cause for not presently the appeal within the specified time.

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16.5 PROCEDURE WHEN ASSESSEE CLAIMS IDENTICAL QUESTION OF LAW IS PENDING BEFORE THE HIGH COURT OR SUPREME COURT [SECTION 158A]

(1) **Identical question of law pending before High Court/Supreme Court:** Section 158A makes provision for avoiding repetitive appeals when identical question of law is pending before High Court or Supreme Court. This is applicable to a situation **where an assessee** claims that any question of law arising in his case for an assessment year which is pending before the Assessing Officer or any appellate authority is identical with a question of law arising in his case for another assessment year which is pending in appeal under section 260A before the High Court or in appeal under section 261 before the Supreme Court.

(2) **Assessee to furnish declaration:** In such a situation, notwithstanding anything contained in the Act, the assessee may furnish a declaration in the prescribed form that if the Assessing Officer or the appellate authority, as the case may be, agrees to apply in the present case, the final decision passed on the other case, the assessee shall not raise again the same question of law in appeal before any appellate authority or in appeal before the High Court under section 260A or in appeal before the Supreme Court under section 261.

(3) **Assessing Officer's report on correctness of claim:** Where such a declaration is furnished by the assessee to an appellate authority, the appellate authority shall call for a report from the Assessing Officer on the correctness of the claim. Where the Assessing Officer makes a request to the appellate authority to give him an opportunity of being heard, it shall allow him such opportunity.

(4) **Admission or rejection of claim by order in writing:** The Assessing Officer or the appellate authority, as the case may be, may, by order in writing –

(i) admit the claim if satisfied that the question of law is identical in the present as well as the other case; or

(ii) reject the claim, if not so satisfied.

(5) **Consequences where claim is admitted: Where a claim is admitted, -**

(i) the Assessing Officer or appellate authority, as the case may be, may make an order disposing of the present case without waiting for the final decision on the other case.

(ii) the assessee would then not be entitled to raise in relation to the relevant case, such question of law in appeal before any appellate authority or in appeal before the High Court under section 260A or the Supreme Court under section 261.

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(6) **Final decision of Supreme Court/High Court to be applied to the case:** When the final decision on the question of law is passed in the other case, the Assessing Officer or the appellate authority, as the case may be would apply it to the present case and amend the order passed, if necessary, in order to conform to such decision.

(7) **Finality of the order:** An order admitting or rejecting the claim of the assessee, as the case may be, would be final. Such order cannot be called in question in any proceeding by way of appeal, reference, revision under the Act.

(8) **Meaning of certain terms:**

Term	Meaning
Appellate authority	Joint Commissioner (Appeals) or Commissioner (Appeals) or Appellate Tribunal.
Case	Any proceeding under the Act for assessment of the total income of the assessee or for the imposition of any penalty or fine on him.

16.6 DEFERMENT OF APPEAL BY REVENUE WHEN AN IDENTICAL QUESTION OF LAW IS PENDING BEFORE HIGH COURT OR SUPREME COURT [SECTION 158AB]

(1) **Deferment of any appeal against an identical question of law pending before the High Court or Supreme Court:** Section 158AB provides that where the collegium (comprising of two or more Chief Commissioners or Principal Commissioners or Commissioners, as may be specified by the CBDT in this behalf) is of the opinion that

Collegium

- any question of law arising in the case of an assessee for any assessment year (i.e., relevant case) is identical with a question of law already raised
  - in his case for any other A.Y. or
  - in the case of any other assessee for any assessment year,

  which is pending before the jurisdictional High Court under section 260A or the Supreme Court in an appeal under section 261 or in a special leave petition under article 136 of the Constitution, against the order of the Appellate Tribunal or the jurisdictional High Court, as the case may be, in favour of such assessee (i.e., other case), the collegium may, decide and inform the Principal Commissioner or

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Commissioner not to file any appeal, at this stage, to the Appellate Tribunal under section 253(2) or to the jurisdictional High Court under section 260A(2) in the relevant case against the order of the Joint Commissioner (Appeals) or the Commissioner (Appeals) or the Appellate Tribunal, as the case may be.

(2) **Direction to Assessing Officer to make an application to the Tribunal or High Court:** On receipt of a communication from the collegium, the Principal Commissioner or Commissioner shall direct the Assessing Officer **to make an application** to the Appellate Tribunal or jurisdictional High Court, as the case may be, in the prescribed form

Application within 120 days from the date of receipt of order

- within 120 days from the date of receipt of the order of the Joint Commissioner (Appeals) or the Commissioner (Appeals) or the Appellate Tribunal, as the case may be,
- stating that an appeal on the question of law arising in the relevant case may be filed when the decision on the question of law becomes final in the other case.

This is notwithstanding anything contained in section 253(3) or 260A(2)(a) which provide the time limit for filing appeal before Tribunal or High Court.

(3) **Application to be made only if the assessee accepts that the question of law is identical:** The Principal Commissioner or Commissioner shall direct the Assessing Officer to make such an application only if an acceptance is received from the assessee to the effect that the question of law in the other case is identical to that arising in the relevant case. In case no such acceptance is received, the Principal Commissioner or Commissioner shall, notwithstanding anything contained in section 253(3) or 260A(2)(a), proceed in accordance with the provisions contained in section 253(2) or section 260A(2)(c).

(4) **Consequences where the order of Joint Commissioner (Appeals) or CIT (Appeals) or the Appellate Tribunal is not in conformity with High Court's or Supreme Court's decision in the other case:** Where the order of the Joint Commissioner (Appeals) or Commissioner (Appeals) or the order of Appellate Tribunal, as the case may be, is not in conformity with the final decision on the question of law in the other case (if the High Court or Supreme Court decides the other case in favour of the Department), as and when such order is received, the Principal Commissioner or the Commissioner may direct the Assessing Officer to appeal to the Appellate Tribunal or Jurisdictional High Court, as the case may be, against such order.

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Unless otherwise provided in section 158AB, all other provisions of Part B-"Appeals to Appellate Tribunal" and Part CC – "Appeals to High Court" of Chapter XX would apply accordingly.

(5) Time limit for filing appeal in the relevant case: The appeal in the relevant case shall be filed within 60 days to the Tribunal or 120 days to the High Court, as the case may be, from the date on which the order of the High Court or the Supreme Court in any other case, is communicated to the Principal Commissioner or Commissioner, in accordance with the procedure specified by the CBDT.

60 days - ITAT
120 days - HC

Example: Let us suppose a question of law (Q1) has arisen in case of an assessee Mr. X and he has received a favourable decision on Q1 from the Commissioner (Appeals). Further, in case of another assessee Mr. Y, where Department's appeal on identical question of law (Q2) in his case is pending before the jurisdictional High Court or the Supreme Court. The collegium is of the opinion that Q1 in case of Mr. X and Q2 in case of Mr. Y are identical questions of law. In this situation, the provisions of section 158AB can be invoked by Revenue to defer filing of appeal in respect of Q1 in case of Mr. X to the higher appellate authority till a decision on Q2 in case of Mr. Y is communicated to the Principal Commissioner or Commissioner having jurisdiction over the assessee, Mr. X. Such a decision on deferment will be subject to acceptance by the assessee Mr. X that question of law in his case Q1 is identical to Q2 in the case of the assessee Mr. Y.

16.7 REVISION OF ORDERS [SECTIONS 263 AND 264]

(1) Revision of Orders prejudicial to the Revenue [Section 263]

(i) Under section 263(1), if the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner considers that any order passed by the Assessing Officer or the Transfer Pricing Officer (TPO) under section 92CA, as the case may be, is erroneous in so far as it is prejudicial to the interests of the Revenue, he may, after giving the assessee an opportunity of being heard and after making an enquiry, pass an order, including an order

Enhance, modify, cancel and direct fresh assessment.

(a) enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment; or

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(b) an order modifying the order under section 92CA; or

(c) an order cancelling the order under section 92CA and directing a fresh order under the said section.

(ii) An order passed by the Assessing Officer or the Transfer Pricing Officer (TPO), as the case may be, shall be deemed to be erroneous in so far as it is prejudicial to the interests of the Revenue, if, in the opinion of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner,—

(a) the order is passed without making inquiries or verification which should have been made;

(b) the order is passed allowing any relief without inquiring into the claim;

(c) the order has not been made in accordance with any order, direction or instruction issued by the CBDT under section 119;

(d) the order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person.

(iii) The term 'record' shall include and shall be deemed always to have included all records relating to any proceedings under the Act available at the time of examination by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

(iv) Where any order referred to in section 263(1) passed by the Assessing Officer or the TPO, as the case may be, had been the subject-matter of any appeal, the powers of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner under section 263(1) shall extend and shall be deemed always to have extended to such matters as had not been considered and decided in such appeal.

(v) No order shall be made **after the expiry of 2 years from the end of the financial year** in which the order sought to be revised was passed.

(vi) In computing the period of 2 years, the time taken in giving an opportunity to the assessee to be reheard under section 129 and ***the period commencing on the date on which stay on any proceeding under this section was granted by an order or injunction of any court and ending on the date on which certified copy of the order vacating the stay was received by the jurisdictional Principal Commissioner or Commissioner*** shall be excluded.

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(vii) The time limit, however, does not apply in case where the effect has to be given to a finding or direction contained in the order of the Appellate Tribunal, High Court or the Supreme Court.

(2) Revision of other orders [Section 264]

(i) In the case of any other order (not being an order prejudicial to the Revenue) passed by any subordinate authority, the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may either on his own motion or on receipt of an application from the assessee, call for the record of any proceedings under the Act in the course of which the order was passed. After making such enquiries as may be necessary the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may pass such order as he thinks fit.

(ii) The Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or 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.**

(iii) If the application for revision is made by the assessee, it must be made within one year from the date on which the order in question was communicated to him or the date on which he otherwise comes to know of it, whichever is earlier.

Application to be filed within 1 year from the date of communication of order or from the date he otherwise came to know about it, whichever is earlier.

(iv) However, the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may admit an application even after the expiry of one year, if he is satisfied that the assessee was prevented by sufficient cause from making the application within that period.

(v) The application to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner for revision must be accompanied by a fee of ₹ 500.

Fee of ₹ 500

(vi) If an order is passed by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner declining to interfere in any proceeding, it shall not be deemed to be an order prejudicial to the assessee.

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(vii) However, the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner **is not empowered to revise any order** in the following cases, viz.,

(a) where an appeal against the order lies to the Joint Commissioner (Appeals) or the Commissioner (Appeals) or the Tribunal but has not been made and the time within which the appeal may be made has not expired or in the case of an appeal to the Joint Commissioner (Appeals) or to the Commissioner (Appeals) or to the Tribunal the assessee has not waived his right of appeal;

Revision not permissible if –

(i) Time for filing appeal before JCIT(A) or CIT(A) or ITAT has not expired or assessee has not waived his right of appeal

(ii) Order is subject matter of appeal before JCIT(A) or CIT(A) or ITAT

(b) where the order has been made subject to an appeal to the Joint Commissioner (Appeals) or the Commissioner (Appeals) or the Appellate Tribunal.

(3) Limitation of time for revision of orders by Principal Commissioner or Commissioner of Income-tax under section 264

Under section 264, the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner of Income-tax is empowered to revise an order passed by the subordinate authority where no appeal has been filed. There is a limitation of one year for filing the application.

(a) It shall be obligatory on the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or 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.**

Order to be passed within 1 year from the end of F.Y. in which application is made

(b) In computing the above referred period of limitation, the time taken in giving an opportunity to the assessee to be re-heard under the proviso to section 129 and ***the period commencing on the date on which stay on any proceeding under this section was granted by an order or injunction of any court and ending on the date on which certified copy of the order vacating the stay was received by the***

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jurisdictional Principal Commissioner or Commissioner shall be excluded [*Explanation* to section 264(6)].

(c) The **aforesaid time limit shall not apply** to any order which has been passed in consequence of or to give effect to any finding or direction contained in an order of the Appellate Tribunal, High Court or the Supreme Court.

(4) Faceless Revision [Section 264A]

(i) The Central Government may make a scheme, by notification in the Official Gazette, for the purposes of revision of orders under section 263 or section 264, so as to impart greater efficiency, transparency and accountability by—

(a) eliminating the interface between the income-tax authority and the assessee or any other person to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialisation;

(c) introducing a team-based revision of orders, with dynamic jurisdiction.

(ii) Every notification has to be laid before each House of Parliament, as soon as may be after the notification is issued.

(5) Faceless Effect of Orders [Section 264B]

(i) The Central Government may make a scheme, by notification in the Official Gazette, for the purposes of giving effect to an order under section 250, 254, 260, 262, 263 or 264, so as to impart greater efficiency, transparency and accountability by—

(a) eliminating the interface between the income-tax authority and the assessee or any other person to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialisation;

(c) introducing a team-based giving of effect to orders, with dynamic jurisdiction

(ii) Every notification has to be laid before each House of Parliament, as soon as may be after the notification is issued.

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16.8 MONETARY LIMITS FOR REGULATING FILING OF APPEALS BY INCOME TAX AUTHORITIES [SECTION 268A]

(i) As per section 268A(1), the CBDT is empowered to issue orders, instructions or directions to other income tax authorities, fixing such monetary limits as it may deem fit. Such fixing of monetary limit is for the purpose of regulating filing of appeal or application for reference by any income tax authority.

(ii) Where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to abovementioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of –

(1) the same assessee for any other assessment year; or

(2) any other assessee for the same or any other assessment year.

(iii) Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

(iv) The Appellate Tribunal or Court should take into consideration the above mentioned orders/instructions/directions of the CBDT and the circumstances under which such appeal or application for reference was filed or not filed in respect of any case.

(v) Every order/instruction/direction which has been issued by the CBDT fixing monetary limits for filing an appeal or application for reference shall be deemed to have been issued under sub-section (1) and all the provisions of this section shall apply accordingly.

Monetary limits for filing of appeals by the Department before Income Tax Appellate Tribunal, High Courts and SLPs/appeals before Supreme Court

The CBDT has specified the monetary limits and other conditions for filing departmental appeals before Income Tax Appellate Tribunal, High Courts and SLPs/ appeals before Supreme Court vide Circular No. 5/2024, Dated 15-3-2024 and Circular No. 09/2024 dated 17.9.2024.

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It has been decided by the CBDT that departmental appeals may be filed on merits before Income Tax Appellate Tribunal and High Courts and SLPs/ appeals before Supreme Court keeping in view the monetary limits and conditions specified below.

Monetary Limits specified:

Appeals/ SLPs shall not be filed in cases where the tax effect does not exceed the monetary limits given hereunder:

S. No.	Appeals/ SLPs in Income-tax matters	Monetary Limit (₹)
1.	Before Appellate Tribunal	60,00,000
2.	Before High Court	2,00,00,000
3.	Before Supreme Court	5,00,00,000

It is clarified that an appeal should not be filed merely because the tax effect in a case exceeds the monetary limits prescribed above. Filing of appeal in such cases is to be decided on merits of the case.

Exceptions where the decision to appeal/file SLP shall be taken on merits, without regard to the tax effect and the monetary limits:

Monetary limits given above with regard to filing appeal/SLP would be applicable to all cases including those relating to TDS/TCS with the following exceptions where the decision to appeal/file SLP shall be taken on merits, without regard to the tax effect and the monetary limits:

a. Where any provision of the Act or the Rules or notification issued thereunder has been held to be constitutionally invalid, or

b. Where any order, notification, instruction or circular of the Board or the Government has been held to be illegal or ultra vires the Act or otherwise constitutionally invalid, or

c. Where the assessment is based on information in respect of any offence alleged to have been committed under any other law received from any of the law enforcement or intelligence agencies such as CBI, ED, DR!, SFIO, NIA, NCB, DGGI, state law enforcement agencies such as State Police, State Vigilance Bureau, State Anti-Corruption Bureau, State Excise Department, State Sales/Commercial Taxes or GST Department, or

d. Where the case is one in which prosecution has been filed by the Department in the relevant case and the trial is pending in any Court or conviction order has been passed and the same has not been compounded, or

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e. Where strictures/adverse comments have been passed and/or cost has been levied against the Department of Revenue, CBDT or their officers, or

f. Where the tax effect is not quantifiable or not involved, such as the case of registration of trusts or institutions under sections 10(23C), 12AAI12AB order passed u/s 263 etc. The reference to cases involving sections referred here, where it is not possible to quantify tax effect or tax effect is not involved, is for the purpose of illustration only.

g. Where addition relates to undisclosed foreign income/undisclosed foreign assets (including financial assets)/undisclosed foreign bank account, or

h. Cases involving organized tax evasion including cases of bogus capital gain/loss through penny stocks and cases of accommodation entries, or

i. Where mandated by a Court's directions, or

j. Writ matters, or

k. Matters related to any matter other than the Income Tax Act, or

l. In respect of litigation arising out of disputes related to TDS/TCS matters in both domestic and International taxation charges:-

- Where dispute relates to the determination of the nature of transaction such that the liability to deduct TDS/TCS thereon or otherwise is under question, or
- Appeals of International taxation charges where the dispute relates to the applicability of the provisions of a Double Taxation A voidance Agreement or otherwise

m. Any other case or class of cases where in the opinion of the Board it is necessary to contest in the interest of justice or revenue and specified so by a circular issued by Board in this regard.

In respect of deferral of appeals under section 158AB, exceptions where the decision to appeal/file SLP shall be taken on merits, without regard to the tax effect and the monetary limits:

(a) When judicial finality is achieved in favour of Revenue in the “other case”, appeal in the “relevant case” is contested on merits subsequent to the decision in the “other case” irrespective of the extant monetary limits.

(b) If the judicial outcome in the “other case” is not in favour of Revenue and is not accepted by the Department, appeal against the same may be contested on merits in the “other case” irrespective of the extant monetary limits, to arrive at judicial finality.

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Meaning of Tax Effect:

	Case	Tax Effect
i.	In case not covered in ii, iii and iv below	The tax on the total income assessed (-) The tax that would have been chargeable had such total income been reduced by the amount of income in respect of the issues against which appeal is intended to be filed ("disputed issues"). **Note** – However, the tax will not include any interest thereon, except where chargeability of interest itself is in dispute.
ii.	In case the chargeability of interest is the issue under dispute	The amount of interest
iii.	In case where returned loss is reduced or assessed as income	The tax effect would include notional tax on disputed additions
iv.	In case of penalty orders	Quantum of penalty deleted or reduced in the order to be appealed against
Note – Tax effect shall be tax including applicable surcharge and cess.		

For calculating the tax effect of cases involving TDS/TCS, the cumulative effect, of all orders passed for an assessment year of a deductor, to be taken into account and would include interest u/s 201(1A).

Computation of tax on the total income assessed where income is computed under the provisions of section 115JB or section 115JC:

In such case, tax on the total income assessed would be computed as given below -

(A - B) + (C - D)

Where,

A = the total income assessed as per the provisions other than the provisions contained in section 115JB or section 115JC (i.e., the general provisions)

B = the total income that would have been chargeable had the total income assessed as per the general provisions been reduced by the amount of the disputed issues under general provisions

C = the total income assessed as per the provisions contained in section 115JB or section 115JC

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D = the total income that would have been chargeable had the total income assessed as per the provisions contained in section 115JB or section 115JC was reduced by the amount of the disputed issues under said provisions

However, where the amount of disputed issues is considered both under the provisions contained in section 115JB or section 115JC and under general provisions, such amount shall not be reduced from total income assessed while determining the amount under item D.

Manner of calculation of tax effect of different assessment years

The Assessing Officer has to calculate the tax effect separately for every assessment year in respect of the disputed issues in the case of every assessee. If, in the case of an assessee, the disputed issues arise in more than one assessment year, appeal can be filed in respect of such assessment year or years in which the tax effect in respect of the disputed issues exceeds the specified monetary limit. No appeal shall be filed in respect of an assessment year or years in which the tax effect is less than the monetary limit specified. Further, even in case of a composite order of any High Court or appellate authority, which involves more than one assessment year and common issues in more than one assessment year, no appeal shall be filed in respect of an assessment year or years in which the 'tax effect' is less than the prescribed monetary limit. In case where a composite order/judgement involves more than one assessee, each assessee shall be dealt with separately.

Department not precluded from filing an appeal against disputed issues for subsequent assessment years if the tax effect exceeds the specified monetary limits in those years

In a case where appeal before a Tribunal or a Court is not filed only on account of the tax effect being less than the monetary limit specified above, the Principal Commissioner or Commissioner of Income-tax shall specifically record that "even though the decision is not acceptable, appeal is not being filed only on the consideration that the tax effect is less than the monetary limit specified in the Circular". Further, in such cases, there will be no presumption that the Income-tax Department has acquiesced in the decision on the disputed issues. The Income-tax Department shall not be precluded from filing an appeal against the disputed issues in the case of the same assessee for any other assessment year, or in the case of any other assessee for the same or any other assessment year, if the tax effect exceeds the specified monetary limits.

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Cases in respect of which appeal is not filed due to tax effect being less than specified monetary limit not to have any precedent value

In the past, a number of instances have come to the notice of the Board, whereby an assessee has claimed relief from the Tribunal or the Court only on the ground that the Department has implicitly accepted the decision of the Tribunal or Court in the case of the assessee for any other assessment year or in the case of any other assessee for the same or any other assessment year, by not filing an appeal on the same disputed issues. The Departmental representatives/counsels must make every effort to bring to the notice of the Tribunal or the Court that the appeal in such cases was not filed or not admitted only for the reason of the tax effect being less than the specified monetary limit and, therefore, no inference should be drawn that the decisions rendered therein were acceptable to the Department. Accordingly, they should impress upon the Tribunal or the Court that such cases do not have any precedent value and also bring to the notice of the Tribunal/ Court the provisions of section 268A(4).

As the evidence of not filing appeal due to this Circular may have to be produced in courts, the judicial folders in the office of Pr. CsIT/ CsIT must be maintained in a systemic manner for easy retrieval.

In cases where appeals are not being filed due to low tax effect despite the judgment not being acceptable on merits or appeals are being filed despite low tax effect in view of exceptions, the Pr. CIT/CIT shall submit a monthly report, to the CIT(J)/Addl./Jt. CIT(J) office. Further, the CIT(J)/ Addl/Jt CIT(J) office shall collate and disseminate the departmental stand, as regards filing of appeals, in respect of the issues involved in such appeals, within the region.

16.9 DOCTRINE OF PARTIAL MERGER AND DOCTRINE OF TOTAL MERGER

Section 154 provides that the doctrine of partial merger shall apply where any matter has been considered and decided in any proceeding, appeal or revision relating to rectifiable order. The authority passing such order may, amend the order in relation to any matter other than the matter which has been so considered and decided. The doctrine of partial merger also holds good for section 263.

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However, the concept of total merger would apply in the case of section 264. The Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner of Income-tax has no power to revise any order under section 264, if the order has been made subject to an appeal to the Appellate Tribunal, even if the relief claimed in the revision is different from the relief claimed in the appeal and irrespective of the fact whether the appeal is by the assessee or by the Department.

Partial Merger – Sections 154 & 263
Total Merger – Section 264

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SIGNIFICANT SELECT CASES

S.No.	Case Law	
1.	***CIT v. Industrial Development Bank of India Ltd. [2023] 454 ITR 811(SC)***	
	Issue	**Relevant Provision, Analysis and Decision**
	Does the limitation period for exercising the powers under section 263 reckoned from date of passing of the original assessment order rather than the date of reassessment order for the issues covered under the original assessment but not covered in the reassessment proceedings?	Section 263 provides that where the Principal Chief Commissioner, Chief Commissioner, Principal Commissioner or Commissioner of Income-tax considers that an order passed by the Assessing Officer or Transfer Pricing Officer is erroneous in so far as prejudicial to the interests of the Revenue, he may pass a revisionary order. The order for revision shall be made within a period of two years from the end of the financial year in which the order sought to be revised was passed. As observed and held by the Court in the earlier decisions, once an order of assessment is re-opened, the previous order of assessment will be held to be set aside. The whole proceedings would start afresh, but the same would not mean that even when the subject matter of reassessment is distinct and different, the entire proceedings would be deemed reopened. It means that only in a case where the issues before the Commissioner at the time of exercising powers under section 263 relate to the subject matter of reassessment would the limitation start from the date of the reassessment order. However, if the subject matter of the reassessment is distinct and different, in that case, the relevant date for the purpose of determining the period of limitation for exercising powers under section 263 would be the date of the original Assessment Order. Accordingly, the Supreme Court held that the issues before the Commissioner while exercising the powers under section 263 related back to the original assessment order which were not covered in the reassessment proceedings and, therefore, the limitation would start from the original assessment order and not from the reassessment order.

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2.	***CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336 (Bom.)***	
	Issue	**Analysis & Decision**
	Can an assessee make an additional/ new claim before an appellate authority, which was not claimed by the assessee in the return of income (though he was legally entitled to), otherwise than by way of filing a revised return of income?	The appellate authorities have jurisdiction to permit additional claims before them, however, the exercise of such jurisdiction is entirely the authorities' discretion. In case an additional ground was raised before the appellate authority which could not have been raised at the stage when the return was filed or when the assessment order was made, or the ground became available on account of change of circumstances or law, the appellate authority can allow the same. **Additional grounds can be raised before the Appellate Authority even otherwise than by way of filing return of income. However, in case the claim has to be made before the Assessing Officer, the same can only be made by way of filing a revised return of income.** ***Note –*** *This view of the High Court has been endorsed by the Apex Court in Wipro Finance Ltd. v. CIT (2022) 443 ITR 250 (SC)*
3.	***Wipro Finance Ltd. v. CIT (2022) 443 ITR 250 (SC)***	
	Issue	**Analysis & Decision**
	Would the loss incurred in foreign currency fluctuation at the time of repayment of loan taken for financing acquisition of plant and machinery on lease/hire purchase by Indian enterprises with whom the assessee-company has lease/hire purchase agreement be treated as allowable revenue expenditure? Can the Tribunal entertain a fresh claim for the first time in exercise of its powers under section 254?	Under section 37, any expenditure (not being in the nature of expenditure described in sections 30 to 36), and **not** being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing income chargeable under the head "Profits and gains of business or profession". Section 254(1) empowers the Appellate Tribunal to pass such orders as it thinks fit, after giving both the parties to the appeal an opportunity of being heard. **Facts of the case**: The assessee-company, which was in the leasing business, obtained a loan in foreign currency from Commonwealth Development Corporation (CDC), having its registered office in the United Kingdom, to be utilised by the assessee for financing the procurement of capital equipment by existing Indian enterprises on hire purchase or lease basis. While repaying the loan, due to the difference in the rates of foreign exchange, the

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		assessee had to pay a higher amount, resulting in loss to the assessee. For the relevant assessment year, the assessee declared, *inter alia*, a loss of ₹ 1.11 crores owing to fluctuation in the rates of foreign exchange. The assessee in its return had taken a conscious explicit plea with regard to part of the claim being ascribable to capital expenditure (₹ 2.46 crores) and partly to revenue expenditure (₹ 1.11 crores). Thereafter, for the first time before the Tribunal it pleaded that the entire claim must be treated as revenue expenditure. The Tribunal was conscious that this claim was made by the assessee for the first time before it and the same was contrary to the stand taken in the return filed by the assessee for the assessment year including the notings made by the officials of the assessee. Yet, the Tribunal entertained the claim as permissible, relying on the dictum of the court in *National Thermal Power Co. Ltd. v. CIT [1998] 229 ITR 383 (SC),* wherein it was held that the Tribunal has the power to entertain question raised for the first time. The Tribunal is not confined only to the issues arising out of the appeal before the Commissioner (Appeals). It has the power to allow the assessee to urge any ground not raised before the Commissioner (Appeals). However, the relevant facts in respect of such ground should be on record. Accordingly, in this case, the Tribunal held that the entire loan and the utilisation thereof was in trading operations of the company more profitably leaving the fixed capital untouched and hence the expenditure was on revenue account and allowable. The Tribunal allowed the entire claim of ₹ 3.57 crores. **Analysis:** The activity of the assessee of financing existing Indian enterprises for procurement or acquisition of plant, machinery and equipment on lease and hire purchase basis, was an independent transaction or activity being the business of the assessee. The transaction of loan between the assessee and CDC was in the nature of borrowing money by the assessee, which was necessary for carrying on its business of financing. It was not for creation of an asset of the assessee as such or acquisition from a country outside India for the purpose of its business. In such a scenario, the assessee would be justified in availing of deduction of the entire

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		expenditure or loss suffered by it in connection with such a transaction in terms of section 37. The loan was wholly and exclusively used for the purpose of business of financing existing Indian enterprises, which in turn, had to acquire plant, machinery and equipment to be used by them. It was a different matter that they may do so because of the leasing and hire purchase agreement with the assessee. That would, nevertheless, be an activity concerning the business of the assessee. The Supreme Court held that the analysis and the conclusion arrived at by the Tribunal in respect of the claim of the assessee were correct. As regards the restriction in powers to accept a new claim for the first time, such limitation on accepting new claims would apply to the "assessing authority", but would not impinge upon the plenary powers of the Tribunal bestowed under section 254. **Decision:** As a result of allowing the entire claim of the appellant to the tune of ₹ 3.57 crores being revenue expenditure, suitable amendment will have to be effected in the final assessment order passed by the Assessing Officer for the concerned assessment year, thereby treating the consequential benefits such as depreciation availed of by the appellant-assessee in relation to the stated amount towards exchange fluctuation related to leased assets capitalized (being ₹ 2.46 crores), as unavailable. ***Note*** *– The crux of this case is that the assessee was engaged in leasing business. The assessee also financed the enterprises with whom it had entered into a lease agreement to enable them to obtain the plant, machinery on lease from it. For such financing, the assessee had obtained loan in foreign currency and incurred loss on account of currency fluctuation while repaying the loan. It was held that since the loan was borrowed for the financing activity, which was an activity concerning the business of the assessee, the loss was allowable under section 37. It was not a loan borrowed for acquisition of asset, in which case, the loss would have had to be adjusted against the actual cost of the asset.*

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4.	***Smt. Ritha Sabapathy v. DCIT [2019] 416 ITR 191 (Mad)***	
	Issue	**Analysis & Decision**
	Can the Appellate Tribunal dismiss an appeal, without deciding the case on its merits, solely on the ground that the assessee had not appeared on the appointed date of hearing?	Even if the assessee could not appear, the Tribunal could have decided the appeal only on merits, *ex parte,* after hearing the Revenue's contentions. It reiterates that the fact-finding Appellate Tribunal should not shirk its responsibility to decide a case on its merits. A legal and binding responsibility, therefore, lies upon the Tribunal to decide the appeal on merits, irrespective of the appearance or otherwise of the assessee or his counsel before it.
5.	***CIT v. Earnest Exports Ltd. (2010) 323 ITR 577 (Bom.)***	
	Issue	**Analysis & Decision**
	Does the Appellate Tribunal have the power to review or re-appreciate the correctness of its earlier decision u/s 254(2)?	The power u/s 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters. **Section 254(2) is not a carte blanche for the Tribunal to change its own view by substituting a view which it believes should have been taken in the first instance.** Section 254(2) is not a mandate to unsettle decisions taken after due reflection. **In this case, the Tribunal, while dealing with the application u/s 254(2), virtually reconsidered the entire matter and came to a different conclusion. This amounted to a reappreciation of the correctness of the earlier decision on merits, which is beyond the scope of the power conferred u/s 254(2)**
6.	***Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB)***	
	Issue	**Analysis & Decision**
	Can the Tribunal exercise its power of rectification u/s 254(2) to recall its order in entirety, where there is a mistake apparent from record?	One of the important reasons for giving the power of rectification to the Tribunal is to see that no prejudice is caused to either of the parties appearing before it by its decision based on a mistake apparent from the record. When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then, it is the duty of the Tribunal to set it right. In that case, the Tribunal had not considered the material which was already on record while passing the judgment. The Apex Court in *Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466* took note of the fact that the Tribunal committed a

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		mistake in not considering material which was already on record and the Tribunal acknowledged its mistake and accordingly, rectified its order. **The Tribunal, while exercising the power of rectification u/s 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.**
7.	***Reliance Telecom Ltd./Reliance Communications Ltd. (2022) 440 ITR 1 (SC)***	
	Issue	**Analysis & Decision**
	Can the powers under section 254(2) be exercised by the Tribunal to recall an order and rehear the entire order on merits?	Section 254(1) empowers the Appellate Tribunal to pass such order thereon as it thinks fit, after giving both the parties to the appeal an opportunity of being heard. Under section 254(2), the Appellate Tribunal, may amend an order passed by it u/s 254(1) with a view to rectifying any mistake apparent from the record. Such amendment may be *suo moto* or if the mistake is brought to its notice by the assessee or the Assessing Officer. **Facts of the Case:** The Department filed an appeal before the Tribunal against the order of Commissioner (Appeals). By a detailed order dated September 6, 2013, the Tribunal allowed the Department's appeal. Against this order, the assessee filed a miscellaneous application for rectification u/s 254(2). The contentions of the applicants in the miscellaneous applications, briefly summarized, were that in the initial order of the Tribunal on the income-tax appeals dated September 6, 2013, there are inadvertent errors and which need to be modified/rectified. The first main heading 'Agreement and general terms and conditions of purchase'. The complaint of the assessee is that it was not considered in arriving at the final conclusion. Then comes heading No. 2 which reads thus: 'Mistake in reading the ratio of the Delhi High Court's decision in the case of *DIT v. Ericsson A. B. reported in [2012] 343 ITR 470*'. The third main heading is 'Ignoring the decisions of the co-ordinate Benches and not constituting larger Bench in case a different view is taken'. Such application was made to the Tribunal seeking correction of the mistakes which are styled as 'apparent from the record'.

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		On being served with such applications, the petitioner-Department raised an objection to the maintainability thereof. Simultaneously, the assessee also filed an appeal before the High Court against the Tribunal's order dated September 6, 2013. By order dated November 18, 2016, the Tribunal allowed the assessee's miscellaneous application filed under section 254(2) and recalled its original order dated September 6, 2013. Immediately thereafter, the assessee withdrew the appeal preferred before the High Court against the original order dated September 6, 2013. Against the order passed by the Tribunal allowing the miscellaneous application under section 254(2) of the Act and recalling its order dated September 6, 2013, the Department preferred a writ petition before the High Court. The High Court dismissed the writ petition observing that, *inter alia*, the Department itself had gone into the merits of the case in detail before the Tribunal and the parties had filed detailed submissions based on which the Tribunal passed its order recalling its earlier order. **Analysis**: The order dated November 18, 2016 passed by the Tribunal recalling its earlier order dated September 6, 2013 was beyond the scope and ambit of the powers u/s 254(2). While allowing the application u/s 254(2) and recalling its earlier order dated September 6, 2013, the Tribunal had reheard the entire appeal on the merits as if the Tribunal was deciding the appeal against the order passed by the Commissioner (Appeals). A detailed order was passed by the Tribunal on September 6, 2013 holding in favour of the Department. That order could not have been recalled by the Appellate Tribunal in exercise of powers u/s 254(2). If the assessee was of the opinion that the order passed by the Tribunal was erroneous, either on the facts or in law, the only remedy available to the assessee was to prefer an appeal before the High Court. In this case, the assessee had already filed appeal before the High Court, and the same was withdrawn by it after the Tribunal, by order dated November 18, 2016, recalled its earlier order dated September 6, 2013.

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		Decision: The order passed by the Tribunal dated November 18, 2016 recalling its earlier order dated September 6, 2013 was unsustainable, and ought to have been set aside by the High Court. ***Notes -(1)*** *In this case, the Supreme Court directed that the original order passed by the Tribunal dated September 6, 2013 passed in the respective appeal preferred by the Department be restored; and that the assessee may prefer appeal before the High Court against the original order dated September 6, 2013.* ***(2)*** *The Delhi High Court's ruling in case of Lachman Dass Bhatia Hingwala (P) Ltd. reported above at Sl. No. 7 still hold good since it is with respect to power of the Tribunal to recall its order solely to rectify the mistake apparent from record. In the present case, the Supreme Court held that the Tribunal do not have power to recall an order and rehear the entire order on merits. The crux of the both the rulings is that Tribunal have the power to recall its order only for the purpose of rectifying mistake apparent from records. However, it cannot recall its order in entirety to* ***rehear/review*** *its order on merits.*
8.	***DCIT v. Pepsi Foods Ltd (2021) 433 ITR 295 (SC)***	
	Issue	**Analysis & Decision**
	Would automatic vacation of stay order upon expiry of extended period of stay of 365 days be valid, where the delay in disposing of the appeal is **not** attributable to the assessee?	The third proviso to section 254(2A) provides that where the appeal filed before the Appellate Tribunal is not disposed of within the period of stay or extended period of stay granted by the Tribunal, the order of stay shall stand vacated after the expiry of 365 days, **even if the delay in disposing of the appeal is not attributable to the assessee**. The Apex Court observed that the Appellate Tribunal, wherever possible, has to hear and decide appeals within a period of four years from the end of the financial year in which such appeal is filed. It is only when a stay is granted by the Appellate Tribunal, the appeal is required to be disposed of within 365 days. So far as the disposal of an appeal by the Appellate Tribunal is concerned, this is a directory provision. However, the condition of automatic vacation of stay on expiry of the period becomes mandatory so far as the assessee is concerned.

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		The Apex Court also pointed out that the said proviso would result in the automatic vacation of a stay upon the expiry of 365 days, even if the Appellate Tribunal could not take up the appeal in time for no fault of the assessee. Further, vacation of stay in favour of the Department would ensue even if the Department is itself responsible for the delay in hearing the appeal. In this sense, the proviso is manifestly arbitrary being a provision which is capricious, irrational and disproportionate so far as the assessee is concerned. Accordingly, the Apex Court held that the third proviso to section 254(2A) has to be read without the word "even" and the word "not" after the words "delay in disposing of the appeal". **Thus, any order of stay shall stand vacated after the expiry of the period or periods mentioned in the section, only if the delay in disposing of the appeal is attributable to the assessee.**
9.	***CIT v. Fortaleza Developers (2015) 374 ITR 510 (Bom)***	
	Issue	**Analysis & Decision**
	Can the Commissioner invoke revisionary jurisdiction u/s 263, when the subject matter of revision (i.e., whether the manner of allocation of revenue amongst the members of AOP would affect the allowability and/or quantum of deduction u/s 80-IB) has been decided by the Commissioner (Appeals) and the same is pending before the Tribunal?	**When the order of the first appellate authority is complete and the appeal is pending before the Tribunal, the Commissioner is precluded from invoking section 263 for revision of the very same matter decided by the first appellate authority since clause (c) of the *Explanation 1* to section 263 debars the same.** Accordingly, the High Court held that the order passed by the Assessing Officer got merged with the order of the first appellate authority. The very same issue cannot be revised by invoking revisionary jurisdiction u/s 263
10.	***Sunil Vasudeva & Others v. Sundar Gupta & Others (2019) 415 ITR 281 (SC)***	
	Issue	**Analysis & Decision**
	Does the High Court have the inherent power to review its own order to correct a mistake apparent from the record?	The High Court can review its own order, where the grounds for review were: (i) discovery of new and important matter or evidence which, after the exercise of due diligence, was not within knowledge of the petitioner or could not be produced by him;

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		(ii) mistake or error apparent on the face of the record; (iii) any other sufficient reason. A review will, however, not be maintainable in the following cases: (i) repetition of old and overruled argument; (ii) minor mistakes of inconsequential import. The following observations were also made by the Supreme Court in relation to entertaining a review application: (i) review proceedings cannot be equated with the original hearing of the case. (ii) a review is not maintainable unless the material error, manifest on the face of the order, undermines its soundness or results in miscarriage of justice. (iii) a review is by no means an appeal in disguise whereby an erroneous decision is reheard and corrected but lies only for patent error. (iv) The mere possibility of two views on the subject cannot be a ground for review. (v) The error apparent on the face of the record should not be an error which has to be fished out and searched. (vi) The appreciation of evidence on record is fully within the domain of the appellate court, it cannot be permitted to be advanced in the review petition. (vii) A review is not maintainable when the same relief sought at the time of arguing the main matter had been negatived.
11.	***CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112 (SC)***	
	Issue	**Analysis & Decision**
	Does the High Court have an inherent power under the Income-tax Act, 1961 to review an earlier order passed on merits?	High Courts being courts of record under Article 215 of the Constitution of India, the power of review would inhere in them. **There is nothing in Article 226 of the Constitution to preclude a High Court from exercising the power of review which inheres in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it.**

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		Section 260A(7) does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals u/s 260A. That does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.
12.	***CIT v. A.A. Estate Pvt. Ltd. (2019) 413 ITR 438 (SC)***	
	Issue	**Analysis & Decision**
	Considering the procedure as prescribed u/s 260A, is the High Court justified in not framing any substantial question of law itself and adjudicating merely on the questions put forth by the appellant?	There lies a distinction between the questions proposed by the appellant for admission of the appeal to the High Court and the questions framed by the High Court. The substantial questions of law, which are proposed by the appellant fall u/s 260A(2)(c) whereas the substantial question of law is required to be framed by the High Court fall u/s 260A(3). **U/s 260A(4), the appeal is heard on merits only on the substantial question of law framed by the High Court u/s 260A(3).** If the High Court is of the view that the appeal did not involve any substantial question of law, it should have recorded a categorical finding to that effect saying that the questions proposed by the appellant either do not arise in the case or/and are not substantial questions of law so as to attract the rigour of section 260A for its admission and accordingly should have dismissed the appeal *in limine*. However, this was not done. Instead, **the appeal was heard only on the questions urged by the appellant u/s 260A(2)(c), which is not in line with the requirement contained in section 260A(4). The High Court, therefore, did not decide the appeal in conformity with the mandatory procedure prescribed in section 260A.**
13.	***Spinacom India (P.) Ltd. v. CIT (2018) 258 Taxman 128 (SC)***	
	Issue	**Analysis & Decision**
	Can the delay in filing appeal u/s 260A be condoned where the stated reason for delay is the pursuance of an alternate remedy by way of filing an	The Supreme Court rejected the question of invoking section 14 of the Limitation Act 1963 which allows condonation of delay on demonstration of sufficient cause. The Supreme Court refused to accept the submission that the application before the ITAT u/s 254(2) was an alternate remedy to filing of the

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	application before the ITAT u/s 254(2) for rectification of mistake apparent on record?	application u/s 260A. The former is an application for rectifying a 'mistake apparent from the record' which is much narrower in scope than the latter. U/s 260A, an order of the ITAT can be challenged on substantial questions of law. The Supreme Court stated that the appellant had the option of filing an appeal u/s 260A while also mentioning in the Memorandum of Appeal that its application u/s 254(2) was pending before the ITAT. **The time period for filing an appeal u/s 260A does not get suspended on account of the pendency of an application before the ITAT u/s 254(2).**
14.	***SAP Labs India Pvt. Ltd. v. ITO (and other appeals) [2023] 454 ITR 121 (SC)***	
	Issue	**Analysis and Decision**
	In an appeal u/s 260A, is the High Court precluded from examining the correctness of the determination of the ALP on the ground that once the Tribunal determines the ALP, the same is final and cannot be the subject matter of scrutiny by the High Court as it does not give rise to a substantial question of law?	The Apex Court laid down the following with respect to the powers of High Court to consider the substantial question of law involving determination of ALP :- - While determining the ALP, the Tribunal has to follow the guidelines stipulated under Chapter X of the Income-tax Act, 1961, namely, sections 92 to 92F of the Act and Rules 10A to 10E of the Rules. Any determination of the ALP under Chapter X not in accordance with the relevant provisions of the Income-tax Act and Rules can be considered as perverse and it may be considered as a substantial question of law as perversity itself can be said to be a substantial question of law. Therefore, there cannot be any absolute proposition of law that in all cases where the Tribunal has determined the ALP, the same is final and cannot be the subject matter of scrutiny by the High Court in an appeal u/s 260A. When the determination of the ALP is challenged before the High Court, it is always open for the High Court to consider and examine whether the ALP has been determined while taking into consideration the relevant guidelines under the Act and the Rules. - The High Court can also examine the question of comparability of two companies or selection of filters and examine whether the same is done judiciously and on the basis of the relevant material/ evidence on record. The High Court can also examine whether the comparable transactions have been taken into consideration properly or not,

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		i.e., to the extent as to whether non-comparable transactions are considered as comparable transactions or not. Therefore, the view taken by the Karnataka High Court in the case of *Softbrands India (P.) Ltd.* that in the transfer pricing matters, the determination of the ALP by the Tribunal is final and cannot be subject matter of appeal under section 260A cannot be accepted. In an appeal challenging the determination of the arm's length price, it is always open for the High Court to examine in each case, within the parameters of section 260A, whether while determining the ALP, the guidelines laid down under the Income-tax Act and the Rules are followed or not and whether the determination of the ALP and the findings recorded by the Tribunal while determining the ALP are perverse or not.

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TEST YOUR KNOWLEDGE

Questions

1. *"SVS Propcon" did not make a claim of ₹ 20 lakhs in the return of income filed for A.Y. 2026-27 which was disallowed in the previous assessment year under section 43B. However, the said claim was also not considered by the Assessing Officer during assessment proceedings on the ground that no revised return was filed. Can the assessee now make such claim before the appellate authority?*

2. *Examine the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961:*

   (i) An appeal before Income-tax Appellate Tribunal cannot be decided in the event of difference of opinion between the Judicial Member and the Accountant Member on a particular ground.

   (ii) A High Court does not have an inherent power to review an earlier order passed by it on merits.

3. *Does the Income-tax Appellate Tribunal have the following powers?*

   (i) Power to allow the assessee to urge any ground of appeal which was not raised by him before the Commissioner (Appeals).

   (ii) Power to recall its own order solely for rectification of mistake apparent from the records.

4. *Can a rectification order under section 254 of the Income-tax Act, 1961 be passed by the Income-tax Appellate Tribunal beyond 6 months from the end of the month in which the order sought to be rectified was passed?*

5. *What do you mean by substantial question of law? Examine.*

6. *An Income-tax authority did not file an appeal to the Income-tax Appellate Tribunal against an order of the Commissioner (Appeals) decided against the Income-tax department on a particular issue in case of one assessee, Alpi for assessment year 2025-26 on the ground that the tax effect of such dispute was less than the monetary limit prescribed by CBDT. In assessment year 2026-27, similar issue arose in the assessments of Alpi and her sister Palki, which was decided by the Commissioner (Appeals) against the Department. Can the Income-tax department move an appeal to the Tribunal in respect of A.Y. 2026-27 against the orders of the Commissioner (Appeals) for Alpi and her sister Palki?*

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7. *A petition for stay of demand was filed by XYZ Ltd. before the Income-tax Appellate Tribunal in respect of a disputed demand for which appeal was pending before it. The Appellate Tribunal granted stay vide order dated 1.1.2025 for a period of 180 days from the date of such order, on deposit of 20% of the amount of tax by XYZ Ltd. Thereafter, the bench was functioning intermittently till 1.2.2026 and therefore, the disputed matter could not be disposed of. In the meanwhile, in June 2025, XYZ Ltd. had made an application for extension of stay and was granted extension of stay upto 31.12.2025. Thereafter, on 5.1.2026, the Assessing Officer attached the bank account of XYZ Ltd. and recovered the amount of ₹ 15 lakhs against the arrear demand of ₹ 25 lakhs. The company requested the Assessing Officer to refund the amount as it holds stay over it. The Assessing Officer, however, rejected the contention of the assessee stating that the stay period expired on 31.12.2025, after which the order of stay stood vacated automatically. Examine the correctness of contention of the Assessing Officer.*

8. *An assessee who had been served with an order of assessment passed under section 143(3) on 1.1.2026 had filed an application against this order before the CIT as per section 264 on 11.1.2026. However, the CIT refused to entertain the application on the pretext of premature application. Assessee seeks your opinion.*

9. (a) *The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143. During the pendency of proceedings before the Commissioner, on the basis of material gathered during survey under section 133A after issue of the first notice, the Commissioner of Income-tax issued a second notice, the contents of which were different from the contents of the first notice. Examine whether the action of the Commissioner is justified as to the second notice.*

   (b) *Examine the circumstances where the appellant shall be entitled to produce additional evidence, oral or documentary, before the Commissioner of Income-tax (Appeals) other than the evidence produced during the proceedings before the Assessing Officer.*

10. *Examine the correctness or otherwise of the following propositions in the context of the Income-tax Act, 1961:*

    (a) *The powers of the Commissioner of Income-tax (Appeals) to enhance the assessment are plenary and quite wide.*

    (b) *At the time of hearing of rectification application, the Income-tax Appellate Tribunal can re-appreciate the evidence produced during the proceedings of the appeal hearing.*

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(c) The High Court cannot interfere with the factual finding recorded by the lower authorities and the Tribunal, without any valid reasons.

11. An assessee, who is aggrieved by all or any of the following orders, is desirous to know the available remedial recourse and the time limit against each order under the Income-tax Act, 1961:

(i) passed under section 143(3) by the Assessing Officer.

(ii) passed under section 263 by the Commissioner of Income-tax.

(iii) passed under section 272A by the Director General.

(iv) passed under section 254 by the ITAT.

12. Who can file memorandum of cross-objections before the Income-tax Appellate Tribunal? What is the time limit? What is the fee for filing memorandum of cross objections?

Answers

1. Yes, the assessee is entitled to raise additional claims before the appellate authorities.

The restriction that an additional claim has to be made by filing a revised return applies only in respect of a claim made before the Assessing Officer. An assessee cannot make a claim before the Assessing Officer otherwise than by filing a revised return. It was so held by the Supreme Court in *Goetze (India) Ltd v. CIT (2006) 284 ITR 323.*

However, this restriction does not apply to an additional claim made before an appellate authority. The appellate authorities have jurisdiction to permit additional claims before them, though, the exercise of such jurisdiction is entirely the authorities' discretion. It was so held by the Bombay High Court in *CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336. This view is also endorsed by the Supreme Court in case of Wipro Finance Ltd. v. CIT (2022) 443 ITR 250.*

Thus, an additional claim can be raised before the Appellate Authority even if no revised return is filed.

2. **(i)** **The statement given is not correct.** As per the provisions of section 255, in the event of difference in opinion between the members of the Bench of the Income-tax Appellate Tribunal, the matter shall be decided on the basis of the opinion of the majority of the members. In case the members are equally divided, they shall state the point or points of difference and the case shall be referred by the President of the Tribunal for hearing on such points by one or more of the other members of the Tribunal. Such point or

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points shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who had first heard it.

(ii) **The statement given is not correct.** The Supreme Court, in *CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112*, observed that the power of review would inhere on High Courts, being courts of record under article 215 of the Constitution of India. There is nothing in article 226[2] of the Constitution to preclude a High Court from exercising the power of review which is inherent in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it. The Supreme Court further observed that section 260A(7) does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under section 260A. The Supreme Court opined that this does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.

3. **(i)** The Income-tax Appellate Tribunal has the power to entertain question raised for the first time. The Tribunal is not confined only to the issues arising out of the appeal before the Commissioner (Appeals). It has the power to allow the assessee to urge any ground not raised before the Commissioner (Appeals). However, the relevant facts in respect of such ground should be on record. The decision of the Supreme Court in the case of *National Thermal Power Company Limited vs. CIT (1998) 229 ITR 383 (SC)* supports this view.

(ii) The Delhi High Court, in *Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243* observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in *Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466,* dealing with the Tribunal's power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to

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review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then, it is the duty of the Tribunal to set it right. The Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety, if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

4. The issue as to whether a rectification order can be passed by the Income-tax Appellate Tribunal under section 254 beyond six months from the end of the month in which order sought to be rectified was passed, has been addressed in *Sree Ayyanar Spinning and Weaving Mills Ltd. v. CIT (2008) 301 ITR 434 (SC)*. Section 254(2), dealing with the power of the Appellate Tribunal to pass an order of rectification of mistakes, is in two parts. The first part refers to the *suo motu* exercise of the power of rectification by the Appellate Tribunal, whereas the second part refers to rectification on an application filed by the assessee or Assessing Officer bringing any mistake apparent from the record to the attention of the Appellate Tribunal.

If Income-tax Appellate Tribunal, *suo moto,* makes the rectification of its order, then the order has to be passed within 6 months from the end of the month in which the order sought to be rectified was passed. Where the application for rectification is made by the Assessing Officer or the assessee within 6 months from the end of the month in which the order sought to be rectified was passed, the Appellate Tribunal is bound to decide the application on merits and not on the ground of limitation i.e. order can be passed after expiry of 6 months from the end of the month in which the order sought to be rectified was passed. However, the application for rectification cannot be filed belatedly after 6 months from the end of the month in which the order sought to be rectified was passed. [*Ajith Kumar Pitaliya vs ITO (2009) 318 ITR 182 (M.P.)]*

5. The expression "substantial question of law" has not been defined anywhere in the Act. However, it has acquired a definite meaning through various judicial pronouncements. The tests are:

(1) whether directly or indirectly it affects substantial rights of the parties; or

(2) the question is of general public importance; or

(3) whether it is an open question in the sense that issue is not settled by the pronouncement of the Supreme Court or Privy Council or by the Federal Court; or

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(4) the issue is not free from difficulty; or

(5) it calls for a discussion for alternative view.

6. Under section 268A(1), the CBDT is empowered to issue orders, instructions or directions to the other income-tax authorities, fixing such monetary limits, as it may deem fit, to regulate filing of appeal or application for reference by any income-tax authority.

Under section 268A(2), where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to above-mentioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of the same assessee for any other assessment year or any other assessee for the same or any other assessment year. Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.

In view of above provision, it would be in order for the Income-tax Department to move an appeal to the Tribunal against the orders of the CIT(A) in respect of A.Y. 2026-27 both for Alpi and Palki.

7. As per section 254(2A), the Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order subject to the condition that the assessee deposits not less than 20% of the amount of tax, interest, fee, penalty, or any other sum payable under the provisions of this Act, or furnishes security of equal amount in respect thereof.

No extension of stay shall be granted by the Appellate Tribunal, where such appeal is not so disposed of within the said period as specified in the order of stay, unless the assessee makes an application and has complied with the condition of depositing 20% of tax and the Appellate Tribunal is satisfied that the delay in disposing of the appeal is not attributable to the assessee, However, the aggregate of the period of stay originally allowed and the period of stay so extended cannot exceed 365 days and the Appellate Tribunal has to dispose of the appeal within the period or periods of stay so extended or allowed.

If such appeal is not so disposed of within 180 days or the period or periods extended not exceeding 365 days, the order of stay shall stand vacated after the expiry of such period or periods, **only if the delay in disposing of the appeal is attributable to the assessee.** It was so held by the Supreme Court in *DCIT v. Pepsi Foods Ltd (2021) 433 ITR 295.*

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Accordingly, if an appeal is not heard by the bench, due to the bench functioning intermittently, the delay is not attributable to XYZ Ltd. In such a case, though the extended stay period of 365 days expired on 31.12.2025, the recovery of ₹ 15 lakhs against the arrear demand of ₹ 25 lakhs made by the Assessing Officer on 5.1.2026 is not in order, since the delay in disposing of the appeal is not attributable to XYZ Ltd. Therefore, the contention of the Assessing Officer is not correct. The order of stay would stand vacated after 31.12.2025, only in a case where the delay in disposing of the appeal had been attributable to XYZ Ltd.

8. An assessee, who is aggrieved by the order of the Assessing Officer under section 143(3) passed on 1.1.2026, had moved an application for revision of order under section 264 on 11.1.2026. The order passed by the Assessing Officer under section 143(3) is an order appealable before the Joint Commissioner (Appeals) or the Commissioner (Appeals). The time limit for filing an appeal is 30 days from the date of order i.e., upto 31.1.2026. This time limit had not expired on 11.1.2026 and the assessee had also not waived his right to appeal while filing the application for revision on 11.1.2026 before the Commissioner of Income-tax. The application filed before the Commissioner of Income-tax for revision under section 264 by the assessee will only be considered when the conditions specified under section 264(4) have been complied with. One of the conditions is that the Commissioner shall not revise any order where an appeal against the order lies to the Joint Commissioner (Appeals) or Commissioner (Appeals) or Appellate Tribunal and the time within which such appeal may be made has not expired, unless the assessee has waived his right of appeal. In the present case, the time limit had not expired on 11.1.2026 and the assessee had also not waived the right to appeal while filing the application for revision before the Commissioner of Income-tax on 11.1.2026 under section 264. Therefore, the Commissioner's refusal to entertain such application is correct.

Note : *In practical situations, the Commissioner could have kept the proceedings in abeyance till the expiry of the time prescribed for filing appeal by the assessee and thereafter, could have assumed jurisdiction for making revision besides taking an undertaking from the assessee for waiving his right of appeal. In reality, taxpayers usually will not prefer revision in such short time period nor would the Commissioner reject the application, the moment it is received by him.*

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9. **(a)** The action of the Commissioner in issuing the second notice is not justified. The term "record" has been defined in clause (b) of *Explanation* 1 to section 263(1). According to this definition "record" shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the *Explanation* 1 to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner.

Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be "record" available at the time of examination as emphasized in *Explanation 1(b)* to section 263(1).

(b) As per Rule 46A(1) of the Income-tax Rules 1962, an appellant shall be entitled to produce before the Commissioner (Appeals), evidence, either oral or documentary, other than the evidence produced by him during the course of proceedings before the Assessing Officer, only in the following circumstances -

(a) where the Assessing Officer has refused to admit evidence which ought to have been admitted; or

(b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Assessing Officer; or

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(c) where the appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence which is relevant to any ground of appeal; or

(d) where the Assessing Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.

Further, no evidence shall be admitted unless the Commissioner (Appeals) records in writing the reasons for its admission.

10. (a) The proposition is correct in law. The Supreme Court has, in *CIT vs. McMilan & Co. (1958) 33 ITR 182 and CIT vs. Kanpur Coal Syndicate (1964) 53 ITR 225*, held that in disposing of an appeal before him, the appellate authority can travel over a whole range of the assessment order. The scope of his powers is co-terminus with that of the Assessing Officer. He can do what the Assessing Officer can do and can also direct him to do, what he has failed to do. He can assess income from sources which have been considered by the Assessing Officer but not brought to tax. He can consider every aspect of the assessment order and give appropriate relief.

The Allahabad High Court has, in *CIT v. Kashi Nath Chandiwala (2006) 280 ITR 318*, held that the appellate authority is empowered to consider and decide any matter arising out of the proceedings in which the order appealed against was passed notwithstanding the fact that such matter was not raised before him by the assessee. The Commissioner (Appeals) is entitled to direct additions in respect of items of income not considered by the Assessing Officer.

Further, the Apex Court has, in the case of *Jute Corporation of India Ltd. vs. CIT (1991)* 187 *ITR* 688, held that the appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter.

Thus, the powers of the Commissioner of Income-tax (Appeals) in enhancing the assessment are very wide and plenary.

(b) The proposition is not correct as per law. This is because section 254(2) specifically empowers the Appellate Tribunal to amend any order passed by it, either *suo-moto* or on an application made by the assessee or Assessing Officer, with a view to rectify any

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mistake apparent from record, at any time within **6 months** from the end of the month of the order sought to be amended.

The powers of the Tribunal under section 254(2) relating to rectification of its order are very limited. Such powers are confined to rectifying any mistake apparent from the record. The mistake has to be such that for which no elaborate reasons or inquiry is necessary. Accordingly, the re-appreciation of evidence placed before the Tribunal during the course of the appeal hearing is not permitted. It cannot re-adjudicate the issue afresh under the garb of rectification *[CIT vs. Vardhman Spinning (1997) 226 ITR 296 (P & H), CIT v. Ballabh Prasad Agarwalla (1998) 233 ITR 354 (Cal.) & Niranjan & Co. Ltd. v. ITAT (1980) 122 ITR 519 (Cal.)]*

(c) The proposition is correct in law. A finding of fact cannot be disturbed by the High Court in exercise of its powers under section 260A. The Income-tax Appellate Tribunal is the final fact finding authority and the findings of fact recorded by the Tribunal can be interfered with by the High Court under section 260A only on the ground that the same were without evidence or material, or if the finding is contrary to the evidence, or is perverse or there is no direct nexus between conclusion of fact and the primary fact upon which that conclusion is based.

In *CIT vs. P. Mohanakala (2007) 291 ITR 278 and M. Janardhana Rao v. Joint CIT (2005) 273 ITR 50*, the Apex Court observed that the High Court had set aside the factual findings of the lower authorities and the Tribunal without any valid reason. The Apex Court held that the findings of fact could not be interfered with by the High Court without carefully considering the facts on record, the surrounding circumstances and the material evidence. There is no scope for interference with the factual findings, unless the findings are *per se* without reason or basis, perverse and/or contrary to the material on record.

Hence, only if the issue gives rise to a substantial question of law, an appeal shall lie before the High Court.

11. (i) An assessee, aggrieved by the order passed under section 143(3) by the Assessing Officer, can file an appeal before the Joint Commissioner (Appeals) under section 246 or the Commissioner of Income-tax (Appeals) under section 246A(1), within 30 days of the date of service of the notice of demand relating to the assessment. However, where the assessee does not want to prefer an appeal, then he can move a revision

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petition before the Principal Commissioner or Commissioner of Income-tax under section 264 within a period of one year from the date of on which the order was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

(ii) An assessee, aggrieved by the order passed under section 263 by the Commissioner of Income-tax, can file an appeal to Income-tax Appellate Tribunal under section 253(1)(c) within two months from the end of the month in which order sought to be appealed against is communicated to the assessee.

(iii) An assessee, aggrieved by the order passed under section 272A by the Director General, can file an appeal before the Income-tax Appellate Tribunal under section 253(1)(c) within , two months from the end of the month in which order sought to be appealed against is communicated to the assessee.

(iv) An assessee, aggrieved by the order passed under section 254 by the Income-tax Appellate Tribunal, can file an appeal before the High Court under section 260A within 120 days from the date of receipt of order of Income-tax Appellate Tribunal, only where the order gives rise to a substantial question of law.

12. Section 253(4) of the Income-tax Act, 1961 gives the respondent (assessee or the Assessing Officer), in every appeal filed before the Income-tax Appellate Tribunal, a right to file a memorandum of cross-objections against any order of the Joint Commissioner (Appeals) or the Commissioner (Appeals). This right of filing a memorandum of cross-objections is an independent right given to the respondent in an appeal and is in addition to the right of appeal which may or may not be exercised by the assessee or the Assessing Officer under section 253(1) or section 253(2). The memorandum of cross-objections has to be in the prescribed form and verified in the prescribed manner and has to be filed within 30 days of the receipt of notice of the appeal. The Tribunal is empowered to permit filing of memorandum of cross-objections after the expiry of the prescribed period if sufficient cause is shown. Such memorandum of cross-objections will be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in section 253(3). There is no fee for filing a memorandum of cross-objections.

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CHAPTER 17

DISPUTE RESOLUTION

LEARNING OUTCOMES

After studying this chapter, you would be able to:

- **appreciate** the meaning of "specified order" and "specified conditions", to be satisfied for making an application before the Dispute Resolution Committee (DRC);
- **recognise** the need for DRC and its composition and terms;
- **comprehend** the procedure to be followed by the DRC;
- **comprehend** the powers of the DRC to reduce or waive penalty or grant immunity from prosecution.
- **know** the time limit for filing application and time limit for passing an order by the Assessing Officer in conformity with the directions issued by the DRC.

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CHAPTER OVERVIEW

17.1 INTRODUCTION

Constitution of DRC – providing early tax certainty

Income-tax Settlement Commission (ITSC) constituted by the Central Government for settlement of cases ceases to operate with effect from 1st February, 2021. Consequently, no application under section 245C for settlement of cases before the Settlement Commission can be made on or after 1st February, 2021. In order to dispose off the pending settlement applications as on 31.01.2021, the Central Government has constituted seven Interim Boards for Settlement vide Notification No. 91 of 2021 dated 10.08.2021.

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While pending disputes are being resolved or adjudicated through the Interim Boards for Settlement, it is also necessary to prevent tax disputes in future and settle the issues at initial stage. Therefore, in order to provide early tax certainty to small and medium taxpayers, with effect from 1st April, 2021, new scheme of Dispute Resolution has been formulated for constitution of one or more Dispute Resolution Committee(s) (DRC).

17.2 DISPUTE RESOLUTION COMMITTEE [SECTION 245MA]

(1) **Constitution of Dispute Resolution Committee (DRC) [Section 245MA(1)]:** The Central Government is empowered to constitute, one or more Dispute Resolution Committees, in accordance with the rules made under this Act, for dispute resolution in the case of such persons or class of persons, as may be specified by the Board, who may opt for dispute resolution under this Chapter in respect of dispute arising from any variation in the specified order in his case and who fulfils the specified conditions.

(I) **Constitution and Composition of DRC [Rule 44DAA]:** Part IX-AA – Dispute Resolution Committee has been inserted in the Income-tax Rules, 1962, which comprises of Rules 44DAA, 44DAB, 44DAC and 44DAD. Rule 44DAA provides that the Central Government shall constitute a DRC for every region of Principal Chief Commissioner of Income-tax for dispute resolution. Each DRC shall consist of 3 members, as under -

Each DRC to consist of 3 members

(a) 2 members shall be retired officers from the Indian Revenue Service (Income-tax), who have held the post of Commissioner of Income-tax or any equivalent or higher post for 5 years or more; and

(b) 1 serving officer not below the rank of Principal Commissioner of Income-tax or Commissioner of Income-tax as specified by the Board.

Decision by majority

The members shall be appointed by the Central Government for a period of **three years.** The decision of the DRC shall be by majority.

The Central Government may fix a sum to be paid as fee to a member, who is retired officer, on a per case basis, along with a sitting fee, so decided by the Board. The

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Central Government may remove any member from the DRC, by recording reasons in writing and after giving an opportunity of being heard.

(II) Application for resolution of dispute before the DRC [Rule 44DAB]: DRC would resolve dispute in the case of a person who opt for dispute resolution under Chapter XIX-AA in respect of dispute arising from any variation in the **specified order** in his case and **who fulfils the specified conditions**.

Such person has to make an application for resolution of dispute before the DRC in the prescribed form accompanied by a fee of ₹ 1,000.

Fees of ₹ 1,000

(a) **Specified order [Explanation (b) to the section 245MA read with Rule 44DAD(ii)]:** Specified order in relation to a dispute under section 245MA means:

(i) a draft order as referred to in section 144C(1) in respect of a person in whose case variation arises as a consequence to order of the TPO passed under section 92CA(3) or a non-corporate non-resident;

(ii) an intimation under section 143(1) after processing income-tax returns or under section 200A(1) after processing of TDS statements or section 206CB(1) after processing of TCS statements, where the assessee or the deductor or the collector objects to the adjustments made in the said order;

(iii) an order of assessment or reassessment, except an order passed in pursuance of directions of the Dispute Resolution Panel;

(iv) a rectification order made under section 154 having the effect of enhancing the assessment or reducing the loss; or

(v) an order made under section 201 or an order made under section 206C(6A) deeming a person as an assessee-in-default for failure to deduct/collect tax at source or remit the same as required under the Act, after deduction/collection.

The variation in the specified order relating to default in deduction or collection of tax at source would refer to the amount on which tax has not been deducted or collected in accordance with the Act.

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and in respect of which the following conditions are satisfied, namely:-

(A) the aggregate sum of variations proposed or made in such order does not exceed ₹ 10 lakhs;

Variations ≤ ₹ 10 lakhs

(B) the return has been furnished by the assessee for the assessment year relevant to such order and the total income as per such return does not exceed ₹ 50 lakhs; and

TI ≤ ₹ 50 lakhs

(C) the order in the case of the assessee is not based on,

(I) search initiated under section 132 of the Act or requisition made under section 132A of the Act in the case of the assessee or any other person; or

(II) survey carried out under section 133A of the Act; or

(III) information received under an agreement referred to in section 90 or 90A

(b) Specified conditions [*Explanation (a)* to the section 245MA]: Specified conditions" in relation to a person means a person who fulfils the following conditions:

(i) He should **not** be a person,

(A) in respect of whom an order of detention has been made under the provisions of the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

COFEPOSA

Such order of detention should not have been revoked before the expiry of the time stipulated under the relevant provisions of such Act, either on the basis of report of Advisory Board or review under the relevant provisions of that Act. Further, such order of detention should not have been set aside by a court of competent jurisdiction.

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The proviso to clause (a)(I)(A) of Explanation to section 245MA reads as follows -

(i) such order of detention, being an order to which the provisions of section 9 or section 12A of the said Act do not apply, has been revoked on the report of the Advisory Board under section 8 of the said Act or before the receipt of the report of the Advisory Board; or

(ii) such order of detention being an order to which the provisions of section 9 of the said Act apply, has not been revoked before the expiry of the time for, or on the basis of, the review under section 9(3), or on the report of the Advisory Board under section 8, read with section 9(2), of the said Act; or

(iii) such order of detention, being an order to which the provisions of section 12A of the said Act apply, has not been revoked before the expiry of the time for, or on the basis of, the first review under sub-section (3) of the said section, or on the basis of the report of the Advisory Board under section 8, read with section 12A(6), of the said Act; or

(iv) such order of detention should not have been set aside by a court of competent jurisdiction;

Note - Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 provides for preventive detention in certain cases for the purposes of conservation and augmentation of foreign exchange and prevention of smuggling activities and for matters connected therewith. Under this Act, the Central and State Government are empowered to detain a person (including a foreigner) to prevent such a person from smuggling of goods or acting in a manner prejudicial to conservation of foreign exchange.

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(B) in respect of whom prosecution for any offence punishable under the provisions of the Indian Penal Code ***(Bharatiya Nyaya Sanhita, 2023)***, the Unlawful Activities (Prevention) Act, 1967, the Narcotic Drugs and Psychotropic Substances Act, 1985, the Prohibition of Benami Transactions Act, 1988, the Prevention of Corruption Act, 1988 or the Prevention of Money-laundering Act, 2002 has been instituted and he has been convicted of any offence punishable under any of those Acts;

Prosecution under other Acts

(C) in respect of whom prosecution has been initiated by an income-tax authority for any offence punishable under the provisions of this Act or the Indian Penal Code ***(Bharatiya Nyaya Sanhita, 2023)*** or for the purpose of enforcement of any civil liability under any law for the time being in force, or such person has been convicted of any such offence consequent upon the prosecution initiated by an income-tax authority;

(D) who is notified under section 3 of the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992;

(ii) He should fulfill such other conditions, as may be prescribed.

Rule 44DAD(iii) provides that the **"specified conditions"** in relation to a person who opts for dispute resolution under section 245MA, means a person in respect of whom:

(A) the conditions mentioned in (b) above are satisfied.

(B) **proceedings** under the **Black Money** (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 have **not** been **initiated** for the **assessment year for which resolution of dispute is sought.**

(c) Specified Person: Rule 44DAD(iv) provides that the specified person is a person who fulfils the specified conditions

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(III) **Time limit for filing application** - Such application has to be filed –

	Case	Time limit
(i)	In cases where appeal has already been filed and is pending before the Commissioner (Appeals)	within such time from the date of constitution of the Dispute Resolution Committee, as may be specified by the Board
(ii)	in any other case	within **one month from the date of receipt** of **specified order**

(IV) **Screening of application by DRC**

Serve SCN before rejection

(i) **Examination of application** - The DRC has to examine the application with respect to the specified conditions and criteria for specified order. Upon such examination, where the DRC considers that the application for dispute resolution should be rejected, it has to serve a notice calling upon the assessee to show cause as to why his application should not be rejected, specifying a date and time for filing a response.

(ii) **Provision of opportunity of being heard** - The assessee can request for an opportunity of being heard. If the DRC receives a request from the assessee, it has to provide him an opportunity of being heard through video telephony or video conferencing facility, to the extent technologically feasible.

(iii) **Furnishing response to show cause notice within the specified date** -The assessee has to furnish a response to the show-cause notice referred to in (i) above within the specified date and time or such extended time as may be allowed on the basis of application made in this behalf, to the DRC;

(iv) **Rejection of application by DRC** - The DRC may, after considering the response furnished by the assessee, reject the application or proceed to decide the application on merits in accordance with the procedure laid out in (V) and (VI) hereinafter. Where no such response is furnished by the assessee, the DRC may reject the application.

Note - In such a case, the assessee may file an appeal to the Commissioner (Appeals). The period taken by the DRC in deciding on the admission has to be excluded from the period available to file such appeal.

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(v) **Communication of decision of DRC to assessee** - The decision of the DRC that the application for dispute resolution should be allowed to be proceeded with or rejected, has to be communicated to the assessee on his registered e-mail address;

(vi) **Submission of proof of withdrawal of appeal/application before DRP** - Within 30 days of receipt of the communication that the application is admitted, the assessee is required to submit a proof of withdrawal of appeal filed under section 246A or withdrawal of application before the Dispute Resolution panel, if any, to the DRC or convey that there is no aforesaid proceeding pending in his case. If the assessee fails to do so, the DRC may reject the application.

(V) <u>Procedure to be followed by the DRC</u>

(i) **Calling for records for further examination** - Upon admission of the application and subsequent to the receipt of the response of the assessee, the DRC may call for records from the income-tax authority and further examine, as it may deem fit, with respect to the issues covered in the application;

Call for records from ITA

(ii) **Seeking report from Assessing Officer** - The DRC may seek a report from the Assessing Officer on the issues covered in the application or on any other issue arising during the course of proceedings;

(iii) **Calling for further information** - The DRC may before disposing off the application, call for further information from the assessee or any other person by sending an email to his registered email address;

(iv) **Submission of response within specified time** - The assessee has to electronically submit its response to the DRC, within the time specified or such time as may be extended by the DRC on the basis of an application in this behalf;

(v) **Decision of DRC** - After considering the material available on record, including any further information or evidence received from the assessee, income-tax authority or any other person, the DRC may decide —

Issue order making modifications not prejudicial to assessee

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(a) to **make modifications to the variations in specified order**, which are not prejudicial to the interest of the assessee, and decide for waiver of penalty and immunity from prosecution in accordance with the provisions of Rule 44DAC, and pass an order of resolution, accordingly; or

(b) to **not make modifications to the variations in the specified order**. However, the DRC may decide to waive penalty and grant immunity from prosecution provisions in accordance with the provisions of Rule 44DAC and pass an order of resolution accordingly. Such an order will be treated as an order not prejudicial to the interest of the assessee; or

(c) to **not make any modification to the specified order and pass an order disposing off the application**. Such an order will be treated as an order 'not prejudicial to the interest of the assessee',

within six months from the end of the month in which application for dispute resolution is admitted by the DRC. The order of the DRC for the resolution of a dispute has to be in accordance with the provisions of the Act.

Issue order within 6 months from the end of month in which application admitted

(vi) **Serving copy of order to AO and assessee** - The DRC has to serve a copy of the order of resolution or order disposing off the application, as the case may be, upon the assessee and also the Assessing Officer for giving effect to the same, if so required;

(vii) **No appeal or reference will lie against the modified order -** Where the specified order is an order of the eligible assessee as referred to in section 144C(1), the assessee will not be eligible to file any reference to the DRP or an appeal to the Commissioner (Appeals) against the modified order.

(viii) **Serving copy of modified order to assessee** – The Assessing Officer has to serve a copy of the modified order along with notice of demand upon the assessee specifying a date for making payment of demand. No appeal or revision would lie against the modified order.

AO to serve modified order + Notice of demand to assessee

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(ix) **Assessee to furnish proof of payment of demand** -The assessee has to furnish proof of payment of the said demand to the DRC and also to the Assessing Officer.

(x) **Grant of immunity from prosecution and waiver of penalty** – The DRC shall, on receipt of **confirmation** of payment of demand, by an order in writing, grant immunity from prosecution and waiver of penalty if applicable, in accordance with the provisions of rule 44DAC [discussed later on in this chapter].

(VI) **Termination of dispute resolution proceedings:** The DRC may, at any stage of the dispute resolution proceedings, if considered necessary, for reasons to be recorded in writing and after giving an opportunity of being heard to the assessee, decide to terminate the dispute resolution proceedings if, -

(i) the assessee fails to cooperate during the course of dispute resolution proceedings; or

(ii) the assessee fails to respond to, or submit any information in response to, a notice issued to him; or

(iii) the Committee is satisfied that the assessee has concealed any particular material to the proceedings or had given false evidence.

(iv) the assessee fails to pay the demand as required in notice of demand.

Where the dispute resolution proceedings are terminated, the DRC has to intimate the income-tax authority for taking necessary action as per the provisions of the Act.

(2) **Powers to reduce or waive any penalty imposable under this Act or grant immunity from prosecution [Section 245MA(2)]:** The Dispute Resolution Committee, subject to such conditions, as may be prescribed, shall have the powers to reduce or waive any penalty imposable under the Income-tax Act, 1961 or grant immunity from prosecution for any offence punishable under the Act in case of a person whose dispute is resolved under Chapter XIX-AA. Accordingly, Rule 44DAC prescribes the following:

(i) **Conditions for grant of waiver of penalty or immunity from prosecution** - The DRC, upon receipt of confirmation from the assessee of payment of demand, should grant to the person who made the application for dispute resolution under section 245MA, waiver of penalty imposable or immunity from prosecution or both, in respect of the order which is the subject matter of resolution, if it is satisfied that such person has,

Paid full tax + co-operated with DRC

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- **paid the tax due on the returned income in full** if available; and
- **co-operated with the DRC** in the proceedings before it.

(ii) **Reasons to be recorded in writing -** The DRC would grant such waiver of penalty or immunity from prosecution or both, subject to such conditions as it may think fit to impose for the reasons to be recorded in writing.

(iii) **No immunity if prosecution proceedings were initiated before application** - No immunity would, however, be granted by the DRC in a case where the proceedings for the prosecution for an offence have been initiated before the date of receipt of the application for dispute resolution from the assessee fulfilling the specified conditions.

(iv) **Withdrawal of immunity** - An immunity granted to a person would stand withdrawn, if such person fails to comply with any of the conditions subject to which the immunity was granted. On such withdrawal, the provisions of the Income-tax Act, 1961 would apply as if such immunity or waiver had never been granted.

(3) **Time limit for passing an order by Assessing Officer in conformity with directions issued by the DRC [Section 245MA(2A)]:** Upon receipt of the order of the Dispute Resolution Committee under this section, the Assessing Officer shall:

Within 1 month from the end of month in which DRC order received

(a) in a case where the specified order is a draft of the proposed order of assessment under section 144C(1), pass an order of assessment, reassessment or recomputation or

(b) in any other case, modify the order of assessment, reassessment or recomputation,

in conformity with the directions contained in the order of the DRC within a **period of one month from the end of the month** in which such order is received.

An eligible assessee (being any person in whose case variation arises as a consequence of order of Transfer Pricing Officer and any non-resident or a foreign company) may opt for approaching either the Dispute Resolution Panel under section 144C or the DRC under section 245MA. Accordingly, the Assessing Officer shall pass the final order in conformity with the order by the DRC within a period of one month from the end of the month in which such order is received.

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(4) Faceless Scheme for Dispute Resolution: The Central Government may make a scheme, by notification[1] in the Official Gazette, for the purposes of dispute resolution under this Chapter, so as to impart greater efficiency, transparency and accountability by -

(a) eliminating the interface between the Dispute Resolution Committee and the assessee in the course of dispute resolution proceedings to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialization;

(c) introducing a dispute resolution system with dynamic jurisdiction.

[1] *Accordingly, e-Dispute Resolution Scheme, 2022 was notified vide Notification No. 27/2022, dated 5.4.2022*

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TEST YOUR KNOWLEDGE

Questions

1. *What is the need for constitution of Dispute Resolution Committee (DRC)? Can an assessee make an application before DRC against an order which is based on information received under an agreement referred to in section 90 or section 90A?*

2. *Can an assessee opt for dispute resolution before DRC if prosecution for any offence punishable under the provisions of the Indian Penal Code has been instituted against him and he has been convicted in respect of the same under the said Act?*

3. *Mr. Vijay furnished his return of income for A.Y.2025-26 declaring total income of ₹ 28,00,000. He received an assessment order under section 143(3) on 26.11.2026 enhancing the total income for the A.Y.2025-26 by ₹ 5,00,000. He is aggrieved by the said order and is desirous of knowing whether he can file an application before the Dispute Resolution Committee (DRC). He informs you that no order of detention has been made and no prosecution proceedings have been initiated or instituted against him under any law for the time being in force. However, penalty under section 271D has been levied on him for failure to comply with the provisions of section 269SS.*

   Can Mr. Vijay file an application before the DRC?

   (i) If yes, what is the time limit for making an application to DRC against such order under the Income-tax Act, 1961. He is also keen to know, whether, in case he is aggrieved by the order passed by the DRC, can he file appeal against such order of DRC?

   (ii) Would your answer be different, if assessment order is based on information received under a DTAA with Country X?

Answers

1. In order to provide early tax certainty to small and medium taxpayers, Dispute Resolution has been formulated for constitution of one or more Dispute Resolution Committee(s) (DRC).

Specified order *inter alia* does not include an order which is based on information received under an agreement referred to in section 90 or section 90A. Thus, an assessee can not opt for dispute resolution before DRC in respect of an order which is based on information received under an agreement referred to in section 90 or section 90A.

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2. Dispute Resolution Committee would resolve dispute in the case of such persons or class of persons, as may be specified by the Board, who may opt for dispute resolution under this Chapter in respect of dispute arising from any variation in the specified order in his case and who fulfils the specified conditions.

Specified conditions include the condition that the person should not be a person in respect of whom prosecution for any offence punishable under the provisions of the Indian Penal Code has been instituted and he has been convicted of any offence punishable under the said Act.

Thus, a person in respect of whom any prosecution has been instituted and who is convicted of any offence punishable under the Indian Penal Code, cannot opt for resolution of dispute in respect of specified order before DRC.

3. Dispute Resolution Committee (DRC) would resolve dispute in the case of a person who opts for dispute resolution under Chapter XIX-AA in respect of dispute arising from any variation in the specified order in his case and who fulfils the specified conditions. Specified order includes an assessment order passed under section 143(3), where the aggregate sum of variations made *vide* such order does not exceed ₹ 10 lakh; the total income as per such return furnished by the assessee for the assessment year relevant to such order does not exceed ₹ 50 lakhs and such order is not based on search or requisition or survey or any information received under a DTAA.

Accordingly, in the present case, Mr. Vijay can file an application before DRC, since the assessment order received on 26.11.2026 is a specified order and he satisfies the specified conditions on account of no order of detention being made and no prosecution proceedings being initiated or instituted against him. Non-levy of penalty under income-tax law is not a specified condition, therefore, the levy of penalty under section 271D on him does not result in non-compliance with the specified condition. Mr. Vijay has to file an application for resolution of dispute in the prescribed form on or before 25.12.2026 i.e., within one month from the date of receipt of the specified order.

However, once a modified order is passed by the DRC, no appeal or revision would lie against such order.

If assessment order is based upon the information received under an DTAA entered with India, Mr. Vijay, will not be eligible to make an application before DRC, since it is not a specified order.

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CHAPTER 18

MISCELLANEOUS PROVISIONS

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the permissible mode of taking or accepting certain loans, deposits and money receivable in relation to transfer of immovable property and **examine** the penal consequences for non-compliance;
- **recognize** the permissible mode of receipt of amounts exceeding a certain threshold limit and **examine** the penal consequences for receipt of such amount by any other mode;
- **identify** the permissible mode of repayment of certain loans or deposit or advance money repayable in relation to transfer of immovable property and **examine** the penal consequences for non-compliance;
- **appreciate** the provisions relating to provisional attachment of property to protect the interest of the revenue;
- **list out** the permissible modes of service of notice and the persons on whom notice should be served;
- **comprehend** the meaning of "specified financial transaction" and **identify** the specified persons responsible for furnishing statement of financial transaction or reportable account;
- **list out** the persons who can act as "authorised representatives" on behalf of the assessee.

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CHAPTER OVERVIEW

- Mode of taking or accepting loan, deposit and specified sum [Section 269SS]
  - Penalty u/s 271D attracted for non-compliance
- Mode of repayment of certain loan or deposits [Section 269T]
  - Penalty u/s 271E attracted for non-compliance
- Mode of undertaking transactions [Section 269ST]
  - Penalty u/s 271DA attracted for non-compliance
- Facility for accepting payment through prescribed electronic modes [Section 269SU]
  - Penalty u/s 271DB attracted for non-compliance
- Statements by producers of cinematograph films or persons engaged in specified activity [Section 285B]
- Statement of Financial Transaction or Reportable Account [Section 285BA]
- Information on transaction of Crypto-Asset [Section 285BAA]
- Annual Information Statement [Section 285BB]
- Transfers to defraud revenue void [Section 281]
- Provisional Attachment to protect the interest of the Revenue [Section 281B]
- Service of Notice [Sections 282, 283 & 284]
- Authentication of notices and other documents [Section 282A]
- Notice deemed to be valid in certain circumstances [Section 292BB]
- Other Miscellaneous Provisions Sections 287, 287A, 288, 290, 291, 292, 293, 292A, 292B, 292C, 293C, 294, 295 and 296

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18.1 MODE OF TAKING OR ACCEPTING CERTAIN LOANS, DEPOSITS AND SPECIFIED SUM [SECTION 269SS]

Section 269SS provides that no person shall take or accept any loan or deposit or specified sum from any other person (depositor) except by account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account or through such other prescribed electronic mode, if –

Loan, deposit and specified sum of ₹ 20,000 or more received otherwise than by specified modes attracts penalty

(1) The amount of such loan or deposit or specified sum or the aggregate amount of such loan, deposit of specified sum**; or**

(2) On the date of taking or accepting such loan or deposit or specified sum, any loan or deposit or specified sum taken or accepted earlier by such person from the depositor is remaining unpaid (whether repayment has fallen due or not), the amount or the aggregate amount remaining unpaid; **or**

(3) The amount or the aggregate amount referred to in (1) together with the amount or the aggregate amount referred to in (2)

is **₹ 20,000 or more**.

However, **higher limit of ₹ 2,00,000** is applicable in case of any deposit or loan where, -

Higher limit of ₹2,00,000 for deposit accepted by/ loan taken from PACS or PCARD

- such deposit is accepted by a primary agricultural credit society (PACS) or a primary cooperative agricultural and rural development bank (PCARD) from its member or
- a loan is taken from a primary agricultural credit society or a primary cooperative agricultural and rural development bank by its member.

Non-applicability of the above requirement in certain cases

(1) Loan or deposit or specified sum taken or accepted from, or any loan or deposit taken from or accepted by

- the Government;
- any banking company;

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- post office saving bank or
- any co-operative bank,
- any corporation established by a Central, State or Provincial Act or any Government company as defined in 2(45) of the Companies Act, 2013.
- any institution, association or body or class of institutions, associations, bodies which the Central Government may, for reasons to be recorded in writing notify in this behalf in the Official Gazette.

Govt. Bank, PO, Co-operative bank and farmers excluded.

(2) Cases where the persons involved in the transaction derive income **only** from agriculture or where neither of them has any income chargeable to tax under the Act.

Meaning of certain terms

	Term	Meaning
(i)	Loan or deposit	Any loan or deposit of money
(ii)	Specified sum	any sum of money receivable, whether as advance or otherwise, in relation to transfer of immovable property, whether or not the transfer takes place.
(iii)	Prescribed electronic modes (for the purposes of section 269SS, 269ST and 269T)	(a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) UPI (Unified Payment Interface); (f) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer), and (h) BHIM (Bharat Interface for Money) Aadhar Pay.

Penalty for failure to comply with the provisions of section 269SS [Section 271D]

If a person takes or accepts any loan or deposit or specified sum in contravention of the provisions of section 269SS, he shall be liable to pay, by way of penalty under section 271D, a sum of equal to the amount of the loan or deposit or specified sum taken or accepted. Further, any such penalty shall be imposed by the ***Assessing Officer***.

Penalty = Amt. of loan, deposit or specified sum

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18.2 MODE OF UNDERTAKING TRANSACTIONS [SECTION 269ST]

Section 269ST provides that no person receive an amount of **₹ 2,00,000** or more except by account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account or through such other prescribed electronic mode, –

(a) in aggregate from a person in a day; or

(b) in respect of a single transaction; or

(c) in respect of transactions relating to one event or occasion from a person.

Circulars

(1) **The CBDT has, vide Circular No. 22/2017 dated 3.7.2017**, clarified that in respect of receipt by **Non-banking Finance Companies(NBFCs) or Housing Finance Companies (HFCs)** in the nature of repayment of loan, the receipt of one instalment of loan repayment in respect of a loan shall constitute a 'single transaction' as specified in clause (b) of section 269ST and all the instalments paid for a loan shall not be aggregated for the purposes of determining applicability of the provisions section 269ST.

Installments not to be aggregated

(2) The CBDT has, vide Circular No. 25/2022 dated 30.12.2022, clarified that in respect of Co -operative Societies, a dealership/ distributorship contract by itself may not constitute an event or occasion for the purposes of clause (c) of section 269ST.

Moreover, the receipt related to such a dealership/distributorship contract by the Co-operative Society on any day in a previous year, which is within 'the prescribed limit' and complies with clause (a) as well as clause (b) of section 269ST, may not be aggregated across multiple days for purposes of (c) of section 269ST for that previous year.

Non-applicability of the above requirement in certain cases

(1) any receipt by Government, any banking company, post office savings bank or co-operative bank

(2) transactions of the nature referred to in section 269SS.

(3) such other persons or class of persons or receipts, notified by the Central Government.

Receipt by Govt. Bank, PO and Co-operative bank excluded

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Accordingly, vide Notification No. 28/2017, dated 5-4-2017 and Notification No. 57/2017, dated 3-7-2017, the Central Government has specified that the provision of section 269ST **shall not apply** to the following, namely:-

(a) receipt (cash withdrawals) by any person from a bank, co-operative bank or a post office savings bank

(b) receipt by a business correspondent on behalf of a banking company or co-operative bank, in accordance with the guidelines issued by the Reserve Bank of India;

(c) receipt by a white label automated teller machine operator from retail outlet sources on behalf of a banking company or co-operative bank, in accordance with the authorisation issued by the Reserve Bank of India under the Payment and Settlement Systems Act, 2007;

(d) receipt from an agent by an issuer of pre-paid payment instruments, in accordance with the authorisation issued by the Reserve Bank of India under the Payment and Settlement Systems Act, 2007;

(e) receipt by a company or institution issuing credit cards against bills raised in respect of one or more credit cards;

(f) receipt which is not includible in the total income under section 10(17A).

Penalty for failure to comply with the provisions of section 269ST [Section 271DA]

If a person receives any sum in contravention of the provisions of section 269ST, he shall be liable to pay, by way of penalty under section 271DA, a sum equal to the amount of such receipt. However, no penalty shall be imposed if such person proves that there were good and sufficient reasons for the contravention. Further, any such penalty shall be imposed by the ***Assessing Officer***.

Penalty = Amount received in contravention of section 269ST

Circular

Applicability of income-tax provisions under section 40A(3), section 269ST and Rule 114B to cash sale of agricultural produce by cultivators/agriculturists to traders [Circular No. 27/2017, dated 3-11-2017]

The provisions of section 40A(3) provide for the disallowance of expenditure exceeding ₹ 10,000 made otherwise than by an account payee cheque/draft or use of electronic clearing system through a bank account. However, Rule 6DD carves out certain exceptions from application of the provisions of section 40A(3) in some specific cases and circumstances, which, *inter alia*, include payments made for purchase of agricultural produce to the cultivators of such produce. Therefore,

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no disallowance under section 40A(3) can be made if the trader makes cash purchases of agricultural produce from the cultivator.

Further, section 269ST, subject to certain exceptions, prohibits receipt of ₹ 2 lakh or more, otherwise than by an account payee cheque/draft or by use of electronic clearing system through a bank account from a person in a day or in respect of a single transaction or in respect of transactions relating to an event or occasion from a person. Therefore, any cash sale of an amount of ₹ 2 lakh or more by a cultivator of agricultural produce is prohibited under section 269ST.

Furthermore, the provisions relating to quoting of PAN or furnishing of Form No. 60 under Rule 114B do not apply to the sale transaction of ₹ 2 lakh or less.

In view of the above, it is clarified by the CBDT that cash sale of the agricultural produce by its cultivator to the trader for an amount less than ₹ 2 lakh will not-

(a) result in any disallowance of expenditure under section 40A(3) in the case of trader.

(b) attract prohibition under section 269ST in the case of the cultivator; and

(c) require the cultivator to quote his PAN or furnish Form No. 60.

18.3 FACILITY FOR ACCEPTING PAYMENT THROUGH PRESCRIBED ELECTRONIC MODES [SECTION 269SU]

(1) **Legislative intent** - In order to achieve the mission of the Government to move towards a cash less economy to reduce generation and circulation of black money and to promote digital economy, section 269SU was inserted w.e.f. 1st November, 2019.

Facility for making digital payments

(2) **Applicability** - This section requires every person, carrying on business to provide facility for accepting payment through the **prescribed electronic modes**, in addition to the facility for other electronic modes of payment, if any, being provided by such person, if his **total sales, turnover or gross receipts in business exceeds ₹ 50 crore during the immediately preceding previous year**.

The CBDT has, *vide* Circular No. 12/2020 dated 20.5.2020 clarified that the provisions of section 269SU shall not be applicable to a specified person having only B2B transactions (i.e., no transaction with retail customer/consumer) if at least 95% of aggregate of all amounts received during the previous year, including amount received for sales, turnover or gross receipts, are by any mode other than cash.

Rule 119AA prescribe the following electronic modes for making payment, namely -

(a) Debit Card powered by RuPay;

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(b) Unified Payments Interface (UPI) (BHIM-UPI); and

(c) Unified Payments Interface Quick Response Code (UPI QR Code) (BHIM-UPI QR Code).

(3) **Penalty for non-compliance** - In order to ensure compliance of the provisions of section 269SU, section 271DB provides that the failure to provide facility for accepting electronic modes of payment prescribed under section 269SU would attract penalty of a sum of ₹ 5,000, for every day during which such failure continues. However, the penalty shall not be imposed if the person proves that there were good and sufficient reasons for such failure. Further, any such penalty shall be imposed by the ***Assessing Officer***.

₹ 5,000 per day penalty

(4) **Consequential amendment in the Payment and Settlement Systems Act, 2007** – This has been effected to ensure that no bank or system provider imposes any charge upon anyone, either directly or indirectly, for using the modes of electronic payment prescribed under section 269SU of the Income-tax Act, 1961.

Further, the CBDT has, vide Circular No.16/2020 dated 30.8.2020 advised banks to immediately refund the charges collected, if any, on or after 1" January, 2020 on transactions carried out using the electronic modes prescribed under section 269SU and not to impose charges on any future transactions carried through the said prescribed modes.

18.4 MODE OF REPAYMENT OF CERTAIN LOANS OR DEPOSITS [SECTION 269T]

Section 269T provides that no branch of the banking company or a co-operative bank or any other company or co-operative society or a firm or other person, shall repay any loan or deposit made with it or any specified advance received by it otherwise than by account payee cheque or account payee bank draft, drawn in the name of the person who has made the loan or depositor paid the specified advance, or by use of electronic clearing system through a bank account or through such other prescribed electronic mode, if –

Repayment of loan

(1) the amount of loan or deposit or specified advance together with interest, if any, payable thereon; or

(2) the aggregate amount of such loans or deposits held by such person with the branch of the banking company or co-operative bank or, as the case may be, the other company or co-operative society or the firm, or other person either in his own name or jointly with any other

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person on the date of such repayment, together with the interest, if any, payable on such loan or deposit; or

(3) the aggregate amount of the specified advances received by such person either in his own name or jointly with any other person on the date of such repayment together with interest, if any, payable on such specified advances

is **₹ 20,000 or more**.

However, **higher limit of ₹ 2,00,000** is applicable in case of any deposit or loan where –

- a deposit is paid by a primary agricultural credit society (PACS) or a primary cooperative agricultural and rural development bank (PCARD) to its member or
- a loan is repaid to a primary agricultural credit society or a primary cooperative agricultural and rural development bank by its member.

Higher limit of ₹ 2,00,000 for deposit paid by/loan repaid to PACS/PCARD

Non-applicability of the above requirement in certain cases

(1) Where the repayment is made by a branch of bank or a co-operative bank, such repayment could be made by crediting the amount of such loan or deposit to the saving bank account or the current account, if any, with such branch of the person to whom such loan or deposit has to be repaid.

(2) Further, the provisions of this section shall not apply in case of repayment of any loan or deposit or specified advance taken or accepted from -

Non-applicability

(i) Government;
(ii) any banking company, post office savings bank or co-operative bank;
(iii) any corporation established by a Central, State or Provincial Act;
(iv) any Government company as defined in section 617 of the Companies Act, 1956[1];
(v) such other institution, association or body or class of institutions, associations or bodies which the Central Government may, for reasons to be recorded in writing, notify in this behalf in the Official Gazette.

[1]Section 2(45) of the Companies Act, 2013

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Meaning of certain terms

	Term	Meaning
(1)	Loan or Deposit	Any loan or deposit of money which is repayable after notice or repayable after a period. In the case of any person other than a company, loan or deposit of any nature will be covered by this section.
(2)	Specified Advance	Any sum of money in the nature of advance, by whatever name called, in relation to transfer of an immovable property, whether or not the transfer takes place.

Penalty for failure to comply with the provisions of section 269T [Section 271E]

If a person repays any loan or deposit or specified advance referred to in section 269T otherwise than in accordance with the provisions of that section, he shall be liable to pay, by way of penalty under section 271E, a sum equal to the amount of the loan or deposit or specified advance so repaid. Further, any such penalty shall be imposed by the ***Assessing Officer.***

Penalty = Amount repaid in contravention of section 269T

18.5 TRANSFERS TO DEFRAUD REVENUE VOID [SECTION 281]

(1) As a safeguard against non-realisation of revenue due to fraudulent transferring of assets by a defaulting assessee it is provided under this section that, certain transfers specified therein are deemed to be void for purpose of income-tax.

Transfer of asset during pendency of proceedings shall be void

(2) Accordingly, in cases where, during the pendency of any proceeding under the Income-tax Act, 1961 or after the completion thereof, but before the service of notice by the Tax Recovery Officer, any assessee creates a charge on, or parts with, the property by way of sale, mortgage, gift, exchange, or any other mode of transfer whatsoever of any of his assets in favour of any other person, such a charge or transfer must be deemed to be void as against any claim in respect of any tax, penalty, interest or fine payable by the assessee as a result of the completion of the proceedings or otherwise.

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(3) This provision applies to all cases where the amount of tax or other sum of money which is payable or likely to be payable exceeds ₹ 5,000 and the assets which are charged or transferred by the assessee exceeds ₹ 10,000 in value, in the aggregate.

(4) The charge or transfer made by the assessee, however, **would not be void** in case where it is made:

Case when transfer is not void

(a) for adequate consideration and without any notice of the pendency of such proceeding or, as the case may be, without any notice of such tax or other monies remaining payable by the assessee; or

(b) with the previous permission of the Assessing Officer.

(5) For this purpose, the term **'assets'** should be taken to mean land, buildings, machinery, plant, shares, securities and fixed deposits in bank to the extent to which any of these assets do not form part of the stock-in-trade of the business carried on by the assessee. In other words, if these items of properties represent the stock-in-trade of the assessee's business, their transfer would not be treated as void.

Assets exclude stock-in-trade

18.6 PROVISIONAL ATTACHMENT TO PROTECT THE INTEREST OF THE REVENUE [SECTION 281B]

(1) Assessing Officer's power to provisionally attach property for protecting interests of the revenue: Under section 281B, the Assessing Officer is empowered to provisionally attach any property of the assessee, by an order in writing, during the pendency of assessment or reassessment proceedings of any income which has escaped assessment or for imposition of penalty under section 271AAD (penalty leviable for false entry etc. in books of accounts) where the amount or aggregate of amounts of penalty likely to be imposed under the said section exceeds ₹ 2 crores, with the prior approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General, Principal Director or Director, if he is of the opinion that it is necessary to do so for the purpose of

Provisional attachment where penalty u/s 271AAD exceeds ₹ 2 crores

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protecting the interests of the revenue. Such provisional attachment has to be made in the manner provided in the Second Schedule.

(2) **Validity of provisional attachment:** The provisional attachment shall be valid for a period of 6 months from the date of the order. However, the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director may extend the period of provisional attachment, for reasons to be recorded in writing, by a further period as he thinks fit. However, the total period of extension should not exceed two years or sixty days after the date of assessment or reassessment, whichever is later.

Valid for 6 months

(3) **Recommendation of Income Tax Simplification Committee:** The Income Tax Simplification Committee under the chairmanship of Justice R.V. Easwar (Retd.) has recommended that provisional attachment of property could be substituted by a bank guarantee subject to fulfilment of certain conditions.

(4) **Furnishing bank guarantee in lieu of provisional attachment of property:** Section 281B(3) to (9) provides for furnishing of bank guarantee in lieu of provisional attachment of property.

(5) **Furnishing of bank guarantee in lieu of provisional attachment [Section 281B(3)]:** The Assessing Officer shall, by an order in writing, revoke provisional attachment of property made under section 281B(1) in a case where the assessee furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

Bank gaurantee in lieu of provisional attachment

(6) **Reference to Valuation Officer [Section 281B(4)]:** For the purpose of determining the fair market value of the property provisionally attached, the Assessing Officer may, make a reference to the Valuation Officer, who is required to estimate of the fair market value of the property and submit the report of such estimation to the Assessing Officer within a period of 30 days from the date of receipt of such reference.

(7) **Time limit for passing order revoking the attachment of property [Section 281B(5)]:** For ensuring revocation of attachment of the property in lieu of bank guarantee in a time bound

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manner, an order revoking the attachment has to be made by the Assessing Officer within the following time period:

	Case	Time period for revoking attachment
(i)	in a case where a reference is made to the Valuation Officer	within 45 days from the date of receipt of such guarantee
(ii)	in any other case	within 15 days from the date of receipt of such guarantee

(8) Assessing Officer empowered to invoke bank guarantee for failure to pay sum specified in notice of demand [Section 281B(6)]: Where a notice of demand specifying a sum payable is served upon the assessee and the assessee fails to pay such sum within the time specified in the notice of demand, the Assessing Officer may invoke the bank guarantee, wholly or partly, to recover the said amount.

Power to invoke bank guarantee

(9) Power to invoke bank guarantee on assessee's failure to renew or furnish new guarantee [Section 281B(7)]: In a case where the assessee fails to renew the bank guarantee or fails to furnish a new guarantee from a scheduled bank for an equal amount fifteen days before the expiry of such guarantee, the Assessing Officer shall, in the interests of the revenue, invoke the bank guarantee.

(10) Manner of adjustment of amount realized by invoking bank guarantee [Section 281B(8)]:

Adjustment against existing demand

(i) The amount realised by invoking the bank guarantee shall be adjusted against the existing demand which is payable by the assessee;

(ii) The balance amount, if any, has to be deposited in the Personal Deposit Account of the Principal Commissioner or Commissioner in the branch of Reserve Bank of India or the State Bank of India or of its subsidiaries or any bank as may be appointed by the Reserve Bank of India as its agent at the place where the office of the Principal Commissioner or Commissioner is situated.

(11) Release of bank guarantee [Section 281B(9)]: In a case where the Assessing Officer is satisfied that the bank guarantee is not required anymore to protect the interests of the revenue, he shall release that guarantee forthwith.

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18.7 SERVICE OF NOTICE [SECTIONS 282, 283 & 284]

(1) Permissible modes of service of notice [Section 282]: The service of a notice or summon or requisition or order or any other communication under the Act may be made by delivering or transmitting a copy thereof to the person named therein -

(i) by post or such courier services as approved by the CBDT; or

(ii) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or

(iii) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or

(iv) by any other means of transmission as may be provided by rules made by the CBDT in this behalf.

(2) Rules to provide for the addresses for communication: The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(3) Addressee in case of different assessees: The following is a list of persons on whom notice should be served and such a notice will be notice to the corresponding assessee mentioned.

	Assessee	Addressee
(i)	An existing firm	Any member of the firm
(ii)	An existing H.U.F.	The Manager or any adult member of the family.
(iii)	A Company	The Principal Officer thereof
(iv)	Local authority	The Principal Officer thereof
(v)	An existing association or body of individuals	The Principal Officer or any member thereof
(vi)	An individual	The individual himself
(vii)	Any other person	The person incharge of the management and control of his affairs.
(viii)	A dissolved firm	Any adult person who was a partner immediately before dissolution.

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(ix)	A partitioned H.U.F.	The last manager of the family; if he is dead, all adults who were members immediately before the partition.
(x)	A dissolved association of persons	Any person who was a member immediately before dissolution
(xi)	A discontinued business	The assessee; In the case of a firm or an association of persons, any person who was a member at the time of discontinuance; In the case of a company, its Principal Officer.

18.8 AUTHENTICATION OF NOTICES AND OTHER DOCUMENTS [SECTION 282A]

(1) Section 282A provides that where any notice or other document is required to be issued by any income-tax authority, such notice or other document should be signed and issued in paper form or communicated in electronic form by that authority in accordance with the prescribed procedure. This is in order to provide adequate legal framework for paperless assessment for improving efficiency and reducing the compliance burden.

Accordingly, Rule 127A provides for authentication of notices and other documents. Every notice or other document communicated in electronic form by an income-tax authority under the Income-tax Act, 1961 shall be deemed to be authenticated –

	Case	When it will be deemed as authenticated?
(i)	**Electronic mail or Electronic mail message**	
	If the notice or other document is in the e-mail body itself	If the name and office of such income-tax authority is printed on the e-mail body and the e-mail is issued from the designated e-mail address of such income-tax authority.
	If the notice or other document is in the attachment	If the name and office of such income-tax authority is printed on the attachment and the e-mail is issued from the designated e-mail address of such income-tax authority.

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(ii)	An electronic record	
	If the notice or other document is contained as text or remark in the electronic record itself	If the name and office of such income-tax authority is displayed as a part of the electronic record and such electronic record is displayed on the designated website.
	If the notice or other document is in the attachment	If the name and office of such income-tax authority is printed on the attachment in the electronic record and such electronic record is displayed on the designated website.

(2) Every notice or other document required to be issued, served or given for the purposes of this Act by any income-tax authority, shall be deemed to be authenticated if the name and office of a designated income-tax authority is printed, stamped or otherwise written thereon.

(3) A designated income-tax authority means any income-tax authority authorised by the CBDT to issue, serve or give such notice or other document after authentication in the manner as provided in (2) above.

18.9 SUBMISSION OF STATEMENTS BY PRODUCERS OF CINEMATOGRAPH FILMS OR PERSONS ENGAGED IN SPECIFIED ACTIVITY [SECTION 285B]

(1) **Time limit for furnishing statement in prescribed form** - Section 285B read with Rule 121A, requires a producer of a cinematograph film or a person engaged in any specified activity, or both, during the whole or any part of any financial year to furnish a statement in the prescribed form[2] within 60 days from the end of the previous year, in respect of the period during which such production or specified activity is carried on by him in such financial year.

60 days from the end of P.Y.

(2) **Manner of furnishing the statement** - The said statement has to be furnished electronically to the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be, or any person authorised by the Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems).

[2] *Form No. 52A*

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(3) **Threshold limit of payments in respect of which particulars have to be included in the statement**- Such statement would contain the particulars of **all payments exceeding ₹ 50,000 in the aggregate made by him or due from him to each such person** as is engaged by him in such production or specified activity.

(4) **Meaning of "specified activity"** - "Specified activity" means any –

(i) event management

(ii) documentary production,

(iii) production of programmes for telecasting on television or over the top platforms or any other similar platform,

(iv) sports event management,

other performing arts or any other activity as the Central Government may, by notification in the Official Gazette, specify in this behalf.

18.10 OBLIGATION TO FURNISH STATEMENT OF FINANCIAL TRANSACTION OR REPORTABLE ACCOUNT [SECTION 285BA]

(1) Section 285BA imposes an obligation on specified persons to furnish statement of financial transaction or reportable account. Thus, the section also provides for furnishing of statement by a prescribed reporting financial institution in respect of a specified financial transaction or reportable account to the prescribed income-tax authority.

(2) As per section 285BA(1), the following persons, who are responsible for registering or maintaining books of account or other document containing a record of any specified financial transaction or any reportable account as may be prescribed under any law for the time being in force, are required to furnish a statement in respect of such specified financial transaction or reportable account which is registered or recorded or maintained by him and information relating to which is relevant and required for the purposes of the Income-tax Act, 1961 to the income-tax authority or such other authority or agency as may be prescribed -

(a) an assessee;

(b) a prescribed person in the case of an office of Government;

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(c) a local authority or other public body or association; or

(d) the Registrar or Sub-Registrar appointed under the Registration Act, 1908; or

(e) the registering authority empowered to register motor vehicles under the Motor Vehicles Act, 1988; or

(f) the Post Master General referred to in the Indian Post Office Act, 1898; or

(g) the Collector referred to in the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013; or

(h) the recognised stock exchange referred to in the Securities Contracts (Regulation) Act, 1956; or

(i) an officer of the Reserve Bank of India; or

(j) a depository referred to in the Depositories Act, 1996; or

(k) a prescribed reporting financial institution; or

(l) a person, other than those referred to in clauses (a) to (k), as may be prescribed.

(3) **"Specified financial transactions"** means any of the following transactions which may be prescribed -

(a) transaction of purchase, sale or exchange of goods or property or right or interest in a property; or

Meaning of SFT

(b) transaction for rendering any service; or

(c) transaction under a works contract; or

(d) transaction by way of an investment made or an expenditure incurred; or

(e) transaction for taking or accepting any loan or deposit,

(4) The CBDT may prescribe different values for different transactions in respect of different persons having regard to the nature of such transaction.

(5) As per Rule 114E, the statement of financial transaction or reportable account shall be furnished in Form No. 61A and shall be verified in the manner indicated therein.

On or before 31st May from the end of FY

Accordingly, the statement of financial transactions has to be furnished on or before 31st May, immediately following the financial year in which the transaction is registered or recorded.

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(6) Where the prescribed income-tax authority considers that the statement furnished under section 285BA(1) is defective, he may intimate the defect to the person who has furnished such statement and give him an opportunity of rectifying the defect within a period of **30 days** from the date of such intimation. The prescribed income-tax authority may allow, on an application made in this behalf, a further period of time, at his discretion.

Rectify the defect within 30 days

(7) If the defect is not rectified within the said period of 30 days or, as the case may be, the further period so allowed, then, notwithstanding anything contained in any other provision of this Act, the provisions of this Act shall apply as if such person had furnished inaccurate information in the statement.

(8) Where a person who is required to furnish a statement under section 285BA(1), has not furnished the same within the specified time, the prescribed income-tax authority may serve upon such person a notice requiring him to furnish such statement within a period not exceeding **thirty days** from the date of service of such notice and he shall furnish the statement within the time specified in the notice [Section 285BA(5)].

Failure to furnish SFT

(9) If any person, having furnished a statement under section 285BA(1), or in pursuance of a notice issued under section 285BA(5), comes to know or discovers any inaccuracy in the information provided in the statement, he shall, within a period of **ten days** inform the income-tax authority or other authority or agency referred to in section 285BA(1), the inaccuracy in such statement and furnish the correct information in the prescribed manner [Section 285BA(6)]

Inform Discrepancy within 10 days

(10) Under section 285BA(7), the Central Government may, by way of rules, specify —

(i) the persons referred to in section 285BA(1) to be registered with the prescribed income-tax authority;

(ii) the nature of information and the manner in which such information shall be maintained by the persons referred to in point (i); and

(iii) the due diligence to be carried out by the persons for the purpose of identification of any reportable account referred to in section 285BA(1).

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(11) **Furnishing of statement of financial transaction [Rule 114E**: The statement of financial transaction required to be furnished under section 285BA(1) of the Income-tax Act, 1961 shall be furnished by every person mentioned in column (3) of the Table below in respect of all the transactions of the nature and value specified in the corresponding entry in column (2) of the said Table, which are registered and recorded by him on or after 1st April, 2016.

S. No.	Nature and value of transaction	Class of person (reporting person)
(1)	(2)	(3)
1.	(a) Payment made in cash for purchase of bank drafts or pay orders or banker's cheque of an amount aggregating to ₹ 10 lakh or more in a financial year. (b) Payments made in cash aggregating to ₹ 10 lakh or more during the financial year for purchase of pre-paid instruments issued by Reserve Bank of India under the Payment and Settlement Systems Act, 2007. (c) Cash deposits or cash withdrawals (including through bearer's cheque) aggregating to ₹ 50 lakhs or more in a financial year, in or from one or more current account of a person.	A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act)
2.	Cash deposits aggregating to ₹ 10 lakhs or more in a financial year, in one or more accounts (other than a current account and time deposit) of a person.	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act); (ii) Post Master General as referred to in the Indian Post Office Act, 1898.
3.	One or more time deposits (other than a time deposit made through renewal of another time deposit) of a person aggregating to₹ 10 lakhs or more in a financial year of a person.	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act);

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		(ii) Post Master General as referred to in the Indian Post Office Act, 1898; (iii) Nidhi referred to in section 406 of the Companies Act, 2013; (iv) NBFC which holds a certificate of registration under section 45-IA of the Reserve Bank of India Act, 1934, to hold or accept deposit from public.
4.	Payments made by any person of an amount aggregating to- (i) ₹ 1 lakh or more in cash; or (ii) ₹ 10 lakh or more by any other mode, against bills raised in respect of one or more credit cards issued to that person, in a financial year.	A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act) or any other company or institution issuing credit card.
5.	Receipt from any person of an amount aggregating to ₹ 10 lakh or more in a financial year for acquiring bonds or debentures issued by the company or institution (other than the amount received on account of renewal of the bond or debenture issued by that company).	A company or institution issuing bonds or debentures.
6.	Receipt from any person of an amount aggregating to ₹ 10 lakh or more in a financial year for acquiring shares (including share application money) issued by the company.	A company issuing shares
7.	Buy back of shares from any person (other than the shares bought in the open market) for an amount or value aggregating to ₹ 10 lakh or more in a financial year.	A company listed on a recognised stock exchange purchasing its own securities under section 68 of the Companies Act, 2013.
8.	Receipt from any person of an amount aggregating to ₹ 10 lakh or more in a financial year for acquiring units of one or more schemes of a Mutual Fund (other than the amount received on account of transfer from	A trustee of a Mutual Fund or such other person managing the affairs of the Mutual Fund as may be duly authorised by the trustee in this behalf.

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	one scheme to another scheme of that Mutual Fund).	
9.	Receipt from any person for sale of foreign currency including any credit of such currency to foreign exchange card or expense in such currency through a debit or credit card or through issue of travelers cheque or draft or any other instrument of an amount aggregating to ₹ 10 lakh or more during a financial year	Authorised person as referred to in section 2(c) of the Foreign Exchange Management Act, 1999.
10.	Purchase or sale by any person of immovable property for an amount of ₹ 30 lakhs or more or valued by the stamp valuation authority referred to in section 50C at ₹ 30 lakhs or more	Inspector-General appointed under the Registration Act, 1908 or Registrar or Sub-Registrar appointed under that Act
11.	Receipt of cash payment exceeding ₹ 2 lakh for sale, by any person, of goods or services of any nature (other than those specified at Sl. Nos.1 to 10 above, if any).	Any person who is liable for audit under section 44AB.

Manner of application of threshold limit: The reporting person mentioned in column (3) of the Table [other than the person at Sl.No.10 and 11] shall, while aggregating the amounts for determining the threshold limit for reporting the amount in respect of any person as specified in column (2) of the said table,-

(a) take into account all the accounts of the same nature as specified in column (2) of the said Table maintained in respect of that person during the financial year;

(b) aggregate all the transactions of the same nature as specified in column (2) of the said Table recorded in respect of that person during the financial year;

(c) attribute the entire value of the transaction or the aggregated value of all the transactions to all the persons, in a case where the account is maintained, or transaction is recorded in the name of more than one person;

(d) apply the threshold limit separately to deposits and withdrawals in respect of transaction specified in item (c) under column (2), against Sl. No.1 of the said Table.

For the purposes of pre-filling the return of income, Rule 114E(5A) provides that the information relating to capital gains on transfer of listed securities or units of Mutual Funds, dividend income, and interest income mentioned in column (2) of Table below shall be

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furnished by the persons mentioned in column (3) of the said Table in such form, at such frequency, and in such manner, as may be specified by the Principal Director General of Income Tax (Systems) or the Director General of Income Tax (Systems), as the case may be, with the approval of the CBDT:

Sl. No.	Nature of transaction	Class of person (reporting person)
(1)	(2)	(3)
1.	Capital gains on transfer of listed securities or units of Mutual Funds	(i) Recognised Stock Exchange; (ii) Depository as defined in section 2(1)(e) of the Depositories Act, 1996 (iii) Recognised Clearing Corporation; (iv) Registrar to an issue and share transfer agent registered under section 12(1) of the SEBI Act, 1992
2.	Dividend income	A company
3.	Interest income	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act) (ii) Post Master General as referred to in section 2(j) of the Indian Post Office Act, 1898 (iii) Non-banking financial company which holds a certificate of registration under section 45-IA of the Reserve Bank of India Act, 1934, to hold or accept deposit from public.

Note - *The information is to be reported for all account/deposit holders where any interest exceeds zero per account in the financial year excluding Jan Dhan Accounts [Notification No. 1/2023, dated 5.01.2023].*

Meaning of certain terms:

Term	Meaning
Listed securities	Securities which are listed on any recognised stock exchange in India
Mutual Fund	A Mutual Fund as referred to in section 10(23D) of the Income-tax Act,1961
Recognised clearing corporation	It has the same meaning as assigned to it in regulation 2(1)(o) of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 made under the Securities Contracts (Regulation) Act, 1956 and the SEBI Act, 1992

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Recognised stock exchange	A stock exchange which is for the time being recognised by the Central Government under section 4 of the Securities Contracts (Regulation) Act, 1956
Securities	It has the same meaning as assigned to it in section 2(h) of the Securities Contracts (Regulation) Act, 1956

Penalty for Failure to Furnish Statement of Financial Transaction or Reportable Account [Section 271FA]

Section 271FA provides that if a person who is required to furnish a statement of financial transaction or reportable account, as required under section 285BA(1), fails to furnish such statement within the time prescribed under section 285BA(2) [i.e., on or before 31st May, immediately following the financial year in which the transaction is registered or recorded], the prescribed income-tax authority [i.e., Director of Income-tax (Central Information Branch)] may direct that such person shall pay, by way of penalty, a sum of **₹ 500** for every day during which the failure continues.

Further, where such person fails to furnish the statement of financial transaction or reportable account within the period specified in the notice under section 285BA(5), he shall pay, by way of penalty, a sum of **₹ 1,000** for every day during which the failure continues, beginning from the day immediately following the day on which the time specified in such notice for furnishing the statement expires.

The penal provisions under section 271FA are summarized below -

Non-compliance of section	Penalty under section 271FA	Period
285BA(1)	₹ 500 per day of continuing default	1st June immediately following the financial year in which the transaction is registered or recorded till the date of furnishing the statement of financial transaction or reportable account or the date of expiry of the time specified in the notice under section 285BA(5), as the case may be.
285BA(5)	₹ 1,000 per day of continuing default	The day immediately following the day on which the time specified in notice under section 285BA(5) for furnishing the statement expires till the date of furnishing of statement.

As per section 273B, no penalty is leviable under section 271FA, if the assessee proves that there was reasonable cause for the said failure.

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ILLUSTRATION 1

A private bank has not filed its statement of financial transaction or reportable account in relation to the specified financial transactions for the financial year 2025-26. A notice was issued by the prescribed income-tax authority on 1st October, 2026 requiring the bank to furnish the statement by 31st October, 2026. The bank, however, furnished the statement only on 15th November, 2026. What would be the penalty leviable under section 271FA?

SOLUTION

(1)	(2)	(3)	(4)	
Non-compliance of section	**Penalty under section 271FA**	**Period**	**Quantum of penalty under section 271FA**	
			(2) × (3)	**(₹)**
285BA(1)	₹ 500 per day of continuing default	1.6.2026 to 31.10.2026	153 days × ₹ 500	76,500
285BA(5)	₹ 1,000 per day of continuing default	1.11.2026 to 15.11.2026	15 days × ₹ 1,000	15,000
				91,500

Penalty for furnishing inaccurate statement of financial transaction or reportable account [Section 271FAA]

Section 271FAA(1) provides for levy of penalty in case of **a person referred to in section 285BA(1)** who is required to furnish a statement of financial transaction or reportable account, where such person provides inaccurate information in the statement.

In such a case, the income-tax authority prescribed under section 285BA

(I) may direct levy of penalty of ₹ 50,000, if the persons:

(i) provides inaccurate information in the statement or fails to furnish correct information within the period specified under section 285BA(6); or

(ii) fails to comply with the due diligence requirement prescribed under section 285BA(7).

While reviewing India's CRS legislative framework under the Automatic Exchange of Information (AEOI) framework, the Global Forum on Transparency and Exchange of Information for Tax purposes has formed a view that the penal sanction available under section 271FAA for inaccuracies would not automatically extend to all cases where due diligence was not correctly done if the information did not lead to incorrect reporting

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(II) shall direct levy of ₹ 5,000 for every reportable account, in addition to the levy of penalty of ₹ 50,000, in case of a prescribed reporting financial institution which is required to furnish a statement under section 285BA, if it provides inaccurate information in the statement and the inaccuracy in such statement is due to false or inaccurate information furnished by the holder or holders of the relevant reportable account or accounts.

Where such penalty is paid by the reporting financial institution, such institution would be entitled to recover the sum so paid on behalf of such reportable account holder, or to retain out of any moneys that may be in its possession or may come to it from every such reportable account holder, an amount equal to the sum so paid.

18.11 OBLIGATION TO FURNISH INFORMATION ON TRANSACTION OF CRYPTO-ASSET [SECTION 285BAA]

(1) Section 285BAA(1) imposes an obligation on prescribed reporting entities to furnish a statement in respect of a transaction of crypto-asset. The statement shall be furnished for such period, within such time, in such form and manner and to such income-tax authority as may be prescribed.

*(2) Where the prescribed income-tax authority considers that the statement furnished under sub-section (1) is defective, he may intimate the defect to the person who has furnished such statement and give him an opportunity of rectifying the defect within **30 days** from the date of such intimation or such further period as may be allowed, and if the defect is not rectified within such period, the provisions of the Income-tax Act, 1961 shall apply as if such person had furnished inaccurate information in the statement.*

*(3) Where a person who is required to furnish a statement under sub-section (1) has not furnished the same within the specified time, the prescribed income-tax authority may serve upon such person a notice requiring him to furnish such statement within a period not exceeding **30 days** from the date of service of such notice and he shall furnish the statement within the time specified in the notice.*

(4) If any person, having furnished a statement under sub-section (1), or in pursuance of a notice issued under sub-section (3), comes to know or discovers any inaccuracy in the information provided in the statement, he shall within 10 days inform the prescribed income-tax authority

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the inaccuracy in such statement and furnish the correct information in such manner as may be prescribed.

(5) The Central Government may, prescribe

(a) the persons to be registered with the prescribed income-tax authority;

(b) the nature of information and the manner in which such information shall be maintained by the persons; and

(c) the due diligence to be carried out by the persons for the purpose of identification of any crypto-asset user or owner.

(6) "Crypto-asset" being a digital representation of value that relies on a cryptographically secured distributed ledger or a similar technology to validate and secure transactions as defined in sub-clause (d) of clause (47A) of section 2.

18.12 ANNUAL INFORMATION STATEMENT [SECTION 285BB]

(1) The prescribed income-tax authority or the person authorised by such authority has to upload in the registered account of the assessee, an annual information statement in the prescribed form and manner and within the prescribed time along with the prescribed information in possession of the said authority.

(2) "Registered account" means the electronic filing account registered by the assessee in designated portal, i.e., web portal designated by the prescribed income-tax authority or the person authorised by such authority.

(3) Accordingly, Rule 114-I requires the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems) or any person authorised by him, under section 285BB, to upload in the registered account of the assessee an annual information statement in Form No. 26AS containing the information specified in column (2) of the table below, which is in his possession within 3 months from the end of the month in which the information is received by him:—

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Sl. No.	Nature of information
(i)	Information relating to tax deducted or collected at source
(ii)	Information relating to specified financial transaction
(iii)	Information relating to payment of taxes
(iv)	Information relating to demand and refund
(v)	Information relating to pending proceedings
(vi)	Information relating to completed proceedings

(4) The CBDT may also authorise the Principal DGIT (Systems) or the DGIT (Systems) or any person authorised by him to upload the information received from any officer, authority or body performing any function under any law or the information received under an agreement referred to in section 90 or section 90A or the information received from any other person to the extent as it may deem fit in the interest of the revenue in the annual information statement.

(5) The Principal DGIT (Systems) or the DGIT (Systems) has to specify the procedures, formats and standards for the purposes of uploading of annual information statement.

18.13 PUBLICATION OF INFORMATION [SECTION 287]

The Central Government is empowered to publish the name and address of any assessee and other particulars relating to any proceedings or prosecutions in respect of such assessees, if it considers it necessary or expedient in the public interest to do so. However, no such publication relating to any penalty or prosecution shall be made until the time for presenting appeal to the Joint Commissioner (Appeals) or Commissioner (Appeals) has expired without an appeal having been presented or until the appeal, if presented, has been disposed of.

In the case of a firm, company or other association of persons, the names of the partners of the firm, directors, managing agents, secretaries and treasurers, or managers of the company or members of the associations, as the case may be, may also be published if, in the opinion of the Central Government, the circumstances of the case justify the same.

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18.14 APPEARANCE BY REGISTERED VALUERS [SECTION 287A]

Any tax payer who is entitled to or required to attend before any income tax authority or the Appellate Tribunal in connection with any matter relating to the valuation of any asset, otherwise than he is required under section 131 to attend personally for examination on oath or affirmation, may attend by a registered valuer.

18.15 APPEARANCE BY AUTHORISED REPRESENTATIVE [SECTION 288]

(1) Section 288 deals with appearance by authorised representative. Accordingly, any assessee who is entitled or required to attend before any income-tax authority or the Appellate Tribunal in connection with any proceeding under this Act otherwise than when required under section 131 to attend personally for examination on oath or affirmation, may attend by an authorised representative.

(2) For the purpose of this section, "authorised representative" means, a person authorised by the assessee in writing to appear on his behalf. The following persons can be authorised representatives:

(a) A person related to the assessee in any manner or a person regularly employed by the assessee

(b) any officer of a Scheduled Bank with which the assessee maintains a current account or has other regular dealings

(c) any legal practitioner who is entitled to practice in any Civil Court in India

(d) an Accountant i.e., a chartered accountant as defined in section 2(1)(b) of the Chartered Accountants Act, 1949 who holds a valid certificate of practice under section 6(1) of that Act. However, the following persons are not included in the definition of "accountant" -

	Assessee	Person
(i)	Company	A person who is not eligible for appointment as an auditor of the said company under section 141(3) of the Companies Act, 2013, namely,

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		(a) A body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008; (b) an officer or employee of the company (c) a person who is a partner, or who is in the employment, of an officer or employee of the company (d) a person who, or his relative or partner – (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company[3] (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 5 lakh. (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 1 lakh. (e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed. (f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel. (g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies (h) a person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction

[3] *However, the relative may hold security or interest in the company of face value not exceeding ₹ 1,000 or such sum as may be prescribed.*

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		(i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144 of the Companies Act, 2013.
(ii)	Individual	The assessee himself or his relative
(iii)	Firm	Partner of the firm or his relative
(iv)	AOP	Member of the AOP or his relative
(v)	HUF	Member of the HUF or his relative
(vi)	Trust or Institution	(1) The author of the trust or founder of the institution or his relative (2) Any person who has made a substantial contribution to the trust or institution, i.e., any person whose total contribution upto the end of the relevant previous year exceeds ₹ 50,000, or his relative (3) Where such author, founder or person is a HUF, a member of the HUF or relative of such member (4) Any trustee of the trust or manager of the institution, or relative of the trustee or manager
(vii)	Any other person	The person who is competent to verify the return under section 139 in accordance with the provisions of section 140 or his relative.
(viii)	Any assessee referred to in (ii) to (vii)	(1) An officer or employee of the assessee (2) An individual who is a partner, or who is in the employment, of an officer or employee of the assessee. (3) An individual who, or his relative or partner - (I) is holding any security of, or interest in, the assessee[4]. (II) is indebted to the assessee[5]. (III) has given a guarantee or provided any security in connection with the indebtedness of any third person to the assessee[6].

[4] However, the relative may hold security or interest in the assessee of the face value not exceeding ₹ 1 lakh

[5] However, the relative may be indebted to the assessee for an amount not exceeding ₹ 1 lakh

[6] However, the relative may give guarantee or provide any security in connection with the indebtedness of any third person to the assessee for an amount not exceeding ₹ 1 lakh

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		(4) a person who, whether directly or indirectly, has business relationship with the assessee of such nature as may be prescribed. "Business relationship" shall be construed as any transaction entered into for a commercial purpose, other than – (i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Income-tax Act, 1961 and the Chartered Accountants Act, 1949 and the rules and regulations made thereunder; (ii) commercial transactions which are in the ordinary course of business of the company at ALP – like sale of products or services to auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses. (5) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.

However, the ineligibility for carrying out any audit or furnishing of any report/certificate in respect of an assessee shall not make an accountant ineligible for attending income-tax proceeding referred to in section 288(1) as authorised representative on behalf of that assessee.

(e) any person who has passed any accountancy examination recognised in this behalf by the Board. Rule 50 prescribes the accountancy examination recognised for this purpose. They are as follows:

(i) The National Diploma in Commerce awarded by the All India Council for Technical Education under the Ministry of Education, New Delhi, provided the diploma-holder has taken Advanced Accountancy and Auditing as an elective subject for the Diploma Examination

(ii) Government Diploma in Company Secretaryship awarded by the Department of Company Affairs under the Ministry of Industrial Development and Company Affairs, New Delhi

(iii) Final Examination of the Institute of Company Secretaries of India, New Delhi

(iv) The Final Examination of the Institute of Cost and Work Accountants of India constituted under the Cost and Works Accountants Act, 1959

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(v) The Departmental Examination conducted by or on behalf of the Central Board of Direct Taxes for promotion

(vi) The Revenue Audit Examination for Section Officers conducted by the Office of the Comptroller and Auditor General of India

(f) any person who has acquired such education qualifications as the CBDT may, prescribe for this purpose. Rule 51 prescribes the concerned educational qualifications as follows:

Educational Qualifications

A degree in Commerce or Law conferred by any of the following Universities:

(i) Indian Universities: Any Indian University incorporated by any law for the time being in force.

(ii) Rangoon University

(iii) English and Welsh Universities: The Universities of Birmingham, Bristol, Cambridge, Durham, Leeds, Liverpool, London, Manchester, Oxford, Reading, Sheffield and Wales

(iv) Scottish Universities: The Universities of Aberdeen, Edinburgh, Glasgow andSt. Andrews

(v) Irish Universities: The Universities of Dublin (Trinity College), the Queen's University, Belfast and the National University of Dublin

(vi) Pakistan Universities: Any Pakistan University incorporated by any law for the time being in force.

(g) Any other person as may be prescribed.

Accordingly, Rule 51B prescribes that any other person, in respect of a company or a limited liability partnership, as the case may be, shall be the person appointed by the Adjudicating Authority (i.e., National Company Law Tribunal constituted under section 408 of the Companies Act, 2013) for discharging the duties and functions of an interim resolution professional, a resolution professional, or a liquidator, as the case may be, under the Insolvency and Bankruptcy Code, 2016 and the rules and regulations made thereunder.

(3) The following persons shall **not** be qualified to represent an assessee:

(i) A person who has been dismissed or removed from government service.

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Persons Not Qualified

(ii) **A person who has been convicted of an offence** connected with any income-tax proceeding or on whom a penalty has been imposed under this Act other than a penalty imposed on him under section 272A(1)(d) - In this case, the person will be disqualified for such time as the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner may, by order, determine.

(iii) **A person has become insolvent -** In this case, he will be disqualified for a period during which the insolvency continues.

(iv) **A person convicted by a court of an offence involving fraud -** He shall not be eligible to act as authorised representative for a period of 10 years from the date of such conviction.

(4) If any person is a legal practitioner or an accountant and is found guilty of misconduct in his professional capacity by any authority entitled to institute disciplinary proceedings against him, an order passed by that authority shall have effect in relation to his right to attend before an income-tax authority as it has in relation to his right to practice as a legal practitioner or accountant.

(5) If a person is not a legal practitioner or an accountant and is found guilty of misconduct in connection with any income-tax proceedings by the prescribed authority, the prescribed authority, may direct that he shall henceforth be disqualified to represent an assessee.

(6) Before any order or direction of disqualification under point 3(ii) or 5 above is made, the following conditions must be satisfied:

(a) No such order or direction shall be made in respect of any person unless he has been given a reasonable opportunity of being heard

(b) any person against whom any such order or direction is made, may within one month of the making of the order or direction, may appeal to the Board to have the order or direction cancelled

(c) No such order or direction shall take effect until the expiration of one month from the making thereof or, where an appeal has been preferred, until the disposal of the appeal.

(7) A person disqualified to represent an assessee under Indian Income-tax Act, 1922 shall stand disqualified under this Act also

(8) Meaning of the term “relative” for the purpose of section 288:

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18.16 POWER TO TENDER IMMUNITY FROM PROSECUTION [SECTION 291]

CG empowered to tender immunity from prosecution

The Central Government is empowered under section 291 to tender any person immunity from prosecution for any offence under this Act if it is of the opinion that it is necessary or expedient in the public interest to do so for the purpose of obtaining the evidence directly or indirectly concerned in or privy to the concealment of the income or to the evasion of payment to tax on any income taxable under the Act.

A tender of immunity made to or accepted by the person concerned shall, to that extent, render him immune from prosecution for any offence in respect of which tender was made or from the imposition of any penalty under the Act. If it appears to the Central Government that any person to whom immunity has been tendered under this section has not complied with the condition on which the tender was made or is willfully concealing anything or is giving false evidence, the Central Government may record a finding to that effect, and thereupon the immunity shall be deemed to have been withdrawn. Further, any such person may be tried for the offence in respect of which tender of immunity was made or for any other offence of which he appears to have been guilty in connection with the same matter and shall also become liable to the imposition of any penalty under this Act to which he would otherwise have been liable.

18.17 COGNIZANCE OF OFFENCES AND BAR OF SUITS IN CIVIL COURTS [SECTIONS 292 AND 293]

(1) No Court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any offence under this Act.

(2) No suit can be brought in any Civil Court to set aside or modify any proceeding taken or order made under this Act; and no prosecution, suit or other proceedings shall lie against the Government or any Government Officer for anything done or intended to be done in good faith under the Act.

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18.18 CERTAIN LAWS NOT TO APPLY [SECTION 292A]

This section provides that the provisions of section 360 of the Code of Criminal Procedure, 1973 Bharatiya Nagarik Suraksha Sanhita (BNSS)) or the Probation of Offenders Act, 1958 shall not be applicable to any person who is convicted of an offence under the Income tax Act,1961 unless that person is under 18 years of age.

18.19 RETURN OF INCOME ETC. NOT TO BECOME INVALID [SECTION 292B]

Section 292B provides that no return of income, order of assessment, notice, summons or other proceedings furnished or made or taken or purported to have been furnished or made in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or shall be deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment, notice , summons or other proceeding, if they are in substance and effect in conformity with or according to the intent and purposes of the Income-tax Act, 1961.

Mistakes or defects not to make ROI invalid

The provision, thus, enables tax authorities to accept returns and other documents and tax payers to accept orders, notice, etc., received from tax authorities even in cases where there are a few typographical, arithmetical or other mistakes which do not materially affect the objects with which the document was submitted by the assessee or order was issued by the department.

18.20 NOTICE DEEMED TO BE VALID IN CERTAIN CIRCUMSTANCES [SECTION 292BB]

(1) This section provides that the assessee would be precluded from raising any objection in any proceeding or inquiry that the notice was not served upon him or was not served in time or was served in an improper manner if he had appeared in any proceedings or co-operated in any enquiry relating to assessment or re-assessment.

Appeared in proceedings or Co-operated in enquiry

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(2) In short, if the assessee had appeared in any proceedings or co-operated in any enquiry, it shall be deemed that any notice required to be served on him has been duly served upon him in time in accordance with the provisions of the Act.

However, such deeming provision would not apply where the assessee has raised an objection (regarding non-service of notice or non-service of notice in time or improper service of notice) before the completion of such assessment or reassessment.

18.21 PRESUMPTION AS TO ASSETS, BOOKS OF ACCOUNT, ETC. [SECTION 292C]

(1) Under section 132(4A), it is provided that the books of account, money, bullion, jewellery or other valuable article or thing found in the possession or control of any person in the course of a search under section 132 will be presumed to belong to the said person.

(2) It is further provided that it will be presumed that -

(i) the contents of such books of account and other documents are true; and

(ii) the signature and every other part of such books of account and other documents which purport to be in handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting, and

Presumption

(iii) in the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

(3) Therefore, section 292C was inserted to clarify that presumptions provided in section 132(4A) can be made in any proceeding under this Act. It would also be available for regular assessment.

(4) This section provides that where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search under section 132 or survey under section 133A, it may, in any proceeding under this Act, be presumed that -

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(i) such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;

Search or Survey

(ii) the contents of such books of account and other documents are true; and

(iii) the signature and every other part of such books of account and other documents which purport to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting;

(iv) In the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

(5) Further, this presumption has also been extended to books of account, other documents or assets which have been delivered to the requisitioning officer in accordance with the provisions of section 132A. For this purpose, section 132A(2) provides that where any books of accounts, other documents or assets have been delivered to the requisitioning officer in accordance with the provision of section 132A then, the presumption would apply as if such books of accounts, other documents or assets which had been taken into custody from the person referred to in clause (a) or clause (b) or clause(c), as the case may be, of section 132A(1), had been found in the possession or control of that person in the course of a search under section 132.

18.22 AUTHORITY EMPOWERED TO GRANT AN APPROVAL UNDER THE INCOME TAX ACT, 1961 DEEMED TO HAVE POWER TO WITHDRAW THE APPROVAL GRANTED [SECTION 293C]

(1) The Central Government, CBDT and income-tax Authorities are empowered under the various provisions of the Income-tax Act to grant approval to the assessees for availing the benefit of incentives available under the Act.

(2) However, only some provisions of the Income-tax Act, 1961 specifically contain provisions for withdrawal of approval. In all other cases, there is no specific power to withdraw the approval granted.

Power to Withdraw

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(3) Therefore, section 293C provides explicitly, such power to withdraw an approval granted. This section provides that an approval granting authority (i.e., the Central Government, CBDT or income-tax authority, as the case may be) shall also have the powers to withdraw the approval at any time.

(4) However, such withdrawal can be made only after giving a reasonable opportunity to the concerned assessee of showing cause against the proposed withdrawal. Further, the reasons for withdrawal of the approval should be recorded by the concerned authority.

18.23 ACT TO HAVE EFFECT PENDING LEGISLATIVE PROVISION FOR CHARGE OF TAX [SECTION 294]

If on the 1st April in any assessment year, provision has not yet been made by a Central Act for the charging of income-tax for that assessment year, this Act shall nevertheless have effect until such provision is so made as if the provision in force in the preceding assessment year or the provision proposed in the Bill then before Parliament, whichever is more favourable to the assessee, were actually in force.

Existing Act

18.24 RULES [SECTIONS 295 AND 296]

Section 295 authorises the CBDT to make rules for the whole or any part of India for carrying out the purposes and to implement the provisions of the Act. The powers of the Board in this regard are subject to the supervision and control of the Central Government. The Rules framed by the Board and approved by the Central Government are required to be placed before each House of the Parliament before enforcing the same. In exercise of the powers conferred on it by this section, the Board, with the approval and sanction of the Central Government and the Parliament, has framed the Income-tax Rules, 1962 which have been amended from time to time.

Notifications

This section also enumerates the important matters on which rules may be framed by the Board: the rules framed under this Act have the same force of the section of the Act. The rules must be interpreted in the light of the sections under which they have been made. But the rules should be so framed as not to adversely affect or derogate from the full operative effect of the provisions of the sections. The rules must be within the term of the mandate given to the Board and must be framed in such a way as to be consistent with and supplementary to the provisions of the Act.

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18.25 SCHEDULES TO THE INCOME TAX ACT, 1961

There are fourteen Schedules to the Income-tax Act, 1961. The matters dealt with in certain schedules are highlighted below:

Schedule I	Method of computing profits and gains of Insurance business [Section 44]
Schedule II	Procedure for Recovery of Tax
Schedule III	Procedure for distraint by Assessing Officer or Tax Recovery Officer
Schedule IV	Recognised Provident Funds, approved superannuation funds and approved gratuity funds
Schedule VII	List of minerals and group of associated minerals in the context of section 35E.

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SIGNIFICANT SELECT CASES

S. No.	Case Law	
1.	***CIT v. V. Sivakumar (2013) 354 ITR 9 (Mad.)***	
	Issue	**Analysis & Decision**
	Can loan, exceeding the specified limit, advanced by a partnership firm to the sole-proprietorship concern of its partner be viewed as a violation of section 269SS to attract levy of penalty?	In the present case, the assessee was a partner in four firms and also had a sole-proprietary business. In the relevant previous year, the partnership firms had advanced loan to the assessee in cash exceeding the specified amount mentioned in section 269SS. There is no separate identity for the partnership firm and that the partner is entitled to use the funds of the firm. In the present case, the assessee has acted *bona fide* and that there was a reasonable cause within the meaning of section 273B. Therefore, the transaction cannot be said to be in violation of section 269SS and no penalty is attracted in this case.
2.	***CIT v. Muthoot Financiers (2015) 371 ITR 408 (Del)***	
	Issue	**Analysis & Decision**
	Is penalty u/s 271D imposable for cash loans/deposits received from partners?	There are three different High Courts, which have held that section 269SS would not be violative when money is exchanged *inter se* between the partners and the firm, since the partnership firm is not a separate legal entity. However, the Supreme Court has held that partners of the firm are distinct as civil entities while the firm as such is a separate and distinct unit for the purpose of assessment. In this case, there was no dispute as regards the money brought in by the partners of the assessee-firm. The source of money was also not doubted. The transaction was *bona fide* and not aimed to avoid any tax liability. **The credit worthiness of the partners and genuineness of the transactions coupled with relationship between the 'two persons' and two different legal interpretations put forward, could constitute a reasonable cause in a given case for not invoking sections 271D/271E read with section 273B.**

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3.	*CIT v. Triumph International Finance (I.) Ltd. (2012) 345 ITR 270 (Bom.)*	
	Issue	**Analysis & Decision**
	Where an assessee repays a loan merely by passing adjustment entries in its books of account, can such repayment of loan by the assessee be taken as a contravention of the provisions of section 269T to attract penalty under section 271E?	The obligation to repay the loan or deposit by account payee cheque/bank draft as specified in section 269T is mandatory in nature. The contravention of the said section will attract penalty under section 271E. The cause shown by the assessee for repayment of the loan otherwise than by account payee cheque/bank draft was on account of the fact that the assessee was liable to receive amount towards the sale price of the shares sold by the assessee to the person from whom loan was received by the assessee. In order to avoid the unnecessary circular transfer of shares, both the parties agreed to set-off the amount payable and receivable by way of passing journal entries and the balance loan amount was paid by the assessee by way of an account payee cheque. The amount of loan settled by way of passing journal entries exceeds ₹ 20,000. It would have been mere formality to repay the loan amount by account payee cheque/draft and receive back almost the same amount towards the sale price of the shares. Also, neither the genuineness of the receipt of loan nor the transaction of repayment of loan by way of adjustment through book entries carried out in the ordinary course of business has been doubted in the regular assessment. Therefore, there is nothing on record to suggest that the amounts advanced to the assessee represented the unaccounted money of either party and also it cannot be said that the whole transaction was entered into to avoid tax. This is accepted as a reasonable cause under section 273B. Section 269T does not make a distinction between a *bonafide* or a *non-bonafide* transaction neither does it require the fulfillment of the condition mentioned therein only in case where there is outflow of funds. It merely puts a condition that in case a loan or deposit is repaid, it should be by way of an account payee cheque/draft. Therefore, in the present case, the assessee has repaid a portion of loan in contravention of provisions of section 269T. In effect, the assessee has violated the provisions of section 269T by repaying the loan amount by way of passing book entries and therefore, penalty under section 271E is

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		applicable. However, since the transaction is *bona fide* in nature being a normal business transaction and has not been made with a view to avoid tax and since the assessee has shown reasonable cause for the failure under section 269T, no penalty under section 271E could be imposed on the assessee for contravening the provisions of section 269T by virtue of the provisions of section 273B. ***Note:*** *In order to mitigate the hardship caused by certain penalty provisions in case of genuine business transactions, section 273B provides that no penalty under, inter alia, section 271E shall be imposed on a person for any failure referred to in the said section, if such person proves that there was reasonable cause for such failure.*
4.	***Dr. Manoj Kabra v. ITO (2014) 364 ITR 541 (All)***	
	Issue	**Analysis & Decision**
	Can the Assessing Officer *suo moto* assume jurisdiction to declare sale of property as void under section 281?	The legislature had no intention to confer any exclusive power or jurisdiction upon the income-tax authority to decide any question arising under section 281. The Income-tax Act, 1961, does not prescribe any adjudicatory machinery for deciding any question which may arise under section 281. In order to declare a transfer as fraudulent under section 281, an appropriate proceeding in accordance with law was required to be taken under section 53 of the Transfer of Property Act, 1882. The Assessing Officer is required to file a suit for declaration to the effect that the transaction of transfer was void under section 281 of the Income-tax Act; but he himself cannot assume jurisdiction *suo moto* to declare the sale deed as void.
5.	***CIT v. Laxman Das Khandelwal (2019) 417 ITR 325 (SC)***	
	Issue	**Analysis & Decision**
	Is the omission to issue notice u/s 143(2) a defect not curable in spite of section 292BB, inspite of participation by the assessee in assessment proceedings?	Without the statutory notice u/s 143(2), the Assessing Officer could not assume jurisdiction. According to section 292BB, if the assessee had participated in the proceedings, by way of legal fiction, notice issued would be deemed to be valid even if there be infractions as detailed in the said section. The scope of the provision is to make service of notice having certain infirmities to be proper and valid if there was requisite participation on the part of the assessee. It is, however, to be noted that the section does not save complete absence

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		of issue of notice. **For section 292BB to apply, the notice must have emanated from the Department. It is only the infirmities in the manner of service of notice that the section seeks to cure.** The section is not intended to cure complete absence of notice itself. Non-issuance of notice u/s 143(2) is not a curable defect u/s 292BB inspite of participation by the assessee in assessment proceedings.
6.	***Principal CIT v. Maruti Suzuki India Ltd. (2019) 416 ITR 613 (SC)***	
	Issue	**Analysis & Decision**
	Is notice issued u/s 143(2) and 142(1) to the amalgamating company, after approval of the Scheme of amalgamation by the High Court and intimation of the same to the A.O., a defect not curable u/s 292BB?	The consequence of the scheme of amalgamation approved u/s 394 of the Companies Act, 1956 (section 232 of the Companies Act, 2013) was that the amalgamating company ceased to exist. It could not thereafter be regarded as a person u/s 2(31) against which assessment proceedings could be initiated or an order of assessment made. Notice u/s 143(2) was issued to the amalgamating company. Prior to the date on which the jurisdictional notice u/s 143(2) was issued, the scheme of amalgamation had been approved by the High Court. Since the notice u/s 143(2) was issued in the name of the amalgamating company in spite of the fact that the amalgamated company had, prior to that date, addressed a communication to the Assessing Officer intimating the fact of amalgamation, **the initiation of assessment proceedings against an entity which had ceased to exist was *void ab initio*.** Further, participation in the proceedings by the amalgamated company would not cure this illegality.

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TEST YOUR KNOWLEDGE

Questions

1. *Fearless General Finance & Investment Limited, a residuary non-banking company, accepts public deposits, issues deposit certificate and repays the same after some period of time alongwith interest, under different schemes run by it. Following transactions were noted from their books of account:*

   (i) *Mr. A, an individual, has deposited ₹ 15,000 on 1st May, 2022 for 48 months by bearer cheque and another ₹ 15,000 on 30th June, 2025 in cash to purchase a new certificate of 48 months tenure.*

   (ii) *Mr. A has applied for premature withdrawal against both the certificates and the company has paid him ₹ 16,500, by a bearer cheque, against principal and interest on 23rd March, 2026, due against his first certificate (purchased in 2022) and ₹ 15,500 in cash on 25th March, 2026, against the second certificate.*

   Discuss the violation of income tax provision, if any, and consequential penalty for each transaction. Will it make any difference if the certificates were held by Mr. A with his wife Mrs. A, jointly, while repaying back in cash or bearer cheque?

2. *The proceedings before the Income-tax Authorities either can be attended by the assessee in person or through an authorized representative. Who can be treated as an authorized representative of the assessee? Mention any five persons who can be treated as an authorized representative of the assessee.*

3. *An order for A.Y. 2024-25 was passed by the Assessing Officer as per section 143(3), but the typist wrongly typed in the order, the assessment year as A.Y. 2023-24 and the relevant previous year as ending on 31.3.2023. The assessee claimed in appeal that the same is an invalid order which was not accepted by the CIT (Appeals) on the ground of the error being of clerical nature. Discuss the correctness of the order of the CIT(Appeals).*

4. *"Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon." In this context answer:*

   (i) *What are the prescribed modes of service of such notice?*

   (ii) *On whom should the notice be addressed and served upon in the cases where the assessee is a dissolved firm, a deceased person and a partitioned HUF.*

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5. *Explain the circumstances under which the Assessing Officer can resort to provisional attachment of the property of the assessee. Also, state the period of time for which such attachment can take place.*

   When can the Assessing Officer revoke provisional assessment of property? Discuss.

6. *Mr. Biswas, a stock broker, has defaulted with regard to his income-tax payments and the Assessing Officer has attached his membership card of Stock Exchange under section 281B of the Income-tax Act, 1961. Mr. Biswas contends that the membership card is not transferable and is not his personal asset. Discuss the validity of attachment of the card by the Assessing Officer in the context of Section 281B.*

7. *An assessee had credited a sum of ₹ 50,000 in cash in the account of Madan, said to represent a loan obtained from him. The Assessing Officer, having gone into the genuineness of the transaction, disbelieved the story of loan and treated the sum of ₹ 50,000 as the income of the assessee from undisclosed sources. He also started proceedings under section 271D and levied a penalty of ₹ 60,000 on the assessee for having accepted the loan in contravention of section 269SS. Examine the correctness of the levy.*

Answers

1. **(i)** There is no violation of section 269SS at the time of acceptance of the first deposit of ₹ 15,000 by bearer cheque on 1.5.2022, since it is not in excess of the threshold limit of ₹ 20,000. However, violation under section 269SS is attracted at the time of acceptance of the second deposit in cash on 30th June, 2025, since as on that date, there is already an outstanding deposit of ₹ 15,000 and another cash deposit of ₹ 15,000 would take the aggregate to ₹ 30,000, which exceeds the threshold limit of ₹ 20,000. Therefore, penalty under section 271D of a sum equal to the amount of deposit taken from Mr. A is attracted for failure to comply with the provisions of section 269SS.

(ii) In this case, there is a violation of the provisions of section 269T at the time of first repayment by bearer cheque on 23rd March, 2026, since on that date, the aggregate amount of deposits held by Mr. A with the non-banking company (together with interest payable on such deposits) is more than ₹ 20,000. Therefore, penalty under section 271E equal to the amount of deposit so repaid will be attracted for failure to comply with the provisions of section 269T.

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However, the second repayment of ₹ 15,500 on 25th March, 2026 in cash cannot be considered as a violation of section 269T, since neither the amount of deposit with interest thereon nor the aggregate amount of deposits held by Mr. A on that date together with interest exceeds the threshold limit of ₹ 20,000.

The provisions of section 269T will be attracted at the time of first repayment of bearer cheque even if the certificate is being held by Mr. A in joint name with his wife.

2. As per section 288, the proceedings before the income-tax authorities can be attended by an assessee in person or through an authorised representative, i.e., a person authorized by the assessee in writing to appear on his behalf, being -

(i) a person who is a relative or a regular employee of the assessee; or

(ii) any officer of a Scheduled Bank in which the assessee maintains a current account or has other regular dealings; or

(iii) a legal practitioner who is entitled to practise in any civil court in India; or

(iv) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 who hold a valid certificate of practice

(v) any person who has passed any accountancy examination recognized in this behalf by the CBDT for this purpose; or

3. Section 292B provides that no return of income, assessment, notice or summons furnished or made or issued or taken in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment or notice etc., if such return of income, assessment, notice, summons etc. is in substance and effect in conformity with or according to the intent and purpose of the Act. **Therefore, a clerical mistake cannot invalidate an otherwise valid assessment.** Thus, the typographical error in the assessment order as to assessment year and previous year does not make the same invalid unless established otherwise. Accordingly, the action of the CIT(Appeals) in not accepting the claim of the assessee is valid.

4. **(i)** As per section 282(1), the service of notice or summon or requisition or order or any other communication under this Act may be made by delivering or transmitting a copy thereof to the person named therein -

(1) by post or such courier services as approved by the CBDT; or

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(2) in such manner as provided in the Code of Civil Procedure, 1908 for the purposes of service of summons; or

(3) in the form of any electronic record as provided in Chapter IV of the Information Technology Act, 2000; or

(4) by any other means of transmission of documents as may be provided by rules made by the CBDT in this behalf.

The CBDT is empowered to make rules providing for the addresses (including the address for electronic mail or electronic mail message) to which such communication may be delivered or transmitted to the person named therein.

(ii) The service of notice in the given cases should be on the persons mentioned hereunder:-

Person	Notice to be addressed and served on
A dissolved firm	Any person who was a partner (not being a minor) immediately before dissolution.
A deceased person	The legal heirs of the deceased.
A partitioned HUF	Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.

5. As per the provisions of section 281B, there can be provisional attachment to protect the interest of Revenue in certain cases i.e.-

(i) The proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment or for imposition of penalty under section 271AAD (penalty leviable for false entry etc. in books of accounts) where the amount or aggregate of amounts of penalty likely to be imposed under the said section exceeds ₹ 2 crores should be pending.

(ii) Such attachment should be necessary for the purpose of protecting the interest of Revenue in the opinion of the Assessing Officer.

(iii) The previous approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director has been obtained by the Assessing Officer.

(iv) The Assessing Officer, may, by an order in writing attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.

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(v) Such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of order made under section 281B(1). However, the period can be extended by the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director, as the case may be, for the reasons to be recorded in writing for a further period or periods as he thinks fit. The total period of extension in any case cannot exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

The Assessing Officer shall, by order in writing, revoke provisional attachment of a property made under section 281B(1) in a case where the assessee furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

6. The right of membership is not a private asset and it is merely a personal privilege granted to the member. It is non-transferable and incapable of alienation by the member or his legal representative except to the limited extent provided in the rules and regulations of the stock exchange and subject to the fulfillment of conditions prescribed by the stock exchange. The nomination, even if permitted, is subject to the rules and is not automatic. The right of nomination is vested in the stock exchange absolutely in the case of death of or default of a member. Thus, the membership card is not the property of the assessee and therefore cannot be attached under section 281B. It has been so held by the Apex Court in the case of *Stock Exchange Ahmedabad vs. ACIT (2001) 248 ITR 209*.

7. Penalty leviable under section 271D cannot exceed the sum equal to the loan taken. Hence, the maximum penalty leviable would be ₹ 50,000. Further, the Assessing Officer cannot, on the one hand, treat the loan as undisclosed income of the assessee and on the other, treat it as a loan for the purpose of section 269SS read with section 271D. Such a treatment will be self-contradictory. The moment the amount of ₹ 50,000 is treated as undisclosed income, it ceases to bear the character of loan and therefore, the foundation for the levy of penalty under section 271D disappears. *[Diwan Enterprises v. CIT and Others (2000) 246 ITR 571]*.

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CHAPTER 19

PROVISIONS TO COUNTERACT UNETHICAL TAX PRACTICES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify and examine** the cases where penalty is leviable and **determine** the quantum of penalty for defaults under various provisions of the Income-tax Act, 1961;
- **list** the conditions to be fulfilled by an assessee for making an application for grant of immunity from penalty and prosecution and the time limit for making such application;
- **appreciate** the powers of the Commissioner to waive penalty in certain cases or grant immunity from penalty in certain cases;
- **comprehend** the procedure to be complied with for imposing penalty under the Act;
- **recall** the limitation period, beyond which penalty cannot be imposed;
- **appreciate** the provisions of Income-tax law relating to offences and prosecution;
- **integrate, analyse and apply** the relevant provisions of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 and related Rules to address relevant issues and make computations.

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CHAPTER OVERVIEW

- Penal provisions [Sections 270A to 275]
- Offences and Prosecution [Sections 275A to 280]
- Black Money Law

19.1 INTRODUCTION

As per Taxpayers' Charter, a taxpayer is expected to be honest, disclose full information, keep accurate records as required under laws, pay timely tax and comply with other requirements of the tax laws. However, where a taxpayer fails in complying with such requirements or indulges in in unlawful activities, the Income-tax Act, 1961 provides for imposition of penalty. The Income-tax Act, 1961 also contains prosecution provisions, which are used as a tool for effective enforcement of tax laws and deterring tax avoidance and tax evasion.

While penalties may be imposed by the income-tax authorities, the imposition of a fine or the launching of prosecution for any offence under the Act can be made only by the Magistrate of a Court under sections 275A to 280. In respect of the same default of an assessee, penalty may be imposed, and a prosecution also may be launched against him.

Penal consequences

In addition to the provisions contained under the Income-tax Act to counteract unlawful tax practices, Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 contains provisions to tax undisclosed foreign income and assets.

The provisions to counteract ethical failures include the penal and prosecution provisions contained under the Income-tax Act, 1961 and the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

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19.2 PENAL PROVISIONS UNDER THE INCOME TAX ACT

Penalty is levied over and above the amount of any tax or interest payable by the assessee and thus, penalty is distinct and different from the tax payable. Penalty proceedings, however, are a part of the assessment proceedings. The authority concerned is entitled to levy penalty only if he is satisfied in the course of any proceedings under the Act that a person has been found guilty of any default in complying with the provisions of the Act. If the order of the penalty is set aside in appeal on the ground that the assessee was not given a reasonable opportunity of being heard, the Assessing Officer would be entitled to levy a penalty again after rectifying the mistakes in proceedings. The penalty to be levied on an assessee is to be based upon the law as it stood at the time the default was committed and not the law as it stands in the financial year for which the assessment is made.

The various sections prescribe the minimum and the maximum penalty that can be levied in certain cases though the Principal Commissioner or the Commissioner is empowered to waive or reduce the penalty in some cases. The authority concerned has been given the discretion to levy or not to levy a penalty. However, penalty levied cannot be less than the prescribed minimum nor can it exceed the maximum amount prescribed by the Act. The quantum of penalty levied by a lower authority can be modified by a higher authority on appeal, reference or revision. The various defaults in respect of which penalty can be levied under the Act are discussed as follows:

19.2.1 PENALTY LEVIABLE FOR UNDER REPORTING OF INCOME [SECTION 270A]

Upto A.Y. 2016-17, section 271(1)(c) provided for penalty on account of concealment of particulars of income or furnishing inaccurate particulars of income.

For the purpose of ensuring objectivity, certainty and clarity in the penalty provisions, section 270A provides for levy of penalty in cases of under reporting and misreporting of income with effect from A.Y.2017-18. Consequently, the penal provisions under section 271 shall not apply in relation to A.Y.2017-18 and onwards.

Under reporting of income

(1) **Authorities empowered to levy penalty:** Section 270A(1) empowers the Assessing Officer, the Joint Commissioner (Appeals) or the Commissioner (Appeals) or the Principal Commissioner or the Commissioner to direct levy of penalty, during the course of proceedings under the Income-tax Act, 1961, if a person has under reported his income. Such penalty

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shall be imposed by an order in writing by such authority.

(2) **Cases of under-reporting of income [Section 270A(2)]:** A person shall be considered to have under reported his income if, **A>B** in the cases given hereunder–

is greater than

	Case	(A)	(B)
(i)	Return of income has been filed	Income assessed	Income determined in the return processed u/s 143(1)(a);
(ii)	No return of income has been filed or where return is furnished for the first time u/s 148	Income assessed	Basic exemption limit
(iii)	Reassessment	Income reassessed	Income assessed or reassessed immediately before such re-assessment
(iv)	Return of income has been filed and assessment/ reassessment is made on the basis of MAT/AMT provisions	The amount of deemed total income assessed or reassessed as per the provisions of section 115JB or 115JC	The deemed total income determined in the return processed u/s 143(1)(a)
(v)	No return of income is filed or where return has been furnished for the first time u/s 148 and assessment/ reassessment is made on the basis of MAT/ AMT provisions	the amount of deemed total income assessed as per the provisions of section 115JB or 115JC	The basic exemption limit, in case of an assessee being an individual, HUF, AOP, BOI, in respect of whom the provisions of AMT are applicable.
(vi)	Reassessment as per the provisions of sections 115JB or 115JC	The amount of deemed total income reassessed as per the provisions of sections 115JB or 115JC	The deemed total income assessed or reassessed immediately before such reassessment.
Further, a person would be considered to have under-reported his income if the income assessed or reassessed has the effect of reducing the loss or converting such loss into income.			

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(3) Calculation of under-reported income in different scenarios [Section 270A(3)]:

<table>
<tr><th></th><th>Case</th><th>Manner of computation of under-reported income</th></tr>
<tr><td>(i)</td><td>Where return is furnished and assessment is made for the first time.</td><td>Assessed income
(-)
Income determined under section 143(1)(a)
[in case of all persons]</td></tr>
<tr><td>(ii)</td><td>Where no return has been furnished or where return has been furnished for the first time u/s 148 and the assessment is made for the first time</td><td><table><tr><th>Person</th><th>Under-reported income</th></tr><tr><td>Company, firm or local authority</td><td>Assessed income</td></tr><tr><td>Other persons</td><td>Assessed income
(-)
Basic exemption limit</td></tr></table></td></tr>
<tr><td>(iii)</td><td>Where income is not assessed for the first time</td><td>Income reassessed or recomputed
(-)
Income assessed or reassessed or recomputed in the order immediately preceding the order during the course of which penalty u/s 270A(1) has been initiated.</td></tr>
<tr><td>(iv)</td><td>Where under reported income arises out of determination of deemed total income in accordance with the provisions of section 115JB or section 115JC</td><td>(A - B) + (C - D)
where,
A = Total income assessed as per the general provisions i.e., provisions other than the provisions contained in section 115JB or section 115JC;
B = The total income that would have been chargeable had the total income assessed as per the general provisions been reduced by the amount of under reported income;
C = The total income assessed as per the provisions contained in section 115JB or section 115JC;
D = The total income that would have been chargeable had the total income assessed as per the provisions contained in section 115JB or section 115JC been reduced by the amount of under reported income.
However, where the amount of under reported income on any issue is considered both under the provisions</td></tr>
</table>

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		contained in section 115JB or section 115JC and under general provisions, such amount shall not be reduced from total income assessed while determining the amount under item D.
(v)	Where an assessment or reassessment has the effect of reducing the loss declared in the return or converting that loss into income	The loss claimed **(-)** The income or loss, as the case may be, assessed or reassessed.

(4) Meaning of Under-reported income in a case where the source of any receipt, deposit or investment is linked to an earlier year [Section 270A(4) & (5)]:

In a case where the source of any receipt, deposit or investment appearing in the current assessment year is claimed to be an amount added to income or deducted while computing loss, as the case may be, in the assessment of such person in any earlier assessment year and no penalty was levied for such preceding year, under-reported income shall include such amount as is sufficient to cover such receipt, deposit or investment.

Note – Such amount shall be deemed to be the amount of income under-reported for the preceding year in the following order –

(i)	The preceding year immediately before the year in which the receipt, deposit or investment appears, being the first preceding year; and
(ii)	Where the amount added or deducted in the first preceding year is not sufficient to cover the receipt, deposit or investment, the year immediately preceding the first preceding year and so on.

(5) Cases not included within the scope of under-reported income under section 270A [Section 270A(6)]:

	Case	Condition
(i)	The amount of income in respect of which the assessee offers an explanation	The Assessing Officer/CIT/PC/ the Joint Commissioner (Appeals) /the Commissioner (Appeals) is satisfied that the explanation is *bona fide* and all the material facts have been disclosed to substantiate the explanation.
(ii)	The amount of under-reported income determined on the basis of an estimate	If the accounts are correct and complete to the satisfaction of the income-tax authority but the method employed is such that the income cannot properly be deduced therefrom

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(iii)	The amount of under-reported income determined on the basis of an estimate	If the assessee has, on his own, estimated a lower amount of addition or disallowance on the same issue and has included such amount in the computation of his income and disclosed all the facts material to the addition or disallowance
(iv)	The amount of under-reported income represented by any addition made in conformity with the arm's length price determined by the Transfer Pricing Officer	Where the assessee had maintained information and documents as prescribed under section 92D, declared the international transaction under Chapter X and disclosed all the material facts relating to the transaction
(v)	The amount of undisclosed income on account of a search operation	Where penalty is leviable under section 271AAB[1] in respect of such undisclosed income.

(6) Cases of misreporting of income [Section 270A(9)]:

(i) misrepresentation or suppression of facts;

(ii) failure to record investments in the books of account;

(iii) claim of expenditure not substantiated by any evidence;

(iv) recording of any false entry in the books of account;

(v) failure to record any receipt in the books of account having a bearing on total income; and

(vi) failure to report any international transaction or deemed international transaction or specified domestic transaction under Chapter X.

(7) Quantum of penalty leviable:

	Section	Case	Penalty
(i)	270A(7)	Under reporting of income	50% of tax payable on under-reported income
(ii)	270A(8)	Where under reporting of income results from misreporting of income by any person.	200% of tax payable on such under-reported income

[1] *On account of introduction of 'Block Assessment' (Chapter XIV-B) vide Finance Act, 2024, where search is initiated under section 132 on or after the 1.9.2024, penalty under section 271AAB would not be levied after the said date.*

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(8) **Manner of computation of tax payable on under-reported income [Section 270A(10)]:**

	Case	Manner of computation of tax payable on under-reported income
(i)	Where no return of income has been furnished or where return has been furnished for the first time u/s 148 and the income has been assessed for the first time	The tax payable on under-reported income shall be the amount of tax calculated on the under-reported income as increased by the basic exemption limit as if it were the total income.
(ii)	Where the total income determined u/s 143(1)(a) or assessed or reassessed or recomputed in a preceding order is a loss	The tax payable in respect of the under-reported income shall be the amount of tax calculated on the under-reported income as if it were the total income.
(iii)	In any other case	The amount of tax calculated on the under-reported income as increased by the total income determined under section 143(1)(a) or total income assessed, reassessed or recomputed in a preceding order as if it were the total income ***Minus*** The amount of tax calculated on the total income determined under section 143(1)(a) or total income assessed, reassessed or recomputed in a preceding order.

(9) No addition or disallowance of an amount shall form the basis for imposition of penalty, if such addition or disallowance has formed the basis of imposition of penalty in the case of the person for the same or any other assessment year [Section 270A(11)].

(10) **Consequential amendments in other provisions:**

Consequential amendments have been made in sections 119, 253, 271A, 271AA, 271AAB[2], 273A, 276C and 279 to provide reference to section 270A.

	Section	Provision	Amendment
(i)	119(2)(a)	Power of CBDT to relax certain provisions, by way of a general or special order, for the purpose of	The CBDT has been empowered to relax the provisions for levy of penalty u/s 270A also.

[2] *On account of introduction of 'Block Assessment' (Chapter XIV-B) vide Finance (No. 2) Act, 2024, where search is initiated under section 132 on or after the 1.9.2024, penalty under section 271AAB would not be levied after the said date.*

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		proper and efficient management of the work of assessment and collection of revenue.	
(ii)	253(1)	Enlists the orders appealable to the Appellate Tribunal.	The order passed by the Joint Commissioner (Appeals) or the Commissioner (Appeals), the Principal Commissioner or the Commissioner u/s 270A would also be appealable to the Appellate Tribunal.
(iii)	271A	Levy of penalty of ₹ 25,000 for failure to keep, maintain or retain books of account as required under section 44AA.	The penalty under this section would be without prejudice to the provisions of section 270A.
(iv)	271AA	Levy of penalty of 2% of value of international transaction or specified domestic transaction, where the person fails to maintain information and documents required u/s 92D or report such transaction or maintains or furnishes an incorrect information or document.	The penalty under this section would be without prejudice to the provisions of section 270A.
(v)	271AAB[3]	Levy of penalty where search is initiated under section 132 on or after 15.12.2016 ***but before 01.09.2024***. Such penalty may be levied either by the Assessing Officer or Commissioner (Appeals)	No penalty under section 270A would be imposable in respect of undisclosed income on which penalty has been levied under section 271AAB(1A).
(vi)	273A(1)	Power of the Principal Commissioner or the Commissioner to reduce or waive penalty in certain cases.	Reduction or waiver of penalty imposable on a person u/s 270A, if prior to detection by the Assessing Officer, the person has voluntarily and in good faith made full and true disclosure of particulars of income i.e., where

[3] *On account of introduction of 'Block Assessment' (Chapter XIV-B) vide Finance (No. 2) Act, 2024, where search is initiated under section 132 on or after the 1.9.2024, penalty under section 271AAB would not be levied after the said date.*

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			the excess of income assessed over the income returned is of such a nature as not to attract the penal provisions u/s 270A.
(vii)	273A(2)	Order reducing or waiving penalty under section 273A(1) to be made by the PC/CIT only with the previous approval of the PCC/CC/ PDG/DG, as the case may be.	Previous approval of higher authorities also required if, in a case falling u/s 270A, the amount of income in respect of which the penalty is imposed or imposable for the relevant A.Y., or where such disclosure relates to more than one A.Y., the aggregate amount of such income for those years exceed ₹ 5 lakh.
(viii)	276C	Prosecution to be instituted if a person willfully attempts in any manner to evade any tax, penalty or interest chargeable or imposable under the Income-tax Act, 1961. Rigorous imprisonment for a period of 6 months to 7 years and fine would be attracted in a case where the amount sought to be evaded exceeds ₹ 25 lakhs.	Prosecution to also be instituted if a person under-reports his income under the Income-tax Act, 1961 Rigorous imprisonment for a period of 6 months to 7 years and fine would also be attracted in a case where the tax on under-reported income exceeds ₹ 25 lakhs.
(ix)	279(1A)	Prosecution not to be instituted against a person u/s 276C or 277 in relation to the assessment for an assessment year in respect of which penalty imposed or imposable u/s 271(1)(iii) has been reduced or waived by an order u/s 273A.	Prosecution not to be instituted against a person u/s 276C or 277 in relation to the assessment for an AY in respect of which penalty imposed or imposable u/s 270A or u/s 271(1)(iii) has been reduced or waived by an order u/s 273A.

19.2.2 REDUCTION OR WAIVER OF PENALTY [SECTION 273A]

(1) Power to reduce/ waive penalty under section 270A

(a) **Exercise of power to reduce/waive penalty under section 270A** - Section 273A(1) authorises the Principal Commissioner or the Commissioner of Income-tax to reduce or waive the amount of penalty imposed or imposable on a person under section 270A. The exercise of this power by the Principal Commissioner or the Commissioner is

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purely at his discretion and may be done either on his own motion or otherwise, that is on receipt of an application from the assessee.

(b) **Conditions to be satisfied -**The Principal Commissioner or the Commissioner can reduce or waive the penalty payable by any person only if the following conditions are satisfied:

(i) **Full and true disclosure -**The reduction or waiver by the Principal Commissioner or the Commissioner would be permissible only if, prior to the detection by the Assessing Officer of the concealment of income or the inaccuracy of particulars furnished in respect of such income, the assessee has made a full and true disclosure of all the particulars in respect of his income and, that, too voluntarily and in good faith.

For this purpose, a person would be deemed to have made a full and true disclosure of his income or of all the particulars relating thereto, in any case where the excess of income assessed over the income returned is of such a nature as not to attract the imposition of any penalty under section 270A.

(ii) **Co-operation in enquiry -** It is essential that the assessee must have co-operated with the department in any enquiry relating to the assessment of his income.

(iii) **Payment of tax or interest -** He must also have either paid or made satisfactory arrangements for the payment of any tax or interest, which may become payable in consequence of any order passed under the Income-tax Act, 1961 in respect of the assessment year.

(c) **Prior approval of higher authorities required in certain cases -** If, in a case falling under section 270A, the amount of income in respect of which the penalty is imposed or imposable for the relevant assessment year or where such disclosure relates to more than one assessment year, the aggregate amount of such income for those years exceeds ₹ 5,00,000, the Principal Commissioner or the Commissioner of Income-tax can exercise his power to reduce or waive penalty, only after getting the previous approval of the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or the Director General.

PC or C can reduce or waive penalty

- **Without approval of higher authorities, where income ≤ 5 lakhs**
- **With approval of PCC or CC or PDG or DG, where income > 5 lakhs**

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(d) **Relief available only once in life time -** Where an order has been made under section 273A(1) in favour of any person, whether such order relates to one or more assessment years, he shall not be entitled to any relief under this section in relation to any other assessment year at any time after the making of such order.

(2) Power to reduce/ waive penalty payable under the Act

(a) **Exercise of power to reduce/waive any penalty** - Section 273A(4) authorises the Principal Commissioner or the Commissioner of Income-tax, without prejudice to the powers conferred on him by any other provision of the Act, to reduce or waive the amount of any penalty payable by the assessee under this Act. The Principal Commissioner or the Commissioner may exercise this power on an application made by the assessee, after recording his reason in writing for so doing. He is also empowered to stay or compound any proceedings for the recovery of any penalty in cases where he is satisfied that:

(i) to do otherwise would cause genuine hardship to the assessee having due regard to all the facts and circumstances of the case; and

(ii) the assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

Such order accepting or rejecting application of an assessee in full or part has to be passed within a period of **12 months from the end of the month in which such application is received by the PC or CIT**.

However, order rejecting the application of the assessee shall not be passed unless the assessee has been an opportunity of being heard.

PC or C can reduce or waive penalty

- **Without approval of higher authorities, where income ≤ 1 lakh**
- **With approval of PCC or CC or PDG or DG, where income > 1 lakh**

(b) **Prior approval of higher authorities required in certain cases -** In case the quantum of penalty payable under this Act exceeds ₹ 1 lakh or the application relates to more than one penalty and the aggregate amount of such penalties exceeds ₹ 1 lakh, the PC or the CIT grant relief only with the previous approval of the PCC or the CC or the PDG or the DG, as the case may be.

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(3) **Finality of order**

The Principal Commissioner or the Commissioner's order under section 273A for reduction or waiver of penalty is final and cannot be challenged in any court or before any authority.

Waiver order cannot be challenged

ILLUSTRATION 1

M/s. XYZ is a firm liable to tax@30%. The following are the particulars furnished by the firm for A.Y.2026-27:

	Particulars of total income	₹
(1)	*As per the return of income furnished u/s 139(1)*	*50,00,000*
(2)	*Determined under section 143(1)(a)*	*60,00,000*
(3)	*Assessed under section 143(3)*	*75,00,000*
(4)	*Reassessed under section 147*	*95,00,000*

Can penalty be levied u/s 270A on M/s. XYZ? If the answer is in the affirmative, compute the penalty leviable u/s 270A.

SOLUTION

M/s. XYZ is deemed to have under-reported its income since:

(1) its income assessed u/s 143(3) exceeds its income determined in a return processed u/s 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed u/s 143(3).

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3) Under-reported income:		
Total income assessed under section 143(3)	75,00,000	
(-) Total income determined u/s 143(1)(a)	60,00,000	
	15,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 15 lakhs *plus* tax on total		

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income of ₹ 60 lakhs determined u/s 143(1)(a) **[30% of ₹ 75 lakh + HEC@4%]**	23,40,000	
Less: Tax on total income determined u/s 143(1)(a) **[30% of ₹ 60 lakh +HEC@4%]**	18,72,000	
	4,68,000	
Penalty leviable@50% of tax payable		2,34,000
Reassessment under section 147 Under-reported income:		
Total income reassessed under section 147	95,00,000	
(-) Total income assessed under section 143(3)	75,00,000	
	20,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 20 lakhs *plus* tax on total income of ₹ 75 lakhs assessed u/s 143(3) **[30% of ₹ 95 lakh + HEC@4%]**	29,64,000	
Less: Tax on total income assessed u/s 143(3) **[30%of ₹ 75 lakh + HEC@4%]**	23,40,000	
	6,24,000	
Penalty leviable@50% of tax payable		3,12,000

Note *– The following assumptions have been made -*

(1) None of the additions or disallowances made in assessment or reassessment qualifies under section 270A(6); and

*(2) The under-*reported income is not on account of misreporting.

ILLUSTRATION 2

Mr. Ram, a resident individual of the age of 55 years, has not furnished his return of income for A.Y.2026-27. However, the total income assessed in respect of such year under section 144 is ₹ 14 lakh. Is penalty u/s 270A attracted in this case, and if so, what is the quantum of penalty leviable?

SOLUTION

Mr. Ram is deemed to have under-reported his income since he has not filed his return of income and his tax liability would be computed applying the provisions of section 115BAC, since w.e.f. A.Y. 2026-27 he has to specifically exercise the option to shift to normal provisions along with the return of income. Hence, penalty under section 270A is leviable in his case in the following manner.

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Computation of penalty leviable under section 270A

Particulars		₹	₹
Assessment under section 144			
Under-reported income:			
Total income assessed under section 144		12,00,000	
Tax payable on under-reported income as per section 115BAC			
Upto ₹ 4,00,000	Nil		
₹ 4,00,001 – ₹ 8,00,000 @ 5%	20,000		
₹8,00,001 – ₹ 12,00,000 @10%	40,000		
₹ 12,00,001 – ₹ 14,00,000 @15%	30,000	90,000	
Add: HEC@4%		3,600	
		93,600	
Penalty leviable@50% of tax payable			46,800

Note *– It is assumed that the under-reported income is not on account of misreporting.*

ILLUSTRATION 3

ABC Ltd. is a domestic company liable to tax @25%. The following are the particulars furnished by the company for A.Y.2026-27:

	Particulars of total income	₹
(1)	*As per the return of income furnished u/s 139(1)*	*(15,00,000)*
(2)	*Determined under section 143(1)(a)*	*(8,00,000)*
(3)	*Assessed under section 143(3)*	*(5,00,000)*
(4)	*Reassessed under section 147*	*4,00,000*

Is penalty leviable under section 270A on ABC Ltd., and if so, what is the quantum of penalty?

SOLUTION

ABC Ltd. is deemed to have under-reported its income since:

(1) the assessment u/s 143(3) has the effect of reducing the loss determined in a return processed u/s 143(1)(a); and

(2) the reassessment u/s 147 has the effect of converting the loss assessed u/s 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

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Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3) Under-reported income:		
Loss assessed u/s 143(3)	(5,00,000)	
(-) Loss determined under section 143(1)(a)	(8,00,000)	
	3,00,000	
Tax payable on under-reported income@25%	75,000	
Add: HEC@4%	3,000	
	78,000	
Penalty leviable@50% of tax payable		39,000
Reassessment under section 147 Under-reported income:		
Total income reassessed under section 147	4,00,000	
(-) Loss assessed under section 143(3)	(5,00,000)	
	9,00,000	
Tax payable on under-reported income@25%	2,25,000	
Add: HEC@4%	9,000	
	2,34,000	
Penalty leviable@50% of tax payable		1,17,000

Notes *– The following assumptions have been made -*

(1) None of the additions or disallowances made in assessment or reassessment qualifies u/s 270A(6); and

(2) The under-reported income is not on account of misreporting.

19.2.3 OTHER PENAL PROVISIONS UNDER THE INCOME TAX ACT

Chapter XXI of the Income-tax Act, 1961 contains various penal provisions which are attracted for failure to comply with the requirements of the provisions contained in other chapters of the Act. To provide easy correlation certain penal provisions are discussed along with related provisions in the respective chapters of the Study Material. To give a bird's eye view of the penal provisions discussed in other chapters, the following table summarizes these penal provisions:

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Section	Nature of Default	Penalty Leviable	Remarks
271A	Failure to keep or maintain or retain books of account, document etc. as required u/s 44AA or rules made thereunder.	₹ 25,000	Penalty may be levied by the Assessing Officer or the Joint Commissioner (Appeals) or the Commissioner (Appeals). Penalty is leviable without prejudice to section 270A.
271AA(1)	Failure to keep and maintain any information and document as required u/s 92D(1)/(2); Failure to report such transaction which he is required to do so; Maintaining or furnishing an incorrect information or document.	2% of the value of each international transaction or specified domestic transaction entered into by such person	Penalty may be levied by the Assessing Officer or Commissioner (Appeals). Penalty is leviable without prejudice to section 270A or section 271BA.
271AA(2)	Fails to furnish the information and documents as required under section 92D(4)	₹ 5,000	Prescribed Income-tax Authority
271AAD	Penalty for false entry etc. in books of account or omission of any entry which is relevant for computation of total income of such person, to evade tax liability. False entry includes use or intention to use – • Forged or falsified documents such as a false invoice or, in general, a false piece of documentary evidence; or • Invoice in respect of supply or receipt of goods or services or	Sum equal to the aggregate amount of false entry or omitted entry	Penalty may be levied by the Assessing Officer or Joint Commissioner (Appeals) or Commissioner (Appeals). Such penalty is leviable on • the person who makes such false entry or omits an entry to evade tax liability; and • any other person, who caused the person in any manner to make a false entry or omit any entry to evade tax liability.

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	both issued by the person or any other person without actual supply or receipt of such goods or services or both; or • Invoice in respect of supply or receipt of goods or services or both to or from a person who does not exist		
271AAE	If during any proceeding under this Act, it is found that any person, being any fund or institution or trust referred under section 10(23C)(iv)/(v)/(vi)/(via) or any trust or institution referred to in section 11 applied income of the trust or institution, directly or indirectly, for the benefit of any person referred to in section 13(3)	Sum equal to - (i) 100% of the aggregate amount of income so applied, where the violation is noticed for the first time during any previous year; and (ii) 200% of the aggregate amount of income so applied, where violation is noticed again in any subsequent previous year.	Penalty may be levied by the Assessing Officer
271B	Failure to get accounts audited or obtain audit report u/s 44AB or to furnish the report of such auditor with return of income.	½% of total sales, turnover or gross receipts of business/ gross receipts of profession or ₹ 1,50,000, which-ever is less.	Penalty may be levied by the Assessing Officer

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271BA	Failure to furnish audit report as required under section 92E	₹ 1,00,000	Penalty may be levied by the Assessing Officer
271C	Failure to deduct tax at source as per chapter XVII-B or to pay or ensure payment of the whole or any part of the tax as required by - - the proviso to section 194B [winnings from lottery or crossword puzzle] or - the first proviso to section 194R(1) [on benefits and perquisites in respect of business or profession] or - the proviso to section 194S(1) [consideration on transfer of virtual digital assets] or - section 194BA(2) [winnings from online games]. **Note** – In all the four situations mentioned above, the winnings/ benefit/ perquisite/ consideration for transfer, as the case may be, is wholly in kind or partly in cash and partly in kind and the part in cash is not sufficient to meet the TDS liability.	A sum equal to the amount of tax which he failed to deduct or pay or ensure payment of said tax at source.	Penalty imposable by the Joint Commissioner. ***However, w.e.f. 01.04.2025 penalty shall be imposed by the Assessing Officer.***
271CA	Failure to collect the whole or any part of the tax as required by or under the provisions of Chapter XVII-BB	A sum equal to the amount of tax which he failed to collect.	Penalty imposable by the Joint Commissioner. ***However, w.e.f. 01.04.2025 penalty shall be imposed by the Assessing Officer.***

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271D	Failure to comply with the provisions of section 269SS.	Penalty of a fixed sum equal to amount of loan or deposit or specified sum taken or accepted otherwise than by way of account payee cheque/ bank draft or use of ECS through a bank A/c.	Penalty imposable by the Joint Commissioner. ***However, w.e.f. 01.04.2025 penalty shall be imposed by the Assessing Officer.***
271DA	Failure to comply with the provisions of section 269ST	Penalty of sum received in contravention of the provisions of section 269ST i.e., sum of ₹ 2 lakh or more received in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person, otherwise than by an account payee cheque/ bank draft or use of ECS through a bank A/c.	Penalty imposable by the Joint Commissioner. ***However, w.e.f. 01.04.2025 penalty shall be imposed by the Assessing Officer.***
271DB	Failure to comply with the provisions of section 269SU	Penalty of ₹ 5,000 per day of continuing default, if the person who is required to provide facility for accepting payment through the prescribed electronic modes of payment referred to in section 269SU, fails to provide such facility	Penalty imposable by the Joint Commissioner. ***However, w.e.f. 01.04.2025 penalty shall be imposed by the Assessing Officer.*** No penalty imposable if the person proves that there were good and sufficient reasons for such failure

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271E	Failure to comply with the provisions of section 269T	A sum equal to the amount of loan or deposit or specified advance repaid otherwise than by an account payee cheque/bank draft or use of ECS through a bank A/c.	Penalty imposable by the Joint Commissioner. ***However, w.e.f. 01.04.2025 penalty shall be imposed by the Assessing Officer.***
271FA	Failure to furnish Statement of financial transaction or reportable account within the time prescribed u/s 285BA(2), i.e., on or before 31st May, immediately following the F.Y. in which the transaction is registered or recorded.	A sum of ₹ 500 for every day during which failure continues.	Penalty leviable by Income Tax Authority prescribed u/s 285BA
	Failure to furnish Statement of Financial Transaction or Reportable Account within the time prescribed u/s 285BA(5).	A sum of ₹ 1,000 for every day during which failure continues, beginning from the day immediately following the day on which the time specified in such notice for furnishing the statement expires.	
271FAA(1)	Furnishing of inaccurate information in the statement of financial transaction or reportable account or failure to furnish correct information within the period specified or fails to comply with due diligence	₹ 50,000	Leviable by the income-tax authority prescribed under section 285BA
271FAA(2)	Furnishing inaccurate statement of financial transaction or reportable account by reporting	₹ 5,000 for every reportable account, in addition to the penalty of ₹ 50,000 levied	

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	financial institution, where the inaccuracy is due to false/inaccurate information furnished by the holder(s) of the relevant reportable account(s).	under section 271FAA(1) above. The reportable financial institution is entitled to recover the sum so paid on behalf of such reportable account holder or to retain out of any money that may be in its possession or may come to it from every such reportable account holder, an amount equal to the sum so paid.	
271FAB	Failure to furnish within the prescribed time, a statement or any information or document as required u/s 9A(5) by an eligible investment fund	₹ 5,00,000	Leviable by the income-tax authority prescribed under section 9A(5)
271G	Failure to furnish information or document under section 92D(3)	2% of the value of the international transaction or specified transaction for each such failure	**Competent Authority to levy penalty:** The Assessing Officer/ the Transfer Pricing Officer/ the Commissioner (Appeals).
271GA	Failure to furnish information or document by an Indian concern under section 285A	2% of the value of the transaction in respect of which such failure has taken place, if such transaction has the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern. In any other case; ₹ 5,00,000.	Penalty imposable by an income-tax authority prescribed under section 285A.

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271GB	Non-furnishing of the report by any reporting entity which is obligated to furnish Country-by-Country report as required under section 286		For details, refer section 286 discussed in Chapter 24 on Transfer Pricing
	Period of delay/default	**Penalty**	
	Not more than a month	₹ 5,000 per day	
	Beyond one month	₹ 15,000 per day for the period exceeding one month	
	Continuing default even after service of order levying penalty	₹ 50,000 per day of continuing failure beginning from the date of service of order	
	Failure to produce information and documents within prescribed time		
	Failure to produce information before prescribed authority within the period allowed u/s 286(6)	₹ 5,000 per day of continuing failure, from the day immediately following the day on which the period for furnishing the information and document expires.	
	Continuing default even after service of penalty order	₹ 50,000 per day for the period of default beyond the date of service of penalty order.	
	Penalty for submission of inaccurate information in the CBC report	₹ 5,00,000	Penalty would be leviable on the reporting entity, if,- (a) the entity has knowledge of the inaccuracy at the time of furnishing the report but does not

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			inform the prescribed authority; or (b) the entity discovers the inaccuracy after the report is furnished and fails to inform the prescribed authority and furnish correct report within a period of fifteen days of such discovery; or (c) the entity furnishes inaccurate information or document in response to notice of the prescribed authority under section 286(6).
271GC	Failure to furnish statement under section 285	₹ 1000 per day for the period of default, if the period of default does not exceed 3 months or ₹ 1,00,000 in any other case.	Penalty leviable by Assessing Officer
271H			Penalty leviable by Assessing Officer
(a)	Failure to furnish TDS/TCS statements within the prescribed time.	₹ 10,000 to ₹ 1,00,000	No penalty would be leviable if the person proves that after paying tax deducted or collected along with the fee under section 234E and interest, if any, to the credit of the Central Government, he had delivered or caused to be delivered the TDS/TCS statements before the expiry of one month from the time prescribed for delivering or causing to be delivered such statements.

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(b)	Furnishing incorrect information in the said statements in respect of tax deducted or collected	₹10,000 to ₹ 1,00,000	
271-I	Failure to furnish information or furnishing inaccurate information by a person who is required to furnish information under section 195(6)	₹ 1,00,000	Penalty leviable by Assessing Officer
271J	Furnishing of incorrect information in reports or certificates furnished by an accountant, merchant banker or a registered valuer	₹ 10,000 for each such report or certificate	Penalty leviable by the Assessing Officer or the Joint Commissioner (Appeals) or the Commissioner (Appeals) who, in the course of proceedings under the Act, finds that the accountant, merchant banker or registered valuer has furnished incorrect information in reports or certificates
271K	Where a research association, university, college or other institution referred to 35(1)(ii)/(iii) or the company referred to in section 35(1)(iia) fails to deliver or cause to be delivered a statement within the time prescribed under 35(1)(i), or furnish a certificate prescribed under 35(1A)(ii). Where an institution or a fund, fails to deliver or cause to be delivered a statement within the time prescribed under section 80G(5)(viii) or furnish a certificate prescribed under section 80G(5)(ix).	₹ 10,000 to 1,00,000	Penalty leviable by the Assessing Officer

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272A(1)	(a) Refusal to answer questions put by income tax authority (b) Refusal to sign statements made in the course of income tax proceedings.	₹ 10,000 for each such default or failure	Penalty imposable by Joint director or Joint Commissioner. However, where the contravention, failure default occurs in the course of any proceeding before income-tax authority not lower in rank than a Joint director or Joint Commissioner, penalty is imposable by such income-tax authority.
	(c) Non-compliance with summons issued u/s 131(1) to give evidence or produce books of accounts.		
	(d) Failure to comply with a notice issued u/s 142(1) or section 143(2) or failure to comply with a direction issued u/s 142(2A)	→	Penalty imposable by the income-tax authority who had issued the notice or direction after giving the person an opportunity of being heard in the matter.
272A(2)	**Failure:** – To comply with notice u/s 94(6) – To give notice of discontinuance of business/ profession u/s 176(3) – To furnish in due time returns statements mentioned in sections 133, 206, 206C or 285B. – To allow inspection of register referred in section 134 – To furnish returns of income u/s 139(4A)/(4C)	**<u>₹ 500 for every day</u>** during which default continues. However, the amount of penalty for failure in relation to a declaration u/s 197A, a certificate u/s 203 and a returns u/s 206 and 206C and statements u/s 200(2A)/(3) or proviso to section 206C(3)/(3A) shall not exceed the amount of tax deductible or collectible.	Section 272A(3) specifies that for the default committed u/s 272(A)(1) and (2), where the contravention occurs in the course of any proceeding before an income-tax authority not lower in rank than a Joint Director or a Joint Commissioner, penalty can be imposed by such income-tax authority. In any other case, by the Joint Director or the Joint Commissioner. In either case, the penalty order can be passed only after the person concerned is given an opportunity of being heard in the matter.

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	– To furnish a certificate as required in section 203 or 206C – To deduct and pay tax u/s 226(2) – To furnish a statement as required by section 192(2C) – To deliver or cause to be delivered in due time a copy of the declaration referred to in section 206C(1A) – To deliver or cause to be delivered the statements within the time specified in section206A(1)/200 (2A)/ 206C(3A) – To deliver or cause to be delivered copy of the declaration u/s 197A	→	Penalty is imposable by the PCC/CC/PC or the Commissioner of Income-tax after giving the person an opportunity of being heard in the matter.
272AA	Failure to comply with the provision of section 133B	Any amount upto ₹ 1,000	Penalty imposable by the Joint Commissioner/Asst. Director/ Dy. Director/Assessing Officer after giving the person an opportunity of being heard in the matter.
272B	Failure to comply with the provisions of section 139A	₹ 10,000	
	Failure to quote/intimate PAN/Aadhaar No. in any document referred to in	₹ 10,000 for each such default	

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	section 139(5)(c) or to intimate such no. as required u/s 139A(5A) or 139A(5C) or quoting/intimating false PAN/Aadhaar No.		Penalty imposable by Assessing Officer No penalty imposable unless the person on whom penalty is to be imposed is given an opportunity of being heard in the matter.
	Failure to quote PAN/Aadhaar No. in documents referred to in section 139A(6A)	₹ 10,000 for each such default	
	Failure to authenticate PAN/Aadhaar No. in accordance with section 139A(6A)	₹ 10,000 for each such default	
	Failure to ensure that PAN/Aadhaar No. has been - - duly quoted in documents relating to transactions referred to in section 139A(5)(c) or 139A(6A); or - duly authenticated in respect of transactions referred to u/s 139A(6A).	₹ 10,000 for each such default	
272BB(1)	Failure to comply with the provisions of section 203A	₹ 10,000	Penalty imposable by Assessing Officer No penalty imposable unless the person on whom penalty is to be imposed is given an opportunity of being heard in the matter.
272BB(1A)	Quoting false TAN willfully in challans/ certificates/ statements/other documents referred to in section 203A(2)		

19.2.4 TAXATION OF UNDISCLOSED SOURCES OF INCOME

There are many occasions when the Assessing Officer detects cash credits, unexplained investments, unexplained expenditure etc., the source for which is not satisfactorily explained by the

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assessee to the Assessing Officer. The Act contains a series of provisions to provide for these contingencies:

(1) Cash Credits [Section 68]

Where any sum is found credited in the books of an assessee maintained for any previous year and the assessee offers no explanation about the nature and source or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the sum so credited may be charged as income of the assessee of that previous year.

Unexplained loan or borrowing - Where the sum so credited consists of loan or borrowing or any such amount, by whatever name called, any explanation offered by the assessee in whose books such sum is credited would not be deemed to be satisfactory, unless

- the person in whose name such credit is recorded in the books of such assessee also offers an explanation about the nature and source of such sum so credited and
- in the opinion of the Assessing Officer, such explanation has been found to be satisfactory.

Unexplained Share Capital/ Premium - Any explanation offered by a closely held company in respect of any sum credited as share application money, share capital, share premium or any such amount, by whatever name called, in the accounts of such company would not be deemed to be satisfactory, unless

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- the person, being a resident, in whose name such credit is recorded in the books of such company also explains about the nature and the source of such sum so credited and
- in the opinion of the Assessing Officer, such explanation has been found to be satisfactory.

Non-applicability to Venture Capital Fund or Venture Capital Company – The above-mentioned additional conditions would not apply if the person, in whose name the sum is recorded, is a Venture Capital Fund or Venture Capital Company registered with SEBI.[4].

(2) Unexplained Investments [Section 69]

Where in the financial year immediately preceding the assessment year, the assessee has made investments which are not recorded in the books of account and the assessee offers no explanation about the nature and the source of investments or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the value of the investments are taxed as deemed income of the assessee of such financial year.

(3) Unexplained money etc. [Section 69A]

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and the same is not recorded in the books of account and the assessee offers no explanation about the nature and source of acquisition of such money, bullion etc. or the explanation offered is not satisfactory in the opinion of the Assessing Officer, the money and the value of bullion etc. may be deemed to be the income of the assessee for such financial year. Ownership is important and mere possession is not enough.

(4) Amount of investments etc., not fully disclosed in the books of account [Section 69B]

Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article and the Assessing Officer finds that the amount spent on making such investments or in acquiring such articles exceeds the amount recorded in the books of account maintained by the assessee and he offers no explanation for the difference or the explanation offered is unsatisfactory in the opinion of the Assessing Officer, such excess may be deemed to be the income of the assessee for such financial year.

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[4] defined under section 10(23FB)

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(5) Unexplained expenditure [Section 69C]

Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or the explanation is unsatisfactory in the opinion of the Assessing Officer, Assessing Officer can treat such unexplained expenditure as the income of the assessee for such financial year. Such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as deduction under any head of income.

Unexplanied expenditure

(6) Amount borrowed or repaid *on hundi* [Section 69D]

Where any amount is borrowed on a *hundi* or any amount due thereon is repaid other than through an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying for the previous year in which the amount was borrowed or repaid, as the case may be.

However, where any amount borrowed on a *hundi* has been deemed to be the income of any person, he will not be again liable to be assessed in respect of such amount on repayment of such amount. The amount repaid shall include interest paid on the amount borrowed.

Unexplained money, investments etc. to attract tax @60% [Section 115BBE]

Taxable @ 78%

(1) In order to control laundering of unaccounted money by availing the benefit of basic exemption limit, the unexplained money, investment, expenditure, etc. deemed as income under section 68 or section 69 or section 69A or section 69B or section 69C or section 69D would be taxed at the rate of 60% plus surcharge @25% of tax. Thus, the effective rate of tax (including surcharge@25% of tax and cess@4% of tax) is 78%.

(2) No basic exemption or allowance or expenditure shall be allowed to the assessee under any provision of the Income-tax Act, 1961 in computing such deemed income.

(3) Further, no set off of any loss shall be allowable against income brought to tax under sections 68 or section 69 or section 69A or section 69B or section 69C or section 69D.

Penalty in respect of undisclosed income in the form of unexplained money, investments etc. under section 271AAC:

In a case where income determined includes any income referred to in sections 68, 69, 69A to 69D for any previous year, in addition to the tax payable under section 115BBE, penalty@10% of tax payable under section 115BBE would be attracted.

Penalty @ 10% of tax payable u/s 115BBE

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Penalty may be levied by the Assessing Officer or the Joint Commissioner (Appeals) or the Commissioner (Appeals). However, no such penalty would be levied on such income to the extent the same has been included by the assessee in return of income furnished u/s 139 and tax in accordance with section 115BBE has been paid on or before the end of the relevant previous year.

The provisions of section 271AAC are notwithstanding anything contained in the Income-tax Act, 1961, other than the provisions for levy of penalty under section 271AAB[5] on undisclosed income detected in search cases.

No penalty under section 270A for under-reporting of income is leviable in respect of income on which penalty is leviable under this section.

19.2.5 PENALTY NOT LEVIABLE IN CERTAIN CASES [SECTION 273B]

No penalty is leviable under sections 271A, 271AA, 271B, 271BA, 271C, 271CA, 271D, 271E, 271FA, 271FAA 271FAB, 271G, 271GA, 271GB, 271GC, 271H, 271-I, 271J, 272A(1)(c) or 272(A)(1)(d), 272A(2), 272AA(1), 272B, 272BB(1)/(1A), if the assessee proves that there was reasonable cause for the said failure.

19.2.6 PROCEDURE FOR ASSESSMENT OF PENALTIES [SECTION 274]

(1) Section 274(1) provides that no penalty under Chapter XXI can be imposed unless the assessee has been heard or has been given a reasonable opportunity of being heard.

(2) Section 274(2) stipulates obtaining prior approval of the Joint Commissioner by the income-tax authorities mentioned in column (2) where the quantum of penalty exceeds the amount specified in column (3).

S. No.	Income-tax authority passing the penalty order	Quantum of penalty
(i)	The Income-tax Officer	> ₹ 10,000
(ii)	The Assistant Commissioner or the Deputy Commissioner	> ₹ 20,000

[5] *On account of introduction of 'Block Assessment' (Chapter XIV-B) vide Finance (No. 2) Act, 2024, where search is initiated under section 132 on or after the 1.9.2024, penalty under section 271AAB would not be levied after the said date.*

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(3) Section 274(2A) empowers the Central Government to formulate a scheme[6], by notification in the Official Gazette

To impart greater efficiency, transparency and accountability by :

(4) In order to give effect to the scheme so formulated, section 274(2B) empowers the Central Government to direct, by notification in the Official Gazette, that any of the provisions of the Income-tax Act, 1961 relating to jurisdiction and procedure for imposing penalty would not apply or would apply with such exceptions, modifications and adaptations as may be mentioned in the notification. Though such direction cannot be issued after 31.3.2022, however, the Central Government may amend such direction by issuing notification.

(5) Every notification issued under section 274(2A)/(2B) has to be laid before each House of Parliament as soon as may be after the notification is issued.

(6) An income-tax authority making an order imposing penalty under Chapter XXI has to send a copy of such order to the Assessing Officer, unless he himself is the Assessing Officer.

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[6] *Accordingly, the Central Government has notified Faceless Penalty Scheme,2021 which is available at* https://incometaxindia.gov.in/Pages/faceless-scheme.aspx

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19.2.7 TIME LIMIT FOR IMPOSITION OF PENALTY [SECTION 275]

1) *No order imposing a penalty shall be passed* ***after the expiry of six months from the end of the quarter*** *in which-*

Time limit for passing penalty order (1)	Circumstances (2)
Proceedings, in the course of which action for the imposition of penalty has been initiated, are completed.	Where the relevant assessment or other order is not the subject matter of an appeal under section 246 or 264A or 253., the proceeding in which imposition of penalty has been completed
Order of revision under section 263 or 264 is passed.	Where the relevant assessment or other order is the subject matter of revision under section 263 or 264.
Order of an appeal under section 246 or 246A is received by the jurisdictional Principal Commissioner or Commissioner.	Where the relevant assessment or other order is the subject matter of an appeal under section 246 or 246A and no further appeal has been filed under section 253.
Order of an appeal under section 253 is received by the jurisdictional Principal Commissioner or Commissioner.	Where the relevant assessment or other order is the subject matter of an appeal under section 253.
Notice for imposition of penalty is issued.	Any other case

2) *Where the relevant assessment or other order is the subject matter of an appeal under section 246 or 246A or 253 or 260A or 261 or revision under section 263 or 264, the order imposing or enhancing or reducing or cancelling penalty or dropping the proceedings for the imposition of penalty may be revised on the basis of assessment as revised by giving effect to order passed under the said sections [Section 275(2)].*

3) *No order imposing or enhancing or reducing or cancelling penalty or dropping the proceedings for the imposition of penalty shall be passed:*

   a) *unless the assessee has been heard or has been given a reasonable opportunity of being heard;*

   b) *after the expiry of* ***six months from end of the quarter*** *in which the order passed under section 246 or 246A or 253 or 260A or 261 is received by the jurisdictional Principal Commissioner or Commissioner or the order of revision under section 263 or 264 is passed.*

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4) *The provisions of 274(2) shall apply to the order imposing or enhancing or reducing penalty under section 275(2).*

Note: *Section 274(2) provides that for passing an order imposing penalty exceeding ₹10,000, the Income-tax officer has to take the prior approval of the Joint Commissioner. Also, for passing an order imposing penalty exceeding ₹20,000, the Assistant Commissioner or the Deputy Commissioner should take the prior approval of the Joint Commissioner.*

5) *Following period shall be excluded from computing the period of limitation:*

   a) *time taken in giving an opportunity to the assessee to be reheard under the proviso to section 129;*

   b) *period commencing on the date on which stay on proceeding for levy of penalty was granted by an order or injunction of any court and ending on the date on which certified copy of the order vacating the stay was received by the jurisdictional Principal Commissioner or Commissioner.*

19.3 OFFENCES AND PROSECUTION UNDER THE INCOME TAX ACT

The punishable offences as well as the prosecution for such offences under the Income-tax Act, 1961 are discussed under Chapter XXII. The prosecution provisions are discussed hereinbelow-

Section	Nature of default	Rigorous imprisonment	Quantum of Fine
275A	Contravention of order made under the second proviso to sub-section (1) or sub-section (3) of section 132 regarding search and seizure	Upto 2 Years **(+) fine**	No limit specified
275B	Failure to afford the authorized officer the necessary facility to inspect the books of account or other documents as required under section 132(1)(iib)	Upto 2 years **(+) fine**	No limit specified
276	Removal, concealment, transfer or delivery of property to thwart tax recovery	Upto 2 years **(+) fine**	No limit specified
276B	Failure to pay to the credit of the Central Government, tax deducted at source by a person as required by or under the provisions of Chapter XVII-B.	3 months to 7 years **(+) fine**	No limit specified

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	If the payment, however, has been made to the credit of the Central Government on or before the time prescribed for filing the statement under section 200(3), no prosecution would be attracted. Failure to pay tax or ensure payment of tax to the credit of the Central Government as required by or under - the proviso to section 194B [winnings from lottery or crossword puzzle] or - the first proviso to section 194R(1) [on benefits and perquisites in respect of business or profession] or - the proviso to section 194S(1) [on transfer of virtual digital assets] or - section 194BA(2) [Winnings from online games]. ***Note** – In all the four situations mentioned above, the winnings/ benefit/ perquisite/ consideration for transfer, as the case may be, is wholly in kind or partly in cash and partly in kind but the part in cash is not sufficient to meet the TDS liability.*		
276BB	Failure to pay to the Central Government tax collected under section 206C. ***However, the above provision may not apply if the payment of tax collected at source has been made to the credit of the Central Government on or before the time prescribed for filing the statement under section 206C(3).***	3 months to 7 years **(+) fine**	No limit specified
276C(1)	Wilful attempt to evade tax, penalty or interest chargeable or imposable or under reports his income	Evaded amount/Tax on under reported income exceeding	No limit specified

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		₹ 25 lakh: 6 months to 7 years **(+) fine** Other cases: 3 months to 2 years **(+) fine**	
276C(2)	Wilful attempt to evade payment of tax, penalty or interest.	3 months to 2 years **(+) fine, at the discretion of the court.**	No limit specified
276CC	Wilful failure to furnish in due time a return of income u/s 139(1) or u/s 142(1)(i) or u/s 148. **Note:** If return of income u/s 139(1) is furnished before expiry of the assessment year or an updated return is furnished within the time specified under section 139(8A) or the tax payable by a person, not being a company, on the total income determined on regular assessment, as reduced by advance tax or self-assessment tax, if any, paid before the expiry of the assessment year, and any TDS/TCS does not exceed ₹ 10,000 - No prosecution.	Evaded tax exceeding ₹ 25 lakh : 6 months to 7 years **(+) fine** Other cases: 3 months to 2 years **(+) fine**	No limit specified
276CCC	Wilful failure to furnish in due time a return of income in search cases u/s 158BC(1)(a).	3 months to 3 years (+) fine.	No limit specified
276D	Wilful failure to produce accounts and documents under section 142(1)/ 142(2A)	Up to one year **(+) fine**	No limit specified
277	False statements in verification.	Evaded tax exceeding ₹ 25 lakh: 6 months to 7 years **(+) fine** In other cases: 3 months to 2 years **(+) fine**	No limit specified

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277A	Falsification of books or documents, etc. to induce or abet any person to evade any tax, penalty or interest chargeable or imposable under the Act. It is not necessary to prove that the other person has actually evaded any tax, penalty or interest chargeable or imposable under the Act for the purpose of establishing the charge under this section.	Imprisonment of 3 months to 2 years **(+) fine**	No limit specified
278	Abetment of false return etc. (relating to any income chargeable to tax)	Evaded tax exceeding ₹ 25 lakh: 6 months to 7 years **(+) fine** In other cases: 3 months to 2 years **(+) fine**	No limit specified
278A	Second and subsequent offences under section 276B, 276BB, 276C(1), 276CC, 277, 278.	6 months to 7 years for every subsequent offence **(+) fine**	No limit specified
280(1)	Disclosure of particulars by public servants in contravention of section 138(2). Prosecution after previous sanction of Central Government under section 280(2).	Up to 6 months **(+) fine**	No limit specified

Section 278AA provides that where a reasonable cause for the failure is proved, punishment shall not be imposed for offences specified in sections 276B or 276BB.

For the purposes of offences and prosecutions, the following individuals will be deemed to be guilty of the offence committed by the respective person:

Person	Section	Individual
Company	278B	Every person in charge of affairs; Director, Manager, Secretary and every officer who is guilty of offence
Firm	278B	Partner
AOP/BOI	278B	Members controlling the affairs
HUF	278C	Karta or member either by acquiescence or negligence.

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Section 278B(3) provides that if an offence under the Act has been committed by a person being a company, it shall be punished with fine. Every other person who was in charge of and was responsible for the conduct of business of the company, or any director, manager, secretary or other officer of the company (with whose consent or connivance or due to whose neglect the offence was committed) would be liable for punishment of imprisonment and fine wherever so provided.

19.3.1 PRESUMPTION AS TO CULPABLE MENTAL STATE [SECTION 278E]

(1) **Onus of proof on accused -** In any prosecution for any offence under this Act which requires a culpable mental state on the part of the accused, the court shall presume the existence of such mental state but it shall be a defence for the accused to prove the fact that he had no such mental state with respect to the act charged as an offence in that prosecution.

It may be noted that penalty proceedings being quasi-criminal in nature, it has been judicially held in the context of various penalty and prosecution proceedings, that the burden is on the department to establish that the assessee concealed the particulars of his income or deliberately furnished inaccurate particulars thereof and it is not enough for the revenue merely to show that a certain amount was received by the assessee. Section 278E has clearly overruled this view and has specifically placed the burden of proof on the assessee.

It specifically provided that where any prosecution requires a culpable mental state *(mens rea*) the court shall presume the existence of such mental state but the assessee is entitled to prove that he had no such mental state with respect to the act charged with. Thus, the burden to prove the non-existence of *mens rea* has been effectively placed on the assessee in prosecution cases.

(2) **Meaning of 'Culpable mental state' -** Culpable mental state includes intention, motive or knowledge of a fact or belief in, or reason to believe, a fact.

(3) **Proof of fact -** For the purposes of this section a fact is said to be proved only when the court believes it to exist beyond reasonable doubt and not merely when its existence is established by a preponderance of probability.

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19.3.2 PROSECUTION TO BE MADE AT THE INSTANCE OF THE PRINCIPAL CHIEF COMMISSIONER OR CHIEF COMMISSIONER OR PRINCIPAL COMMISSIONER OR COMMISSIONER [SECTIONS 279 AND 279A]

(1) **Prior sanction of higher authorities -** Section 279(1) provides that the proceedings to punish a person for an offence under sections 275A, 275B, 276, 276B, 276BB, 276C, 276CC, 276D, 277, 277A and 278 can be initiated only after previous sanction of the Principal Commissioner or Commissioner or the Joint Commissioner (Appeals) or the Commissioner (Appeals) or the appropriate authority. However, the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or Director General may issue such instructions or directions to the said authorities for institution of proceedings under section 279(1).

(2) **Cases where prosecution cannot be initiated -** Section 279(1A) provides that the proceedings to punish a person for an offence under section 276C or 277 cannot be initiated in relation to the assessment of an assessment year in respect of which the penalty imposed or imposable on him under section 270A has been waived or reduced under section 273A.

(3) **Compounding of offences -** An offence may, either before or after the institution of prosecution proceedings be compounded by the concerned authorities under section 279(2).

In order to provide better understanding with respect to the revised guidelines, the CBDT has issued clarifications, v*ide [F.No. 285/08/2014-IT(Inv.V/t63 dated 17.10.2024 and Circular No. 4/2025 dated 17.3.2025, in the form of FAQs which are discussed below:*

Revised Guidelines for Compounding of Offences along with FAQs

Before moving to these Guidelines, lets first understand what is compounding of offence as included in the FAQs.

Q. What is compounding of offence?

Ans *Compounding of an offence is a mechanism whereby the defaulter is reprieved of major legal consequences by affording him an opportunity to pay certain sum of money to escape prosecution. The specified offences can be compounded by the competent authority either before or after the initiation of proceedings.*

Q. Are there any offence(s) under Income-tax Act, 1961 which are not compoundable?

Ans *All offence under the Income-tax Act, 1961 is compoundable in these revised guidelines.*

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1. Scope of the Guidelines to prosecutions under Income-tax Act, 1961

These guidelines shall come into effect from the date of issuance i.e.,17th October 2024 and applies to all compounding applications filed after this date as well as to applications which have already filed earlier but not yet disposed of.

Q. Whether revised guidelines are applicable on pending compounding applications? If yes, whether applicants have to file a fresh application?

Ans: *Yes, revised guidelines are applicable on the applications, pending before issuance of these guidelines. The applicants whose applications were pending on 17.10.2024 are not required to file a fresh application or pay any fresh application fees.*

In case applications under earlier guidelines were rejected solely on account of curable defects, fresh applications may also be filed again.

Curable defects are such as non-payment of outstanding tax, interest, penalty, or any other sum related to the offence, filing of application in incorrect proforma, mention of incorrect assessment year/financial year or section under which offence has been committed, non-payment or short payment of compounding charges, non-submission of undertaking regarding withdrawal of appeals, etc.

Applications rejected in the past on merits by the Competent Authority shall not be reconsidered under these revised guidelines.

Q. Whether the applicant whose application was rejected in earlier guidelines on the ground of being convicted is eligible to re-apply for compounding as per revised guidelines?

Ans: *Yes, in case the rejection was solely on account of conviction, without examination of merits, as per any of the earlier guidelines, such applicant can reapply in terms of revised guidelines.*

2. Conditions for consideration of Compounding Application

Offences may be considered for compounding provided all the following conditions are satisfied:

(i) Compounding Application

An application for compounding is made to the Jurisdictional Principal Chief Commissioner/ Chief Commissioner/ Principal Director General/ Director General of Income-tax, being the Competent Authority, for compounding of the offence(s).

The compounding application may be filed for offence(s) pertaining to one financial year (in case of taxpayers) or quarter (in case of tax deductors) or for multiple years/quarters. The compounding

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application filed for multiple years/ quarters are referred to as "Consolidated Compounding Application".

If there are more than one rejected application under the previous Guidelines, one Consolidated Compounding Application may be filed for all such previous applications.

Q. Whether applicant can withdraw a compounding application and file a new application?

Ans: *The applicant can file a new single application or consolidated application after withdrawal of earlier application(s). However, such new application shall be treated as a subsequent application and higher compounding rate shall be applicable which is discussed later on.*

Q. Whether applicant is required to file compounding application for all the offences together, for which prosecution proceedings has been initiated?

Ans: *No, the applicant may apply for one or multiple offences in an application. His application cannot be rejected on the ground that he has not applied for particular offence for which notice for prosecution has been issued and proceedings are under progress.*

Q. Is there any limitation as to the number of times compounding applications can be filed by a person?

Ans: *No, there is no limitation on the number of times a person can file compounding application. However, the Competent Authority may reject an application filed by a person on the ground of him being a "habitual offender".*

(ii) Time limit for filing application

The compounding application or Consolidated Compounding Application may be filed suo-moto at any time after the offence(s) is committed, irrespective of whether it comes to the notice of the Department or not. The Compounding Application or the Consolidated Compounding Application may also be filed after the launch of prosecution proceedings.

Q. Is there any time limit for filing of an application for compounding?

Ans: *No, an application for compounding can be filed at any time after committing the offence, regardless of whether the same has come to the notice of the department or prosecution proceedings have been launched.*

(iii) Compounding Application Fee

For Compounding Applications or the Consolidated Compounding Applications, filed on or after 17.10.2024, the applicant has to deposit non-refundable Compounding Application Fee of ₹25,000

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for a single Compounding application (per application) and ₹ 50,000 for a consolidated Compounding application (per such application).

The said fee is a non-refundable fee, but adjustable against applicable total compounding charges decided by the Competent Authority, if any.

Q. Whether compounding application fee is adjustable against compounding charge payable?

Ans: *Yes, compounding fee is adjustable but only against compounding charges payable for the offence(s) sought to be compounded* ***in the particular application****. Cross application adjustment is not allowed. However, if compounding application is rejected for any reasons, the application fees shall neither be refundable nor adjustable against any subsequent application.*

Q. Whether compounding is allowed if the application for such an offence was previously rejected? If so, whether separate applications need to be filed for more than one application rejected under the previous guidelines? How will the compounding application fees be charged?

Ans: *Yes, an applicant may apply for compounding of offence(s) through a single consolidated application, if one or more applications had been rejected under previous guidelines.*

However, the fresh application can only be filed if such rejection(s) were on account of curable defects and no application is allowed to be filed for any of the rejection(s), made by the Competent Authority, on merits with those particulars i.e. offence and relevant financial year.

Compounding application fees chargeable for a "consolidated compounding application" would be charged in this case.

(iv) Payment of all taxes, interest & other sums relating to offence for which compounding sought

All outstanding tax, interest (including interest u/s 220), penalty and any other sum due, relating to the offence(s) for all relevant year(s) and/or quarter(s) for which compounding has been sought is to be paid before making the Compounding Application or the Consolidated Compounding Application, as the case may be.

However, if on verification by the Department, any related demand is found outstanding or is considered payable, the same, on being intimated to the applicant, has to be paid (including interest u/s 220) within 30 days of the intimation by the Department or such period (not exceeding three months) allowed by the Competent Authority. The compounding application or the consolidated compounding application, as the case may be, shall be considered valid only consequent to the payment of all the demand pertaining to the offence(s) for respective years/quarters.

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(v) Undertaking by the applicant

The applicant has to undertake to pay the Compounding charges within the stipulated timeframe.

(vi) Withdrawal of appeals

The person/applicant has to undertake to withdraw appeals filed by him, if any, related to the offence(s) sought to be compounded. In case such an appeal has mixed grounds, one or more of which may not be related to the offence(s) under consideration, an undertaking has to be given for withdrawal of such grounds as are related to the offence to be compounded.

Q. Whether an applicant is required to withdraw appeal related to offence sought to be compounded before filing a compounding application?

Ans: *No such withdrawal is required. However, applicants shall undertake to withdraw appeals including Writ petitions, if any, related to offences being compounded and in case where appeal has mixed grounds, grounds of appeal related to the offence to be compounded.*

(vii) Consolidation of offences

Any application for compounding of offence u/s 276B/276BB by an applicant for any period for a particular TAN should cover all defaults constituting offence u/s 276B/276BB in respect of that TAN for such period.

The total default on account of non-payment of TDS/TCS for a quarter shall be considered by combining the defaults in all the statements filed by the TDS deductor, in respect of the relevant quarter.

3. Revival of a defective application

Applications which do not fulfil any of the specified conditions or are not acceptable due to curable defects such as

- *Non-payment of outstanding tax, interest, penalty, or any other sum related to the offence;*
- *Application not filed in correct proforma;*
- *Applications filed for incorrect financial year or assessment year or under incorrect section, etc.;*

shall be treated as 'defective' under these guidelines and shall not be proceeded with.

However, such applications can be revived without additional payment of Compounding Application Fee, provided the defects are cured within a period of one month from the date of intimation of the

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defect(s). In case, the defect is not cured within time allowed, defective application will be returned back to the applicant.

Any further application filed for the same purpose, will be considered as subsequent compounding application and charges will be applicable.

4. Offences compoundable with the approval of higher authority

The Competent Authority, in the following cases, may compound only with the approval of Chairman, CBDT.

(a) In case of an offence for which the applicant has been convicted with imprisonment for 2 years or more, with or without fine, by a court of law;

(b) In case of an offence which is related to another offence under any other law for which he has been convicted with imprisonment for 2 years or more, with or without fine, by a court of law;

(c) If the applicant, as per information available on the basis of an investigation conducted by any Central or State Agency, has been found to be involved, in any manner, in anti-national or terrorist activity. In such cases, the Competent Authority shall consult with relevant Agency and seek inputs regarding the said activity and its implications, for the purpose of deciding it as a deserving case and incorporate them while seeking approval;

(d) In the case of an applicant, being a person other than the main accused, where it is proved that the applicant facilitated tax evasion through mechanisms such as use of entities for laundering of money, generation of bogus invoices of sale/purchase without actual business, by providing accommodation entries or in any other manner, as prescribed in section 277A;

(e) If the offence is directly related to an offence under the following Acts:

- *the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015; or*
- *Prohibition of Benami Property Transactions Act,1988;*

(f) In case of an offence under section 275A and/or 275B.

Q. Whether offence can be compounded where applicant has been convicted for imprisonment for two years or more?

Ans: *Yes, even if applicant has been convicted with imprisonment of two years or more for any offence under Income-tax Act, 1961 or for an offence under any other law, which is related to offence under the Income-tax Act, 1961, may apply for compounding. Such offence shall, however, be compoundable only with the approval of Chairman, CBDT.*

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Q. Whether cases involving other agencies such as ED /CBI can be compounded?

Ans: *Yes, such offence(s) may be compounded by the competent authority if applicant is not found to be involved in anti-national or terrorist activity. However, if the applicant is found to be involved in such activity, the offence shall be compounded only with the approval of Chairman, CBDT.*

5. Authority Competent to Compound an Offence

The jurisdictional Principal Chief Commissioner/ Chief Commissioner/ Principal Director General/ Director General of Income-tax is the Competent Authority for compounding of offences.

If a person has committed an offence u/s 276B/276BB for non-payment of TDS/TCS in respect of both resident and non-resident payees/ collectees then the jurisdiction over such person normally lies with more than one jurisdictional charge. In such case, the Principal Chief Commissioner/ Chief Commissioner/ Principal Director General/ Director General of Income-tax in whose jurisdiction compounding application has been filed will be the Competent Authority. However, in case the applicant files applications in more than one jurisdictional charge, the Competent Authority will be the jurisdictional authority where the quantum of TDS default is higher. All other applications shall be transferred to such Competent Authority.

In case an applicant files Compounding application for offences committed u/s 276B/276BB, in respect of two or more TANs falling in two or more jurisdictions, the jurisdictional authority where the quantum of TDS default is higher shall be the Competent Authority. All other applications shall be transferred to such Competent Authority.

6. Compounding Procedure

Report from Assessing Officer/Assistant or Deputy Director - *On receipt of the Compounding application, the Competent Authority has to obtain a report from the Assessing Officer/Assistant or Deputy Director concerned who has to submit it promptly to the Competent Authority, through proper channel.*

Time to pass application order if application is not acceptable - *In cases where, the compounding application is not found to be acceptable, then the Competent Authority shall dispose of such application through a speaking order. Such order may be passed* ***within two months from the end of the month of receipt of the application as far as possible****.*

Time to pass application order if application is acceptable - *In cases where, the compounding application is found to be acceptable, then the Competent Authority has to intimate the applicant accordingly, along with the compounding charges payable and other pending liabilities, if any. Such intimation may be issued <u>within 2 months from the end of the month of receipt of the application as far as possible</u>.*

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Time limit for payment for compounding charges - *The Competent Authority shall, while intimating the amount of compounding charges to the applicant, require him to pay the same within 1 month from the end of the month of receipt of such intimation.*

Extension of time limit for payment of compounding charges - *On written request of the applicant for further extension of time period for payment of compounding charges, the Competent Authority, under exceptional circumstances, may extend this period up to six months. Extension beyond 6 months and upto 12 months shall not be permissible except with the prior approval in writing of the Principal Chief Commissioner of Income Tax of the Region concerned. Extension beyond 12 months and upto 24 months from the end of month shall not be permissible except with the prior approval of Chairman, CBDT or a Member, CBDT authorized by the Chairman, CBDT on a proposal of the Competent Authority concerned. No extension shall be allowed after 24 months from the end of the month of receipt of such intimation of compounding charges.*

Rejection of application on non payment of compounding charges - *Where compounding charge is not paid within the time allowed/extended, the application will be rejected and prosecution proceedings shall be initiated, if not already done so.*

The complainant shall serve a copy of the prosecution complaint to each accused within 15 days of filing complaint to allow prompt filing of compounding application.

In all cases where prosecution proceedings have been instituted, the order of acceptance/rejection of application of compounding has to be brought to the notice of the Court immediately through prosecution counsel, where the said prosecution proceedings are pending before the Court.

Time to pass compounding order - *Where the payment of compounding charges is made within time allowed/extended, the Competent Authority shall pass the compounding order within 1 month from the end of the month of payment of total compounding charges.*

In case proceedings to impose penalty related to the offence sought to be compounded are pending at the time of filing of the compounding application, such proceedings should be concluded expeditiously and the demand related to penalty, if any, recovered before issuing the compounding order.

Taxpayers, particularly NRIs, avoid opting for compounding due to a misconception that it constitutes an admission of offences, which could affect their reporting obligations at various statutory and international forums. To address this misconception and encourage taxpayers to seek compounding, it is directed that the Competent Authority has to include the following paragraph in the compounding order issued under section 279(2):

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"This compounding order is intended to resolve the offence under section 279(2) of the Act and should not be construed as an admission of the offence(s) by the applicant."

The timelines for processing the compounding applications by the Competent Authority prescribed in these Guidelines, are administrative and do not prescribe a limitation period for disposal of the compounding application.

Q. Whether time for payment of compounding charges may be extended beyond 24 months?

Ans: *No, beyond 24 months extension is not allowable and the application shall be rejected followed by initiation of prosecution proceedings, if not already initiated. However, the applicant can file new application for the same particulars which shall be treated as a subsequent application for the purpose of determination of compounding charges.*

Q. As per the revised guidelines, the payment period for compounding charges may be extended up to 24 months only from the end of the month in which the compounding charges were intimated. For pending applications where the payment initiation was made before the issuance of the revised guidelines but not fully paid, how will the period of 24 months be calculated? Additionally, will such applications require approval for extension?

Ans: *For applications pending as on 17.10.2024, wherein compounding charges were not fully paid within time allowed as per earlier Guidelines or wherein time allowed had not elapsed, the period of 24 months will commence from the end of the month of issuance of these guidelines i.e., October 2024. The extension of timelines will require approval as prescribed in the Guidelines.*

Q. Are extension for payment of compounding charges subject to interest or additional charges?

Ans: *No, interest or additional charges are not applicable on extension allowable under the guidelines. Further, for cases pending as on date of issuance of revised guidelines, additional compounding charge (chargeable under previous guidelines) shall not be applicable and compounding charge shall be determined as per these revised guidelines.*

7. Compounding Charges

For the purpose of computation of the compounding charges, the word "tax" means tax including surcharge and any cess, by whatever name called, as applicable. However, interest shall not be included in 'tax' to be considered for computation of Compounding Charge.

The compounding charges for the 'first' compounding application or consolidated compounding application by a person has to be computed, for each offence disclosed in the application.

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Further, any application filed subsequent to the first application, shall be counted as second, third and fourth compounding application or consolidated compounding application and so on.

Furthermore, if a person applied for compounding of an offence(s), the type of which was applied for earlier, then compounding charges for subsequent offence(s) shall be 1.2 times, 1.4 times, 1.6 times, and so on of the compounding charges for the second, third, fourth, etc. time of such offence.

If a subsequent application(s) includes any offence(s), the type of which had not been disclosed in any of the earlier applications, the compounding charges for the said offence(s) shall be computed only as per the charges given in these Guidelines.

Where the compounding application(s) had been filed in accordance with prior guidelines and are either pending or were rejected or have been compounded, all such applications, filed prior to issuance of these guidelines, shall together be considered as 'first' compounding application.

If the application is made beyond 12 months from the end of the month in which the prosecution complaint is filed, the compounding charges shall be increased by 50% of the amount calculated above.

Q. What will be the date of applications in case of carried forwarded applications - original date of application or date of issue of revised guidelines?

Ans: *The application pending as on 17.10.2024 shall be governed under these revised guidelines. However, date of such pending application shall be the original date of application for any purpose.*

Q. How shall the compounding charges be calculated for applications pending before issuance of these guidelines?

Ans: *The compounding charges for pending application are subject to redetermination as per the revised guidelines. All pending applications, whether for single or multiple years/quarters, shall be treated as first compounding application and compounding charge shall be re-computed for each offence disclosed in the application.*

Q. If a new consolidated application includes a year for which application was filed earlier and then withdrawn, whether partial compounding charges paid for such year for which application is withdrawn can be adjusted against total compounding charges towards consolidated application?

Ans: *No. Partial compounding charges paid for the year for which application is withdrawn can be adjusted in new consolidated application only towards the offence and particular year for which payment was made.*

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Q. An applicant has filed compounding applications under earlier guidelines, two of which were rejected on account of curable defects, two were compounded and three are pending as on issuance of this guideline. How should the applicant file a compounding application after issuance of these guidelines and how shall the new application be treated?

Ans: *No action is pending for the applications which have been compounded. A consolidated application may be filed for all applications which were rejected (on account of curable defects) and no fresh application is required to be filed for pending applications.*

All pending applications, whether for single or multiple years/quarters, shall be treated as first compounding application and compounding charge shall be re-computed for each offence disclosed in the application. The fresh consolidated application for rejected applications will be considered as second application. Accordingly, the application filed after issuance of these guidelines shall be treated as subsequent application (2nd application) and compounding charge shall be re-computed for each offence disclosed in the application.

Q. How the rate of compounding charges will be determined in subsequent application(s)?

Ans: *The rate of compounding charge is based on sequence of application as well as offence applied for. If a subsequent application includes an offence which has also been included in earlier application(s), it shall be liable for higher rate i.e. 1.2 times, 1.4 times, 1.6 times and so on; irrespective of the fact that the offence and year of the offence are same in subsequent application and earlier application was rejected or pending or even compounded.*

However, if subsequent application includes offence(s) which were not included in any compounding application filed earlier (rejected or compounded or pending) and the offence has been applied for first time, the compounding charge for such offence(s) shall be computed at normal rate.

Illustration *- An applicant has filed different applications on different dates to compound different offences which will be considered as below:*

Scenario			***Clarification***		
Application Date	***Status***	***Offence (FY)***	***Sequence of Application***	***Offence included in Earlier Application?***	***Rate***
15/01/2021	*Compounded*	*276B (2012-13)*	*NA*	*NA*	*NA*
17/10/2022	*Compounded*	*276C(1) (2018-19)*	*NA*	*NA*	*NA*

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18/08/2023	*Rejected*	*276B (2013-14)*	*NA*	*NA*	*NA*
17/09/2024	*Pending*	*276D (2019-20)*	*First (No fresh application required)*	*NA*	*Normal rate*
01/11/2025	*Single application (for earlier application rejected)*	*276B (2013-14)*	*Second*	*Yes, in application dated 15/01/2021 and 18/8/2023 (Considered as 2nd time)**	*1.2 times of normal rate*
18/12/2025	*Consolidated application*	*276B (2017-18)*	*Third*	*Yes, in application dated 15/01/2021, 18/08/2023 and 01/11/2025 (3rd time)#*	*1.4 times of normal rate*
		276C(1) (2019-20)		*Yes, in application dated 17/10/2022 (2nd time)*	*1.2 times of normal rate*
		275A (2023-24)		*No, first time applied for (1st time)*	*Normal rate*

** The applicant has opted for compounding for section 276B offence for the third time in third application and accordingly compounding charges at 1.4 times of normal rate should apply. However, since both applications were filed under previous guidelines, all such applications will be cumulatively considered as "first" application. Thus, offence under first two applications will be considered as clubbed together for calculation of compounding charges.*

 # The applicant has opted for compounding for section 276B offence for the fourth time in fourth application and accordingly compounding charges at 1.6 times of normal rate should apply. However, since first two applications were filed under previous guidelines, both these applications will be cumulatively considered as "first" application. Application filed on 01.11.2025 will be considered as "second" and this application will be considered as "third". Thus, offence under first two applications will be considered as clubbed together for calculation of compounding charges.

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Q. Whether compounding application may be filed after launch of the prosecution? If yes, how the compounding charge will be determined?

Ans: *Yes. If application is filed within 12 months from end of the month in which prosecution complaint is filed, the compounding charge will be determined as per the guidelines as illustrated in above question. For applications filed after 12 months, the compounding charge so calculated shall be increased by 50% as per the guidelines.*

Illustration: *Assessee had made TDS default of ₹ 10,00,000 for 3 months during F.Y. 2019-20. The prosecution has been launched on 01/04/2022 u/s 276B of the Act. Normal compounding charges in this case, suppose is ₹ 45,000.*

Scenario	Case	Date of Application	Time Elapsed	Rate	Compounding charges
Scenario 1 (No earlier application rejected)	Case-1	12/10/2022 (Pending as on 17/10/2024)	Less than 12 months	Normal compounding charges	₹ 45,000
	Case-2	31/10/2025	More than 12 months	Increase by 50% of normal compounding charges	₹ 67,500 (1.5 x ₹ 45,000)
Scenario 2 (First application rejected, revised application filed)	Cace-3	12/10/2022 (Rejected)	Less than 12 months	NA (Application rejected)	NA
		31/10/2025	More than 12 months	1.2 times of normal compounding charges increased by 50%	₹ 81,000 [1.5 x (1.2 x ₹ 45,000)]

8. Co-accused and Abettor- Section 278B (Offences by companies) and Section 278C (Offences by Hindu undivided families)

Where an offence under this Act has been committed by a Company or HUF as defined in section 278B or 278C, an application for compounding may be filed separately or conjointly by the main accused i.e., Company, or HUF and/or any of the person(s) deemed to be guilty of the offence under section 278B or 278C (Co-accused) which are referred as "Co-accused" for the purpose of compounding.

In cases of offences by a company or HUF, the main accused or co-accused may apply separately or conjointly. On payment of compounding charges for the offence, by any one of them separately

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or jointly, the Competent Authority shall compound the offences of the main accused as well as all the co-accused, vide an order u/s 279(2).

In case liability of a company for an offence committed prior to the commencement of the corporate insolvency resolution process ceases due to the provisions of section 32A of the Insolvency Bankruptcy Code (IBC), the prosecution proceedings against the co-accused can still continue. In such a case, the compounding application and payment of compounding charges can be made by the co-accused and/or the main accused company.

Q. Whether co-accused can file compounding application under revised guideline?

Ans: *Yes, co-accused may apply for compounding of offence separately or conjointly.*

Q. Where the compounding application of the co-accused was rejected earlier on the ground that the main accused has not filed for compounding, whether such applicants will be eligible for filing again? If yes, whether such application shall be a subsequent application?

Ans: *Yes, other than the case where application was rejected in past on merit, any of the co-accused applicant is eligible to file compounding application again separately or conjointly. Such application shall be treated as a subsequent application for the purpose of determination of compounding charges.*

Q. Similarly, where the compounding application of the main accused was rejected earlier on the ground that the co-accused has not filed for compounding or given undertaking, whether such applicants will be eligible for filing again? If yes, whether such application shall be a subsequent application?

Ans: *Yes, other than the case where application was rejected in past on merit, the main accused applicant is eligible to file compounding application again separately or conjointly with the co-accused. Such application shall be a subsequent application for the purpose of determination of compounding charges.*

Q. If any application filed by co-accused or accused under previous guidelines is pending, whether they are required to file a fresh application under revised guidelines?

Ans: *No. All such pending applications will be clubbed together and none of the applicants (main accused and/or co-accused) are required to file a fresh application under revised guidelines. This consolidated application shall be considered as first application for the purpose of determination of compounding charges.*

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Q. If application is filed by main accused or co-accused or by both of them co-jointly, whether separate compounding fee shall be applicable for co-accused or not?

Ans: *No separate compounding fee for co-accused shall be payable, irrespective of the fact that application has been filed by main accused or co-accused or by both of them co-jointly. Only compounding charge(s) for the concerned offence(s) shall be payable. Once such payment is made by the applicant being main accused or co-accused or both of them conjointly, the Competent Authority shall compound concerned offences for main accused as well as all the co-accused.*

Q. Whether any person other than mam accused or co-accused can file compounding application for compounding of an offence of company or HUF?

Ans: *No, person other than main accused or co-accused cannot file compounding application. The applicant is required to disclose his status as main accused or co-accused in the compounding application.*

Q. Can co-accused furnish an undertaking for withdrawal of appeals as required in of the guidelines, on behalf of the main accused?

Ans: *No, co-accused cannot furnish undertaking for withdrawal of appeal on behalf of the main accused. Such undertaking shall be furnished by the main accused only which must be attached with the application if application has been filed by the co-accused, since offences of both main accused and co-accused are being compounded.*

Q. If application has been filed by only main accused or co-accused, in such case against whom name the compounding order shall be passed?

Ans: *The compounding order u/s 279(2) shall be passed in the name of person(s) who have applied for compounding. If co-accused has applied, then order shall include the name of main accused also. Further, in a case where main accused has applied and co-accused has been identified, the order shall be passed in the name of main accused and co-accused.*

(4) **Admissibility of statement made or books of account produced as evidence -** If a person is proceeded against under section 279(1), then a statement made or account or documents produced before any authority under Act shall not be inadmissible as evidence for purpose of the prosecution proceedings merely on the ground that such account or document was produced or statement was made in the belief that the penalty imposed or imposable under section 270A would be reduced or waived under section 273A or that the offence would be compounded.

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(5) **Scheme to be formulated by Central Government -** The Central Government is empowered to make a scheme, by notification in the Official Gazette, for the purposes of granting sanction under section 279(1) or compounding under section 279(2), so as to impart greater efficiency, transparency and accountability by—

(a) eliminating the interface between the income-tax authority and the assessee or any other person to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialisation;

(c) introducing a team-based sanction to proceed against, or for compounding of, an offence, with dynamic jurisdiction.

In order to give effect to such scheme, the Central Government may, by notification in the Official Gazette, direct that any of the provisions of the Income-tax Act, 1961 shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in the notification. However, no such direction can be issued after 31st March, 2022. Further, every such notification issued has to be laid before each House of Parliament, as soon as may be after the notification is issued.

(6) **Non-cognizable offences -** Section 279A provides that offences punishable under sections 276B, 276C, 276CC, 277 and 278 shall be deemed to be non-cognizable offences.

19.3.3 IMMUNITY FROM IMPOSITION OF PENALTY AND PROSECUTION [SECTION 270AA]

(1) Application to be made by the assessee to the Assessing Officer for grant of immunity from penalty and prosecution [Section 270AA(1)]

An assessee may make an application to the Assessing Officer for grant of immunity from imposition of penalty under section 270A and initiation of proceedings under section 276C or section 276CC, if he -

Pay tax and interest + No appeal

(i) **pays the tax and interest payable** as per the order of assessment under section 143(3) or reassessment under section 147, within the period specified in such notice of demand; and

(ii) **does not prefer an appeal** against such assessment/reassessment order.

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(2) Time limit for making application [Section 270AA(2)]

The assessee can make such application in the prescribed form and verified in the prescribed manner **within one month from the end of the month** in which the order of assessment or reassessment is received

(3) **Circumstances in which the Assessing Officer cannot grant immunity from penalty and prosecution [Section 270AA(3)]**

The Assessing Officer shall grant immunity from initiation of penalty under section 270A and prosecution under section 276C or section 276CC, on fulfilment of the conditions specified in (1) above, and after the expiry of period of filing appeal as specified in section 249(2)(b).

However, immunity shall be granted by the Assessing Officer only if the penalty proceedings u/s 270A have not been initiated on account of the following, namely:—

No immunity for misreporting

(a) misrepresentation or suppression of facts;

(b) failure to record investments in the books of account;

(c) claim of expenditure not substantiated by any evidence;

(d) recording of any false entry in the books of account;

(e) failure to record any receipt in the books of account having a bearing on total income; or

(f) failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction to which the provisions of Chapter X apply.

(4) Time limit for passing order accepting or rejecting application for immunity from penalty and prosecution [Section 270AA(4)]

3 months from the end of the month of receipt of application

The Assessing Officer shall pass an order accepting or rejecting the application for immunity from penalty under section 270A or prosecution under section 276C or section 276CC within a period of ***three months* from the end of the month in which such application is received**. However, in the interest of natural justice, no order rejecting the application shall be passed by the Assessing Officer **unless the assessee has been given an opportunity of being heard**.

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(5) **Finality of order passed by the Assessing Officer under section 270AA(4) [Section 270AA(5)]**

The order of the Assessing Officer passed under section 270AA(4) accepting or rejecting the application made by the assessee for immunity from penalty under section 270A or prosecution under section 276C or section 276CC shall be final.

(6) **Order of assessment/reassessment, in respect of which application for immunity is accepted, is neither appealable before the Commissioner (Appeals) nor can the same be admitted by the Commissioner for revision under section 264 [Section 270AA(6)]**

No appeal under section 246 or section 246A or an application for revision under section 264 shall be admissible against the order of assessment or reassessment referred to in section 270AA(1)(a), in a case where an order under section 270AA(4) has been made accepting the application.

(7) **Exclusion of period when application for immunity is pending before Assessing Officer from the time limit for filing of appeal before the Commissioner (Appeals), in a case where such application is rejected [Second Proviso to section 249(2)(b)]**

As per section 249(2)(b), an appeal before the Commissioner (Appeals) is to be made within 30 days of the receipt of the notice of demand relating to an assessment or penalty, where the appeal relates to such assessment or penalty.

In a case where the assessee makes an application under section 270AA seeking immunity from penalty, then, the following period has to be excluded for calculation of the aforesaid 30 days period –

Exclusion of period	
beginning from	**ending with**
the date on which application under section 270AA for immunity from penalty under section 270A is made	the date on which the order rejecting the application is served on the assessee.

19.4 OVERVIEW OF THE BLACK MONEY & IMPOSITION OF TAX LAW

The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, passed on 26.5.2015, provides for stringent taxation of any undisclosed income in relation to foreign income and assets. This new law has been formulated to act as a strong deterrent and curb the menace of black money stashed away abroad by Indians. This law is effective from **A.Y.2016-17**, unless otherwise provided in any section of this Act and extends to the **whole of India.**

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19.4.1 BASIS OF CHARGE [CHAPTER II – SECTIONS 3 TO 5]

(i) **Charge of tax [Section 3]**

(A) **Rate of tax [Section 3(1)]** - Every assessee would be liable to tax@30% in respect of his undisclosed foreign income and asset of the previous year.

However, an **undisclosed asset located outside India** shall be charged to tax on its value in the previous year in which such asset comes to the notice of the Assessing Officer.

Tax@30%

Meaning of certain terms:

Term	Section	Meaning
Undisclosed foreign income and asset	2(12)	The total amount of undisclosed income of an assessee from a source located outside India and the value of an undisclosed asset located outside India, referred to in section 4, and computed in the manner laid down in section 5
Undisclosed asset located outside India	2(11)	An asset (including financial interest in an entity) located outside India, - held by the assessee in his name or - in respect of which he is a beneficial owner, and - he has no explanation about the source of investment in such asset or the explanation given by him is in the opinion of the Assessing Officer unsatisfactory.
Assessee	2(2)	A person,— (a) being a **resident in India** within the meaning of section 6 of the Income-tax Act, 1961 in the previous year; or (b) being a **non-resident or not ordinarily resident in India** within the meaning of section 6(6) of the Income-tax Act, 1961 in the previous year, **who was resident in India either in the previous year to which the income referred to in section 4 relates**; or in the previous year in which **the**

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		undisclosed asset located outside India was acquired: However, the previous year, in case of acquisition of undisclosed asset outside India, shall be determined **without giving effect to the provisions of section 72(c)** which states that where any asset has been acquired or made prior to commencement of this Act, and no declaration in respect of such asset is made under Chapter VI (Tax Compliance for Undisclosed Foreign Income and Assets), such asset shall be deemed to have been acquired or made in the year in which a notice under section 10 is issued by the Assessing Officer and the provisions of this Act would apply accordingly In effect, it has been clarified that a person would be an assessee, if he is resident in the previous year in which the undisclosed asset located outside India was actually acquired by him and not the year in which notice under section 10 is issued by the Assessing Officer.
Previous year	2(9)	

	Circumstance	Period	
		Beginning with	Ending with
a	In case of a newly set up business	The date of setting up of a business	The date of closure of business or 31st March following the date of setting up of business, whichever is earlier.
b	Where a new source of income comes into existence	The date on which the new source comes into existence	The date of closure of business or 31st March following the date on which such new source comes into existence, whichever is earlier.
c	In case of discontinuance	1st day of the FY	The date of discontinuance of

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				of business or dissolution/ liquidation		business [other than business referred to in (b) above] or dissolution of an unincorporated body or liquidation of a company, as the case may be.
			d	In any other case	1st April of the relevant year	31st March following. (i.e., a period of 12 months commencing from 1st April and ending on 31st March)

(B) **Relevant previous year of chargeability to tax [Proviso to section 3(1)]** - Undisclosed asset located outside India to be charged to tax on its value in the previous year in which the asset comes to the notice of the Assessing Officer.

Relevant P.Y.

(C) **Value of an undisclosed asset [Section 3(2)]** - The **fair market value** of an asset (including financial interest in any entity) determined in the prescribed manner as laid down in Rule 3 of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Rules, 2015, would be the value of an undisclosed asset. The following table gives the manner of determination of fair market value of different assets -

	Asset	Fair market value as per Rule 3(1)
(a)	Bullion, jewellery or precious stone	Higher of – (i) its cost of acquisition; and (ii) the price that the bullion, jewellery or precious stone shall ordinarily fetch if sold in the **open market on the valuation date.** For this purpose, the assessee may obtain a report from a valuer recognised by the Government of a country or specified territory outside India or any of its agencies for the purpose

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		of valuation of bullion, jewellery or precious stone under any regulation or law.
(b)	Archaeological collections, drawings, paintings, sculptures or any work of art (artistic work)	Higher of - (i) Cost of acquisition; and (ii) the price that the artistic work shall ordinarily fetch if sold in the open market on the valuation date for which the assessee may obtain a report from a valuer recognised by the Government of a country or specified territory outside India or any of its agencies for the purpose of valuation of artistic work under any regulation or law;
(c)(I)	Quoted Shares and securities	Higher of – (i) cost of acquisition; and (ii) the price as determined in the following manner, namely: (A) the average of the lowest and highest price of such shares and securities quoted on any established securities market on the valuation date; or (B) where on the valuation date there is no trading in such shares and securities on any established securities market, average of the lowest and highest price of such shares and securities on any established securities market on a date immediately preceding the valuation date when such shares and securities were traded on such securities market;
(c)(II)	Unquoted shares and securities	Higher of – (i) Cost of acquisition; and (ii) The value, on the valuation date, of such equity shares as determined in the following manner, namely:— the fair market value of unquoted equity shares =
		$\frac{(A+B-L)}{PE} \times PV$

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		Where,		
		A	book value of all the assets (other than bullion, jewellery, precious stone, artistic work, shares, securities and immovable property) ***minus*** (i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any, and (ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;	
		B	fair market value of bullion, jewellery, precious stone, artistic work, shares, securities and immovable property as determined in the manner provided in this rule	
		L	book value of liabilities, but not including the following amounts, namely:	
			(i)	the paid-up capital in respect of equity shares;
			(ii)	the amount set apart for payment of dividends on preference shares and equity shares;
			(iii)	reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation
			(iv)	any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;
			(v)	any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

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			(vi)	any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;
		PE	total amount of paid-up equity share capital as shown in the balance sheet;	
		PV	the paid-up value of such equity shares	
(c)(III)	Unquoted share and security other than equity share in a company	Higher of,— (i) its cost of acquisition; and (ii) the price that the share or security shall ordinarily fetch if sold in the open market on the valuation date for which the assessee may obtain a report from a valuer recognised by the Government of a country or specified territory outside India or any of its agencies for the purpose of valuation of share and security under any regulation or law		
(d)	Immovable property	Higher of,— (i) its cost of acquisition; and (ii) the price that the property shall ordinarily fetch if sold in the open market on the valuation date for which the assessee may obtain a valuation report from a valuer recognised by the Government of a country or specified territory outside India in which the property is located or any of its agencies for the purpose of valuation of immovable property under any regulation or law		
(e)	An account with a bank	(I) the sum of all the deposits made in the account with the bank since the date of opening of the account; or (II) where a declaration of such account has been made under Chapter VI and the value of the account as computed under sub-clause (I) has been charged to tax and penalty under that Chapter, the sum of all the deposits made in the account with the bank since the date of such declaration. However, where any deposit is made from the proceeds of any withdrawal from the account,		

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<table>
<tr><td></td><td></td><td>such deposit shall not be taken into consideration while computing the value of the account</td></tr>
<tr><td>(f) & (g)</td><td>value of an interest of a person in a partnership firm or in an AOP or a LLP of which he is a member</td><td>The net asset of the firm, AOP or LLP on the valuation date shall first be determined.

Thereafter, the portion of the net wealth of the firm, AOP or LLP as is equal to the amount of its capital shall be allocated among its partners or members in the proportion in which capital has been contributed by them.

The residue of the net asset shall be allocated among the partners or members in the following manner:
<table>
<tr><th>Circumstance</th><th>Manner of allocation</th></tr>
<tr><td>In the event of dissolution of the firm or AOP</td><td>In accordance with the agreement of partnership or association for distribution of assets</td></tr>
<tr><td>In the absence of such agreement for distribution of assets on dissolution</td><td>in the proportion in which the partners or members are entitled to share profits</td></tr>
</table>
The sum total of the amount so allocated to a partner or member shall be treated as the value of the interest of that partner or member in the partnership or association.

Net asset of the firm, AOP or LLP shall be (A + B - L), determined in the manner specified in C(II) above.</td></tr>
<tr><td>(h)</td><td>Any other asset</td><td>Higher of –

(I) its cost of acquisition or the amount invested; and

(II) the price that the asset would fetch if sold in the open market on the valuation date in an arm's-length transaction.</td></tr>
</table>

FMV of an asset (other than bank account) transferred before the valuation date [Rule 3(2)]:

Where an asset (other than a bank account) was transferred before the valuation date, the FMV of such asset shall be **higher of its cost of acquisition and the sale price**. This is notwithstanding the valuation rules given in Rule 3(1),

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However, where such asset was transferred without consideration or for inadequate consideration before the valuation date, the FMV of the asset shall be higher of its cost of acquisition and the FMV on the date of transfer.

FMV, in a case where a new asset is acquired out of consideration received on account of transfer of an old asset or withdrawal from a bank account [Rule 3(3)]:

In such a case, the fair market value of the old asset or the bank account, as the case may be, determined in accordance with Rule 3(1) and Rule 3(2), shall be reduced by the amount of the consideration invested in the new asset.

Example

House A located in a country outside India was bought in 1995 for ₹ 15 lakh. It was sold in 2000 for ₹ 22 lakh. This amount was deposited in a bank account in that country. In the year 2001 another House B was purchased for ₹ 35 lakh. The investment in House B was made through withdrawal from the bank account in the foreign country. House B has not been transferred before the valuation date and its value on the valuation date is ₹ 48 lakhs. Assuming that the value of foreign bank account as computed under Rule 3(1)(e) is ₹ 60 lakhs, the fair market value (FMV) of the assets would be computed in the following manner:

FMV of House A = ₹ 22 lakh (being higher of ₹ 15 lakh and ₹ 22 lakh) - ₹ 22 lakh (invested in foreign bank account) = Nil

FMV of Foreign Bank account = ₹ 60 lakh - ₹ 35 lakh (invested in House B) = ₹ 25 lakh

FMV of House B = Higher of ₹ 35 lakh and ₹ 48 lakh = ₹ 48 lakh

Rate of conversion of currency used to determine FMV of an asset [Rule 3(4) & 3(5)]: The fair market value of an asset determined in a currency which is one of the permitted currencies designated by the RBI under the Foreign Exchange Management Regulations, has to be converted into Indian currency as per the reference rate of the RBI on the date of valuation.

Rate of Conversion

Where the FMV of an asset is determined in a currency other than one of the permitted currencies designated by the RBI, then, such value shall be converted into United States Dollar on the date of valuation as per the rate specified by the Central Bank of the country or jurisdiction in which the asset is located. Such value in United States Dollar shall be converted into Indian currency as per the reference rate of the RBI on the date of valuation:

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However, where the Central Bank of the country or jurisdiction in which the asset is located does not specify the rate of conversion from its local currency to United States Dollar, then, such rate shall be the one as specified by any other bank regulated under the laws of that country or jurisdiction.

Meaning of certain terms [*Explanation 1 to Rule 3*]

	Term	Meaning
(a)	Established securities market	An exchange that is officially recognised and supervised by a Governmental entity in which the market is located and that has a meaningful annual value of shares traded on the exchange
(b)	Meaningful annual value of shares traded on the exchange	With respect to an exchange, it means it has an annual value of shares traded on the exchange (or a predecessor exchange) exceeding one billion United States Dollar during each of the three calendar years immediately preceding the calendar year in which the determination is being made.
(c)	Meaningful volume of trading on an on-going basis	With respect to each class of shares, it means,- (i) trades in each such class are effected, other than in *de minimis* quantities, on one or more established securities markets on at least 60 business days during the prior calendar year; and (ii) the aggregate number of shares in each such class that are traded on such market or markets during the prior year are at least 10% of the average number of shares outstanding in that class during the prior calendar year
(d)	Quoted share or security	The share or security which has a meaningful volume of trading on an ongoing basis on an established securities market and is regularly quoted by dealers where they actively do offer to, and in fact do, purchase the share from, and sell the share to, customers who are not related to the dealer in the ordinary course of a business.
(e)	Unquoted share and security	In relation to share or security, means share or security which is not a quoted share or security.

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Relevant Date for determination of market value and conversion of currency [*Explanation 2* to Rule 3]

For the purpose of determining the market value as on valuation date referred to in Rule 3(1), and for the purpose of conversion into Indian currency or conversion of foreign currency into United States Dollar and thereafter into Indian currency, the date would be —

	Case	Date
(a)	in respect of asset declared under section 59 of the Act	1st July, 2015
(b)	in any other case	1st April of the previous year

(ii) **Scope of total undisclosed foreign income and asset [Section 4]**

(a) **Total undisclosed foreign income and asset** of any previous year would be -

(1) the income from a source located outside India **which has not been disclosed in the return of income** filed under the Income-tax Act, 1961 on or before the due u/s 139(1) or in the belated return of income u/s 139(4) or in the revised return of income u/s 139(5).

(2) the income from a source located outside India in respect of which a return is required to be filed under section 139 of the Income-tax Act, 1961, but **no return, belated return or revised return has been filed under section 139(1)/(4)/(5) of that Act.**

(3) the value of any **undisclosed asset located outside India**.

(b) Any variation made in the income from a source outside India in the assessment or reassessment of the total income of any previous year, of the assessee under the Income-tax Act, 1961 in accordance with the following provisions of the Income-tax Act, 1961 is not includible in the total undisclosed foreign income:

Section	Provision
29	Manner of computation of income under the head "Profits and gains of business or profession"
43C	Special provision for computation of cost of acquisition of an asset which becomes the property of an amalgamated company under a scheme of amalgamation and is sold by the amalgamated company as stock-in-trade of the business carried on by it.

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57	Manner of computation of income chargeable under the head "Income from other sources"
59	Profits (Deemed income) chargeable to tax
92C	Computation of arm's length price

(c) **Non-inclusion of income included in undisclosed foreign income and asset in the total income under the Income-tax Act, 1961** - The income included in the total undisclosed foreign income and asset under this enactment would not form part of total income under the Income-tax Act, 1961.

(iii) **Computation of total undisclosed foreign income and asset [Section 5]**

(a) **Disallowance of expenditure and set-off of loss** - No deduction in respect of any expenditure or allowance or set off of any loss would be allowed in computing the total undisclosed foreign income and asset of any previous year of an assessee, irrespective of whether the same is allowable under the Income-tax Act, 1961.

(b) **Permissible deduction from value of undisclosed asset located outside India** - From the value of undisclosed asset located outside India, **any income which has so far been assessed to tax** for any assessment year under the Income-tax Act, 1961 prior to the assessment year to which the Act applies and **any income which is assessable or has been assessed to tax** for any assessment year under this Act, will be **reduced**.

However, the assessee has to furnish evidence to the satisfaction of the Assessing Officer that the asset has been acquired from the income which has been assessed or assessable to tax.

(c) **Permissible deduction from value of immovable property** - If the deduction referred to in (b) above in respect of income which is assessable or has been assessed to tax is in relation to an **immovable property**, the quantum of deduction would be the amount which bears to the value of the asset as on the first day of the financial year in which it comes to the notice of the Assessing Officer, the same proportion as the assessable or assessed foreign income bears to the total cost of the asset.

Example

A house property located in a country outside India was acquired by Mr. A, an assessee in the previous year 2012-13 for ₹ 60 lakh. Out of the investment of ₹ 60 lakh, ₹ 35 lakh was

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assessed to tax in the total income of the previous year 2012-13 and earlier years. Such undisclosed asset comes to the notice of the Assessing Officer in the year 2025-26. If the value of the house property in the year 2025-26 is ₹ 120 lakh, the amount chargeable to tax shall be X-Y=Z where,

X = ₹ 120 lakh,

Y = ₹ 120 lakh x 35/60 = ₹ 70 lakh,

Z = ₹ 120 lakh – ₹ 70 lakh = ₹ 50 lakh.

19.4.2 PENALTIES [CHAPTER IV – SECTIONS 40 TO 47]

(i) **Penalty in relation to undisclosed foreign income and asset [Section 41]** - In case, where tax has been computed in respect of undisclosed foreign income and asset, the Assessing Officer may direct the assessee to pay by way of penalty, in addition to tax, if any, payable by him, a sum equal to **three times the tax so computed**.

(ii) **Penalty for failure to furnish return in relation to foreign income and asset [Section 42]** - Failure to furnish return of income as required under section 139(1) before the end of the relevant assessment year by a person, being a resident other than not ordinarily resident in India, holding any asset (including financial interest in any entity) located outside India as a beneficial owner or otherwise or being a beneficiary of any asset (including financial interest in any entity) located outside India or having any income from a source located outside India, would attract penalty of **₹ 10 lakh**.

(iii) **Penalty for failure to furnish information in the return of income or for furnishing inaccurate particulars about an asset located outside India [Section 43]** - If such failure is in relation to an asset (including financial interest in any entity) held by a person, being a resident other than not ordinarily resident in India, as a beneficial owner or otherwise, or in respect of which such person was a beneficiary, or if such failure is in relation to any income from a source located outside India, at any time during such previous year, the Assessing Officer may direct such person to pay, by way of penalty, a sum of ₹ 10 lakh.

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(iv) **Non-applicability of penalty under sections 42 & 43 in certain cases [Proviso to sections 42 & 43]** -

Penalty under sections 42 and 43 would, however, not apply in respect of an asset or assets (other than immovable property), where the aggregate value of such asset or assets does not exceed ₹ 20 Lakh.

(v) **Determination of the value equivalent in rupees of the balance in an account maintained in foreign currency [*Explanation* to sections 42 & 43]** – For determining the value equivalent in rupees of the balance in an account maintained in foreign currency, the rate of exchange for calculation of the value in rupees shall be the telegraphic transfer buying rate of such currency as on the date for which the value is to be determined as adopted by the State Bank of India constituted under the SBI Act, 1955.

(vi) **Penalty for default in payment of tax arrear [Section 44]** – Penalty equal to the amount of tax arrears is leviable in case of an assessee in default or an assessee deemed to be in default in making payment of tax and in case of continuing default by such assessee. An assessee shall not cease to be liable to any penalty merely by reason of the fact that before levy of such penalty, tax has been paid by him.

(vii) **Penalty for other defaults [Section 45]** – Penalty of a sum not less than ₹50,000 but extending upto ₹ 2 lakh would be attracted in case a person liable to penalty has, without reasonable cause, failed to -

(a) answer any question put to him by a tax authority in exercise of his powers under the Act

(b) sign any statement made by him in the course of any proceedings under the Act which a tax authority may legally require him to sign

(c) attend or produce books of account or documents at the place or time, if he is required to attend or to give evidence or produce books of account or other documents at certain place and time in response to summons issued under section 8.

(viii) **Prior approval of Joint Commissioner or Joint Director** - An order imposing a penalty under this Chapter shall be made with the approval of the Joint Commissioner or Joint Director, if –

(1) the penalty exceeds ₹1 lakh and the tax authority levying the penalty is in the rank of Income-tax Officer; or

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(2) the penalty exceeds ₹ 5 lakhs and the tax authority levying the penalty is in the rank of Assistant Commissioner or Deputy Commissioner or Assistant Director or Deputy Director

Summary of Penal Provisions contained in Chapter IV

Section	Failure/Default	Quantum of penalty
41	Where tax has been computed in relation to undisclosed foreign income and asset	In addition to tax, a sum equal to three times the tax so computed.
42	Failure to furnish return in relation to foreign income and asset	₹ 10 lakh
43	Failure to furnish information in the return of income or for furnishing inaccurate particulars about an asset located outside India	₹ 10 lakh
44	Default in payment of tax arrear	Amount equal to the amount of tax arrears
45	Failure, without reasonable cause, to answer any question put to him by a tax authority or to sign any statement made by him in the course of any proceedings under the Act or to attend or produce books of account or documents at the place or time in response to summons issued under section 8	₹ 50,000 to ₹ 2 lakh

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19.4.4 OFFENCES AND PROSECUTION [CHAPTER V]

(i) **Provisions of Chapter V not in derogation of any other law or any other provision of the Act [Section 48]** – The provisions relating to offences and prosecution contained in Chapter V are in addition to, and not in derogation of, the provisions of any other law providing for prosecution for offences thereunder. Further, the provisions of Chapter V to be independent of any order under this Act that may be made, or has not been made, on any person. Also, it shall not be a defence that the order has not been made on account of time limitation or for any other reason.

(ii) **Punishment for failure to furnish return in relation to foreign income and asset [Section 49]** – Willful failure to furnish return required to be furnished under section 139(1) of the Income-tax Act, 1961 in due time, by a person, being a resident other than not ordinarily resident in India, who at any time during the previous year, held any asset (including financial interest in any entity) located outside India as a beneficial owner or otherwise, or was a beneficiary of such asset or had income from a source outside India, would be punishable with rigorous imprisonment for a term which would **not be less than six months but which may extend to seven years and with fine. However, prosecution would not be attracted if he furnishes such return before the expiry of the assessment year.**

(iii) **Punishment for failure to furnish information about an asset located outside India in the return of income [Section 50]** - If such failure in relation to an asset (including financial interest in any entity) held by a person, being a resident other than not ordinarily resident in India, as a beneficial owner or otherwise, or in respect of which he was a beneficiary, or if such failure in relation to any income from a source located outside India, at any time during such previous year, is willful, the punishment would be rigorous imprisonment for a term which would **not be less than six months but which may extend to seven years and with fine**.

(iv) **Punishment for willful attempt to evade tax [Section 51]** – Willful attempt to evade any tax, penalty or interest under this Act by a person, being a resident other than not ordinarily resident in India, is punishable with rigorous imprisonment for a term **not less than three years but extending to ten years and with fine**.

Willful attempt to evade payment of any tax, penalty or interest under the Act, is punishable with rigorous imprisonment for a term **not less than three months but extending upto three years** and also a fine, in the discretion of the Court.

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Meaning of willful attempt to evade tax, penalty or interest

A willful attempt to evade any tax, penalty or interest chargeable or imposable under this Act or the payment thereof includes a case where any person—

(1) has in his possession or control any books of account or other documents (being books of account or other documents relevant to any proceeding under this Act) containing a false entry or statement; or

(2) makes or causes to be made any false entry or statement in such books of account or other documents; or

(3) willfully omits or causes to be omitted any relevant entry or statement in such books of account or other documents; or

(4) causes any other circumstance to exist which will have the effect of enabling such person to evade any tax, penalty or interest chargeable or imposable under this Act or the payment thereof.

(v) **Punishment for false statement in verification [Section 52]** – If a person, makes a statement in any verification under this Act or under any rule made thereunder, or delivers an account or statement which is false, and which he either knows or believes to be false, or does not believe to be true, he shall be punishable with rigorous imprisonment for a term **not less than six months but extending to seven years and with fine**.

(vi) **Punishment for abetment [Section 53]** – Rigorous imprisonment for a term **not less than six months but extending to seven years and fine** would be attracted for abetment to make and deliver an account or statement or declaration relating to tax payable under this Act which is false or to commit an offence under section 51(1).

(vii) **Presumption as to culpable mental state [Section 54]** – In any prosecution for any offence under this Act which requires a culpable mental state on the part of the accused, the court shall presume the existence of such mental state. However, it shall be a defence for the accused to prove the fact that he had no such mental state with respect to the act charged as an offence in that prosecution. "Culpable mental state" includes intention, motive or knowledge of a fact or belief in, or reason to believe, a fact. For this purpose, a fact is said to be proved only when the court believes it to exist beyond reasonable doubt and not merely when its existence is established by a preponderance of probability.

(viii) **Prosecution to be at instance of Principal Chief Commissioner or Principal Director General or Chief Commissioner or Director General or Principal Commissioner or Commissioner. [Section 55]** - A person shall not be proceeded against for an offence under section 49 to section 53 except with the sanction of the Principal Commissioner or

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Commissioner or the Commissioner (Appeals), as the case may be. The Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or the Director General may issue such instructions, or directions, to the tax authorities as he may think fit for the institution of proceedings under this section.

(ix) Offences by companies [Section 56] -

(a) **Persons in charge at the time when offence was committed deemed guilty of offence** - Where an offence under this Act has been committed by a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company would be deemed to be guilty of the offence and would be liable to be proceeded against and punished accordingly. If, however, such person 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 would not be deemed guilty of the offence.

(b) **Director/manager/secretary/officer of company deemed guilty of offence committed with their consent or connivance** - Where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

(c) **Fine and imprisonment** - Where an offence under this Act has been committed by a person, being a company, and the punishment for such offence is imprisonment and fine, then, such company shall be punished with fine. Further, every person, referred to in (a), or the director, manager, secretary or other officer of the company referred to in (b), would be proceeded against and punished in accordance with the provisions of this Act.

(d) **Meaning of certain terms for this section**

	Term	Meaning
(1)	Company	Means a body corporate. Includes — (i) an unincorporated body (i.e., a firm, AOP or BOI); (ii) a Hindu undivided family.

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			In relation to	Meaning of Director
(2)	Director	(i)	A firm	A partner in the firm
		(ii)	An AOP/BOI	A member of the AOP/BOI
		(iii)	A HUF	An adult member of the family
		(iv)	A company	A whole-time director
		(v)	A company not having a whole-time director	Any other director or manager or officer, who is in charge of the affairs of the company

(x) Proof of entries in records or documents [Section 57]

The entries in the records, or other documents, in the custody of a tax authority are admissible in evidence in any proceeding for the prosecution of any person for an offence under Chapter V of this Act. These entries may be proved by the production of –

(a) the records or other documents (containing such entries) in the custody of the tax authority; or

(b) a copy of the entries certified by that authority under its signature, as true copy of the original entries contained in the records or other documents in its custody.

(xi) Punishment for second and subsequent offences [Section 58]

If any person convicted of an offence under section 49 to section 53 is again convicted of an offence under any of the aforesaid provisions, he shall be punishable for the second and every subsequent offence with rigorous imprisonment for a term of three to ten years and with fine ranging from ₹ 5 lakh to ₹ 1 crore.

(xii) Summary of Prosecution Provisions in Chapter V

Section	Offence	Punishment
49	Willful failure to furnish return in relation to foreign income and asset (including financial interest in any entity) before the expiry of the assessment year by a person, being a resident other than not ordinarily resident in India	Rigorous Imprisonment: 6 months to 7 years **(+)** Fine
50	Willful failure to furnish in the return of income, any information about an asset (including financial interest in any entity) located outside India by a person, being a resident other than not ordinarily resident in India	Rigorous Imprisonment: 6 months to 7 years **(+)** Fine

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51(1)	Willful attempt to evade any tax, penalty or interest chargeable or imposable under the Act by a person, being a resident other than not ordinarily resident in India	Rigorous Imprisonment: 3 to 10 years **(+)** Fine
51(2)	Willful attempt to evade payment of any tax, penalty or interest under the Act by any person	Rigorous Imprisonment: 3 months to 3 years **(+)** Fine, at the discretion of the court.
52	Making false statement in verification or delivering an account of statement which is false knowingly	Rigorous Imprisonment: 6 months to 7 years **(+)** Fine
53	Abetting or inducing a person to make or deliver a false statement, account or declaration knowingly or to commit an offence u/s 51(1)	Rigorous Imprisonment: 6 months to 7 years **(+)** Fine
58	Second and subsequent offence	Rigorous Imprisonment: 3 to 10 years **(+)** Fine: ₹ 5 lakh to ₹1 crore.

Note: *Students are advised to read the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 and the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Rules, 2015 available at the website of the Income-tax Department, Government of India, www.incometaxindia.gov.in*

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SIGNIFICANT SELECT CASES

S. No.	Case Law	
1.	*CIT v Jindal Tractebel Power Co. Ltd. (2025) 474 ITR 77 (Karn.)*	
	Issue	**Facts, Analysis and Decision**
	Whether reliance on professional advice can be treated as a reasonable cause for not deducting tax at source, and consequently, whether penalty u/s 271C is leviable for failure to deduct tax?	**Facts of the Case:** The assessee-company did not effect TDS from the monies payable to a foreign entity under the contract relating to supply and services of off-shore equipment. This it did on the professional advice that no tax was required to be deducted by way of TDS in as much as no income was deemed to accrue or arise in India pursuant to off-shore contract. The foreign entity had also applied for advance ruling seeking a final opinion in this regard which was not processed. The competent authority-initiated penalty proceedings under section 271C for failure to deduct tax and disregarded the explanation offered by the assessee that the non-deduction of tax was due to the bona fide belief formed on the basis of the professional advice. The Commissioner of Income-tax agreed with the explanation offered by the assessee and granted relief to it observing that the non-deduction of tax was not tainted with mala fide; there was reasonable cause for not deducting. The Tribunal rejected revenue's appeal. **Analysis and Decision**: The Hon'ble High Court noted that, the assessee in its reply specifically stated that the non-deduction of tax for the subject period was due to the *bona fide* belief formed on the basis of the legal opinion obtained from a Law firm of repute; and the opinion of a Chartered Accountant's firm. This apart, the foreign entity had also sought advance ruling and the Chairman of the Advance Ruling Authority (now Board of Ruling Authority) did not process the same for personal reasons. Added what benefit the assessee could derive by not deducting the tax at source is also a factor. All these certainly constitute a reasonable cause for not effecting TDS and, therefore, the impugned order being consistent with the same is not vulnerable for challenge, as rightly contended by the assessee. Accordingly, it was held that non-deduction of TDS was not tainted with *mala fide* and reasonable cause was shown for not deducting TDS, therefore, penalty under section 271C was not leviable.

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2.	*US Technologies International Pvt. Ltd. v. CIT [2023] 453 ITR 644 (SC)*	
	Issue	**Analysis and Decision**
	Can penalty under section 271C be levied for non-payment or belated remittance of the tax deducted at source under Chapter XVII-B to the credit of the Central Government?	Section 271C(1)(a) is applicable in a case of failure on the part of the assessee to "deduct" the whole or any part of the tax as required by or under the provisions of Chapter XVII-B of the Act. The words "fails to deduct" used in section 271C(1)(a) are clear; and it does not speak about belated remittance of the tax deducted at source. On a plain reading of section 271C(1)(a), no penalty would be leviable on belated remittance of TDS after it is deducted by the assessee. The scope of section 271C(1)(a) and the extent of its application are discernible from the provision itself, in unambiguous terms. Wherever Parliament intended consequences for non-payment or belated remittance of the tax deducted at source, Parliament has provided for it, such as in section 201(1A) and section 276B of the Act. Section 201(1A) provides that in case a tax has been deducted at source but is subsequently remitted belatedly, such a person is liable to pay interest as provided under section 201(1A). The consequences of non-payment or belated remittance/payment of the tax deducted at source are specifically provided under section 201(1A). Similarly, section 276B speaks about prosecution for failure to pay the tax deducted at source to the credit of the Central Government within the prescribed time. The words "fails to deduct" in section 271C(1)(a) cannot be read as "failure to deposit/pay the tax deducted". Therefore, on correct interpretation of section 271C, no penalty would be leviable under section 271C on delay in remittance of the tax deducted at source after deducting it on time. ***Note:*** *Section 271C provides that if any person fails to* *(a) deduct the whole or any part of the tax as required by or under the provisions of Chapter XVII-B; or* *(b) pay or ensure payment of the whole or any part of the tax as required by or under* *- the second proviso to section 194B,* *- the first proviso to section 194R(1);*

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		- the proviso to section 194S(1) *- section 194BA(2)* *then, such person shall be liable to pay, by way of penalty, a sum equal to the amount of tax which such person failed to deduct or pay or ensure payment of, as aforesaid.* *Penalty under clause (a) above is attracted where a person fails to deduct tax wholly or partly. However, under clause (b) penalty is attracted for failure to pay tax or to ensure payment of such tax. These are specific cases where winnings/ benefits/ perquisites/ consideration for transfer, as the case may be, are wholly in kind or partly in cash or partly in kind, but the cash portion is not sufficient to meet the TDS liability.* *Therefore, the above Apex court ruling is applicable only with respect to clause (a) of section 271C(1). In respect of clause (b), both penalty u/s 271C and prosecution u/s 276B would be attracted.*
3.	***ACIT v. AT-Dev Prabha (JV) and others (2023) 454 ITR 59 (SC)***	
	Issue	**Analysis & Decision**
	Can prosecution proceedings under section 276B be launched for delay in depositing tax to the credit of Central Government, where the period of delay and the amount of TDS were not substantial and the amount of TDS has been subsequently deposited with some delay along with interest?	**Relevant provision of law**: As per section 276B, if a person fails to pay to the credit of the Central Government, the tax deducted at source by him as required under Chapter XVII-B, he shall be punishable with rigorous imprisonment for not less than 3 months but which may extend to 7 years. ***No prosecution would be attracted if TDS is paid to the credit of the Central Government on or before the time prescribed for filing the statement u/s 200(3) (i.e., Quarterly Statement under Rule 31A).*** **Analysis and Decision**: In the present case, the High Court, considering the CBDT Circular (wherein it is mentioned that prosecution under section 276B shall not normally be proposed when the amount involved, or the period of default was not substantial and the amount in default had been deposited in the meantime to the credit of the Central Government) quashed the criminal proceedings and orders passed by the Special Economic Offences court against the assessee holding that the tax deducted at source in all the

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		cases had been deposited with interest, though there was some delay in depositing the tax. Moreover, apart from one or two cases, the deducted amounts were not more than ₹ 50,000. The Apex Court upheld the High Court decision and accordingly, dismissed the special leave petition. ***Note -*** *The CBDT has, vide Circular No. 24/2019 dated 9.9.2019, in exercise of the powers under section 119, listed out the offences covered under Chapter XXII of the Income-tax Act, 1961 in respect of which prosecution proceedings shall be launched by Approving Authority being the Sanctioning Authority where the quantum of offences exceed the prescribed monetary threshold. Accordingly, in case of failure to pay TDS under section 276B or failure to pay TCS u/s 276BB, no prosecution will be processed if the TDS/TCS amount does not exceed ₹ 25 lakhs and delay in deposit is less than 60 days. However, for these offences, in exceptional cases like habitual defaulters, based on particular facts and circumstances of each case, prosecution may be initiated only with the previous administrative approval of the Collegium of two CCIT/DGIT rank officers though the amount involved does not exceed the threshold limit of ₹ 25 lakhs.* *Students may read the detailed circular available at the following link–* *https://incometaxindia.gov.in/communications/circular/circular-24-2019-11-09-2019.pdf*
4.	***Union of India v. Bhavecha Machinery and Others (2010) 320 ITR 263 (MP)***	
	Issue	**Analysis & Decision**
	Would prosecution proceedings under section 276CC be attracted where the failure to furnish return in time was not willful?	The provisions of section 276CC to get attracted, there should be a willful delay in filing return and not merely a failure to file return in time. There should be clear, cogent and reliable evidence that the failure to file return in time was 'willful' and there should be no possible doubt of its being 'wilful'. The failure must be intentional, deliberate, calculated and conscious with complete knowledge of legal consequences flowing from them. In this case, it was observed that there were sufficient grounds for delay in filing the return of income and such delay was not willful. Therefore, prosecution proceedings under section 276CC are not attracted in such a case.

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5.	*Income-tax department v. D. K. Shivakumar [2021] 434 ITR 367 (Kar)*	
	Issue	**Analysis & Decision**
	Can prosecution be launched in every case where unaccounted transactions (like unaccounted loan) are unearthed during search, irrespective of whether there is a liability to pay tax, penalty or interest under the Act in respect thereof?	The gist of the offence under section 276C(1) is the wilful attempt to evade any tax, penalty or interest chargeable or imposable on income. What is made punishable is "attempt to evade tax, penalty or interest". In legal parlance, an "attempt" is understood to mean "an act or movement towards commission of an intended crime". It is doing "something in the direction of commission of offence". A positive act on the part of the accused is required to be established to bring home the charge against the accused for the offence under section 276C(2). There is no presumption under law that every unaccounted transaction (uncounted loan, in the present case) would lead to imposition of tax, penalty or interest. Therefore, until and unless it is determined that the unaccounted transactions unearthed during search were liable for payment of tax, penalty or interest, no prosecution could be launched on the ground of attempt to evade such tax, penalty or interest.

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TEST YOUR KNOWLEDGE

Questions

1. *What is the quantum of penalty that could be levied in each of the following cases -*

   (i) Failure to get books of accounts audited as required under section 44AB within the time prescribed under the Act.

   (ii) Failure to comply with a direction issued under section 142(2A).

   (iii) Failure to furnish report from an accountant as required under section 92E.

2. *X, an individual whose total sales in the business of food grains for the year ending 31.3.2026 was ₹ 205 lakhs, did not maintain books of account for P.Y.2025-26, even though his turnover was ₹ 28 lakhs in the P.Y.2024-25. During the previous year 2025-26, majority of payment were made either in cash or by bearer cheque by Mr. X. The Assessing Officer levied penalty of ₹ 25,000 under section 271A for non-maintenance of books of account and penalty of ₹ 1,02,500 under section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B?*

3. *State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) regarding the waiver of penalty. Can the Principal Commissioner or the Commissioner refuse to grant relief, when the conditions laid down in the section was complied with, by the assessee?*

4. *Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act, 1961.*

   (i) Raman & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.

   (ii) Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of ₹ 10,000. They have not furnished the requisite information in spite of various reminders.

5. *Fox Limited failed to furnish information and documents sought by the Transfer Pricing Officer (TPO). Can TPO levy penalty for such failure? How much would be the quantum of penalty imposable for the said failure?*

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6. *What would be the penalty leviable under section 270A in case of the following assessees, if none of the additions or disallowances made in the assessment or reassessment qualify under section 270A(6) and the under-reported income is not on account of misreporting?*

	Particulars of total income of A.Y.2026-27	**M/s. Alpha, a resident firm**	**Beta Ltd., an Indian company**
		(₹)	(₹)
(1)	As per the return of income furnished u/s 139(1)	35,00,000	(12,00,000)
(2)	Determined under section 143(1)(a)	45,00,000	(6,00,000)
(3)	Assessed under section 143(3)	62,00,000	(2,00,000)
(4)	Reassessed under section 147	81,00,000	6,00,000

Note – *Beta Ltd. is a trading company. The total turnover of Beta Ltd. for the P.Y.2023-24 was ₹ 401 crore and the company has not exercised option under section 115BAA.*

7. *Can prosecution be launched for each of the following actions or defaults committed? If yes, then explain the relevant provisions of the Act and the quantum of prescribed punishment.*

   (i) *The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in the form of electronic record and the books of accounts.*

   (ii) *The assessee deliberately has failed to comply with the requirement of section 142(1) and/or 142(2A).*

   (iii) *The assessee deliberately has failed to make the payment of the tax collected under section 206C.*

8. *The Assessing Officer lodged a complaint against M/s. KLM, a firm, under section 276CC of the Income-tax Act, 1961 for failure to furnish its return of income for the A.Y.2024-25 within the due date under section 139(1). The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was ₹ 60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was ₹ 8,900. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not preferred an appeal against it to the Income Tax Appellate Tribunal. The firm desires to know of the maintainability of the prosecution proceedings in the facts and circumstances of the case.*

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Would your answer change if the person against whom complaint was lodged was KLM Ltd., a company, instead of a firm?

9. *Explain section 278C applicable in respect of offences committed by Hindu undivided families.*

10. *Can the Department launch prosecution in a case where they have accepted the revised return filed by the assessee, rectifying a mistake in the original return of income?*

11. *Ravinder, an Indian citizen, left India and settled in United Kingdom from 10.4.2016. He had never left India previously since April, 2008. He acquired a property worth ₹ 200 lakhs in his name in the financial year 2013-14 at Malaysia. The Assessing Officer came to know of this in March, 2026 based on the investigation made by Enforcement Directorate in some other person's case.*

    The Assessing Officer, having recorded some concrete evidences against Ravinder, issued a notice under section 10 of the Black Money and Imposition of Tax Act, 2015 on 27.3.2026. Mr. Ravinder's counsel contended that since Mr. Ravinder is not a resident in the financial year 2025-26, a notice under section 10 could not be issued to him.

    Is the issue of notice on Ravinder under section 10 of the Black Money Act, 2015 tenable in law? Examine.

12. *Mr. Harshit stayed in India only for 48 days during P.Y. 2025-26. He had acquired a house property located in Country A in September 2013 for ₹ 80 lakh. Out of the investment of ₹ 80 lakh, ₹ 55 lakh was assessed to tax in the total income of the P.Y.2013-14 and P.Y.2012-13, when he was resident in India. The remaining income has not been assessed to tax in any year. This asset comes to the notice of the Assessing Officer in March 2026. The value of the house property on 1.4.2025 was ₹ 120 lakh.*

    What is the value of undisclosed asset (house property located in Country A) in the hands of Mr. Harshit for the purpose of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 and in which year would the same be chargeable to tax?

13. *An apartment located in Country X was bought in 1988 for ₹ 10 lakh. It was sold in the year 2003 for ₹ 30 lakh. This amount was deposited in a bank account in Country X. In the year 2004, another apartment was purchased for ₹ 45 lakh. The investment in the new apartment was made through withdrawal from the bank account in Country X. The new apartment has not been transferred before the valuation date and its value on the valuation date is ₹ 55 lakh. Assuming that the value of foreign bank account in Country X as computed under Rule 3(1)(e) is ₹ 70 lakh, what would be the fair market value of the new apartment as per Rule 3 of Black Money (Undisclosed Foreign Income and Assets) Imposition of Tax Rules, 2015?*

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14. *Mr. Piloo (age 72) was the managing director of Ashok (P) Ltd. at Surat. He retired in June, 2009 and left India permanently in January, 2012. It came to the notice of the Joint Director of Income-tax (Investigation) in June, 2025 that Mr. Piloo had accumulated assets during the previous year 2008-09 exceeding ₹ 500 lakhs outside India (consisting of residential apartments and deposits in banks) which were not disclosed for income-tax purposes up to the assessment year 2012-13 for which the return of income was filed in India. Mr. Piloo was served with a notice under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 in August, 2025.*

    Mr. Piloo is of the opinion that since 10 years have elapsed from the last assessment year in which he was assessed in India, no proceedings could be initiated against him under the Income-tax Act, 1961 and the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015. Mr. Piloo is a non-resident for the assessment year 2026-27.

    Discuss the liability of Mr. Piloo under the Black Money law and state the procedure and methodology for determination of the value of undisclosed asset outside after evaluating the validity of the contentions raised by him.

15. *Deepak, aged 45 (an Indian citizen) has settled in California, USA since 2015. Prior to that, he has always been in India. He had acquired a residential property in California on 25-06-2009 for USD 20,000. He kept bank deposit of USD 10,000 in a bank account in New York since 15-04-2010.*

    Notice under Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 was issued on 20-10-2025. The fair market value of residential property as on 01-04-2025 was USD 25,000; on 01-04-2026 USD 32,000 and 20-10-2025 USD 30,000. The bank deposit with accrued interest thereon was USD 12,500 on 01-04-2025; USD 12,800 on 01-04-2026 and USD 12,700 on 20-10-2025.

    Note: *USD = United States Dollar*

    The exchange rate of Indian currency per 1 USD as per the reference rate of the RBI on the various dates are:

    01-04-2025 = ₹ 71

    20-10-2025 = ₹ 72

    01-04-2026 = ₹ 73

    Compute the value of undisclosed foreign asset chargeable to tax in the hands of Deepak as per Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

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Answers

1. The penalty that could be levied in each case is:

(i) **Failure to get books of accounts audited as required under section 44AB of the Income-tax Act, 1961 -** a sum equal to ½% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of ₹ 1,50,000, whichever is less [Section 271B].

(ii) **Failure to comply with a direction issued under section 142(2A)** – a sum of ₹ 10,000 [Section 272A(1)(d)].

(iii) **Failure to furnish report from an accountant as required by section 92E** - a sum of ₹ 1,00,000 [Section 271BA].

2. X is required to maintain books of account as per section 44AA for the P.Y.2025-26 since his turnover exceeded ₹ 25 lakhs in the P.Y.2024-25. He also has to get them audited under section 44AB, since his gross sales in the P.Y.2025-26 exceeds ₹ 1 crore. He is liable to pay penalty under section 271A for not maintaining his books of account as per section 44AA. Accordingly, the action of the Assessing Officer in levying penalty of ₹ 25,000 under section 271A is correct. However, where books of account have not been maintained, there cannot be a question of getting them audited. Audit of books of account presupposes maintenance of books of account. When admittedly X has not maintained books, he cannot obviously get the audit done.

In *Surajmal Parsuram Todi v. CIT (1996) 222 ITR 691*, the Guwahati High Court has held that when a person commits an offence by not maintaining books of accounts as contemplated by section 44AA, the offence is complete and after that there can be no possibility of any offence as contemplated by section 44AB and, therefore, the imposition of penalty under section 271B is erroneous.

Therefore, in this case, the Assessing Officer is **not** justified in levying penalty under section 271B.

3. There are two conditions to be satisfied by an assessee in order to get relief in the form of a waiver or reduction of penalty by the Principal Commissioner or the Commissioner of Income-tax under section 273A(4) of the Act. These conditions are:

(i) The payment of penalty would cause "genuine hardship" to the assessee and the Commissioner is satisfied about the existence of genuine hardship having regard to

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the circumstances of the case. The existence of genuine hardship would entitle the assessee to relief. The CBDT in its *Circular No 784 dated 22-11-1999* has clarified that "genuine hardship" referred to in the provisions of section 273A(4) should exist both at the time at which the application under section 273A(4) is made by the assessee before the Principal Commissioner or the Commissioner and at the time of passing of order under section 273A(4) by the Principal Commissioner or the Commissioner.

(ii) The assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

As per the decision of Andhra Pradesh High Court in *K.S.N. Murthy v. Chairman, CBDT (2001) 252 ITR 269,* if the above conditions laid down for exercise of the discretion are satisfied, the Principal Commissioner or the Commissioner cannot refuse to exercise the discretion. Though the power given to the Commissioner under section 273A is discretionary, the exercise of discretion cannot be either arbitrary or capricious and has to be judicious and objective, once the conditions required for exercise of discretion in any judicial or quasi-judicial proceedings are satisfied. Such discretion must be exercised taking into consideration all relevant facts. The satisfaction for exercise of discretionary power under section must be based on objective consideration and not on subjective satisfaction.

Also, as per the proviso to section 273A(4), in case the quantum of penalty exceeds ₹ 1 lakh, the Principal Commissioner or the Commissioner can grant relief only with the previous approval of the Principal Chief Commissioner or the Chief Commissioner or the Principal Director General or the Director General, as the case may be.

Note - The Principal Commissioner or the Commissioner has to pass an order under section 273A(4), either accepting or rejecting the application in full or in part, within a period of 12 months from the end of the month in which the application is received. Further, no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard.

4. (i) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Assessing Officer. Therefore, Raman & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to deduct under section 194C from the payments made to the contractors. The penalty would be in addition to the disallowance of 30% of expenditure/payment under section 40(a)(ia).

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(ii) Section 133(6) empowers the Income-tax authority to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required makes him liable for penalty under section 272A(2) of ₹ 500 for every day during which the failure continues.

Note – An income-tax authority below the rank of the Principal Director or Director or Principal Commissioner or Commissioner can exercise this power in respect of an enquiry in a case where no proceeding is pending, only with the prior approval of the Principal Director or Director or Principal Commissioner or Commissioner. Such power can, however, be exercised by the Joint Director, Deputy Director and Assistant Director, without the prior approval of the Principal Director/Director/Principal Commissioner/Commissioner. In this case, it is presumed that the Income-tax authority has obtained the approval of the Principal Director/Director or Principal Commissioner/ Commissioner before exercising this power.

5. Under section 271G, if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by section 92D(3) sought for by the Transfer Pricing Officer, then, such person shall be liable to a penalty which may be levied by the Assessing Officer or the Transfer Pricing Officer or the Commissioner (Appeals). Thus, the Transfer Pricing Officer is a competent authority to levy penalty.

Penalty would be a sum equal to 2% of the value of international transaction or specified domestic transaction for each such failure.

6. Penalty leviable under section 270A in case of M/s. Alpha, a resident firm

M/s. Alpha is deemed to have under-reported its income since:

(1) its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed under section 143(3).

Therefore, penalty is leviable under section 270A for under-reporting of income.

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Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	62,00,000	
(-) Total income determined u/s 143(1)(a)	45,00,000	
	17,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of ₹ 17 lakhs *plus* total income of ₹ 45 lakhs determined u/s 143(1)(a) ***[30% of ₹ 62 lakh + HEC@4%]***	19,34,400	
Less: Tax on total income determined u/s 143(1)(a) ***[30% of ₹ 45 lakh + HEC@4%]***	14,04,000	
	5,30,400	
Penalty leviable@50% of tax payable		2,65,200
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	81,00,000	
(-) Total income assessed under section 143(3)	62,00,000	
	19,00,000	
Tax payable on under-reported income		
Tax on under-reported income of ₹ 19 lakhs *plus* total income of ₹ 62 lakhs assessed u/s 143(3) ***[30% of ₹ 81 lakh + HEC@4%]***	25,27,200	
Less: Tax on total income assessed u/s 143(3) ***[30% of ₹ 62 lakh + HEC@4%]***	19,34,400	
	5,92,800	
Penalty leviable@50% of tax payable		2,96,400

Penalty leviable under section 270A in the case of Beta Ltd., an Indian company

Beta Ltd. is deemed to have under-reported its income since:

(1) the assessment under 143(3) has the effect of reducing the loss determined in a return processed under section 143(1)(a); and

(2) the reassessment under section 147 has the effect of converting the loss assessed under section 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

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Computation of penalty leviable under section 270A

Particulars	₹	₹
Assessment under section 143(3)		
Under-reported income:		
Loss assessed u/s 143(3)	(2,00,000)	
(-) Loss determined under section 143(1)(a)	(6,00,000)	
	4,00,000	
Tax payable on under-reported income@30%	1,20,000	
Add: HEC@4%	4,800	
	1,24,800	
Penalty leviable@50% of tax payable		62,400
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	6,00,000	
(-) Loss assessed under section 143(3)	(2,00,000)	
	8,00,000	
Tax payable on under-reported income@30%	2,40,000	
Add: HEC@4%	9,600	
	2,49,600	
Penalty leviable@50% of tax payable		1,24,800

Note – The applicable rate of tax for Beta Ltd., a trading company, for A.Y.2026-27 is 30%, since its turnover for the P.Y.2023-24 exceeded ₹ 400 crores.

7. **(i)** Failure to afford facility to the officer authorized as per section 132(1)(iib) is a case for which **prosecution can be launched under section 275B** and such person shall be punishable with rigorous imprisonment **for a term which may extend to two years and shall also be liable to fine.**

(ii) Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A) is a case for which **prosecution can be launched under section 276D** and such person shall be **punishable with rigorous imprisonment for a term which may extend to one year and with fine.**

(iii) Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government is a case for which **prosecution can be launched under section**

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276BB and such person shall be **punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.**

8. (i) Section 276CC provides for prosecution for wilful failure to furnish a return of income within the prescribed time, in a case where tax would have been evaded had the failure not been discovered. Since the amount of tax which would have been evaded does not exceed ₹ 25 lakh, the imprisonment would be for a term of 3 months to 2 years. In addition, fine would also be attracted.

However, in a case where the return of income is not filed within the due date, prosecution proceedings will not be attracted if the tax payable by a person, other than a company, on the total income determined on regular assessment, as reduced by the advance tax or self assessment tax, if any, paid and any tax deducted at source, does not exceed ₹ 10,000.

In this case, even though the tax liability of the firm as per the original order of assessment exceeded ₹ 10,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to ₹ 8,900, which is less than ₹ 10,000. Therefore, since the tax liability of the firm on final assessment was determined at ₹ 8,900, the prosecution proceedings are not maintainable.

In *Guru Nanak Enterprises v. ITO (2005) 279 ITR 30*, where the facts were similar, the Supreme Court held that prosecution was unwarranted.

(ii) Yes, in case of a company, the answer would be different and prosecution proceedings would be maintainable.

9. As per section 278C(1) of the Income-tax Act, 1961, where an offence under the Income-tax Act, 1961 has been committed by a Hindu undivided family (HUF), the karta shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, the karta shall not be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

As per section 278C(2), where an offence under the Income-tax Act, 1961 has been committed by a HUF and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any member of the HUF, such member shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

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10. This question came up before the Karnataka High Court in *K.E. Sunil Babu, Asst. CIT v. Steel Processors (2006) 286 ITR 315*. The High Court observed that since the Department had accepted the revised returns filed under section 139(5), it was clear that there was a *bona fide* mistake in the original return and there was no element of *mens rea.* Therefore, the High Court held that the Department cannot launch prosecution under sections 276C, 277 and 278.

11. Every assessee would be liable to tax@30% in respect of his undisclosed foreign income and asset of the previous year. Undisclosed foreign asset would be liable to tax in the previous year in which such asset comes to the notice of the Assessing Officer.

The term "assessee" defined under section 2(2) of the Black Money Act includes a person being a resident in India within the meaning of section 6 of the Income-tax Act, 1961 in the relevant previous year; or being a non-resident or not ordinarily resident in India within the meaning of section 6(6) of the Income-tax Act, 1961 in the relevant previous year, who was resident in India in the previous year in which the undisclosed asset located outside India was acquired.

Since Mr. Ravinder left India and settled in United Kingdom from 10.4.2016 and has not visited India at any time thereafter, he would be **non-resident in India in the previous year 2025-26** in which notice is issued. However, he was resident and ordinarily resident in India in the financial year 2013-14 when he acquired the property at Malaysia. Accordingly, the issue of notice on Mr. Ravinder under section 10 of the Black Money Act, 2015, is tenable in law.

12. Although Mr. Harshit is a non-resident in A.Y.2026-27 (since he stayed in India only for 48 days in the P.Y.2025-26), he is a resident in the P.Y. 2013-14 in which the undisclosed asset located in Country A was acquired. Hence, he is an assessee under the Black Money (Undisclosed Foreign Income and Assets) Imposition of Tax Act, 2015.

If the value of the house property in the year 2025-26 is ₹ 120 lakh, the amount chargeable to tax shall be X-Y=Z where,

X = ₹ 120 lakh,

Y = ₹ 120 lakh x 55/80 = ₹ 82.50 lakh,

Z = ₹ 120 lakh – ₹ 82.50 lakh = ₹ 37.50 lakh.

₹ 37.50 lakh chargeable to tax in the hands of Mr. Harshit in the A.Y. 2026-27.

13. FMV of the new apartment = ₹ 55 lakh, being higher of cost of acquisition i.e., ₹ 45 lakh and price which the property would ordinarily fetch if sold in the open market on the valuation date as per the valuation report i.e., ₹ 55 lakh.

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14. The contention of the assessee that the proceedings under the Black Money law are barred by limitation is not tenable in law. The time limitation given in the Income-tax Act, 1961, will not apply for the purpose of Black Money law. There is no time limit for initiation of proceedings under the Black Money Law, therefore, proceedings can be initiated against Piloo, even though 10 years have elapsed from the last assessment year in which he was assessed in India.

Every assessee would be liable to tax @ 30% in respect of his undisclosed foreign income and asset of the previous year. Undisclosed foreign asset would be liable to tax in the previous year in which such asset comes to the notice of the Assessing Officer.

Since Mr. Piloo left India permanently in January, 2012, he is a non-resident in India for the previous year 2025-26, the year in which the notice under the Black Money Act was served on him. However, he was resident in India during the previous year 2008-09, being the year in which he accumulated assets outside India which were not disclosed by him in the return of income.

The term "assessee" defined under section 2(2) of the Black Money Act, *inter alia* includes a person being a non-resident or not ordinarily resident in India within the meaning of section 6(6) of the Income-tax Act, 1961 in the relevant previous year, but who was resident in India in the previous year in which the undisclosed asset located outside India was acquired. Accordingly, Piloo who was resident in India in the P.Y.2008-09 would be an assessee under the Black Money Act, even though he is a non-resident for P.Y.2025-26.

Accordingly, Piloo is liable to pay tax @30% in respect of undisclosed foreign asset during the previous year 2025-26, the year in which such assets came to the notice of the Assessing Officer.

The relevant date for determination of the value of undisclosed assets would be the first day of April of the previous year in which the undisclosed asset located outside India comes to the notice of the Assessing Officer. The notice under the Black Money law was served in August, 2025 and the question states that it came to the notice of Joint Director of Income-tax (Investigation) in June, 2025. Accordingly, the fair market value of the asset as on 01.04.2025 would be adopted.

He is also liable to pay penalty, in addition to tax, if any, payable by him, of a sum equal to three times the tax so computed.

The value of the undisclosed asset would be the fair market value of an asset (including financial interest in any entity) determined in the prescribed manner as laid down in Rule 3 of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Rules, 2015.

The value of residential apartments would be the higher of -

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(i) its cost of acquisition; and

(ii) the price that the property shall ordinarily fetch if sold in the open market on the valuation date

The value of bank deposits would be the sum of all the deposits made in the account with the bank since the date of opening of the account. However, where any deposit is made from the proceeds of any withdrawal from the account, such deposit shall not be taken into consideration while computing the value of the account.

15. The definition of "assessee" under the Black Money Law, *inter alia,* includes a person who, being a non-resident in the previous year when the undisclosed income came to the notice of the Assessing Officer, was resident in India in the previous year in which the undisclosed asset located outside India was acquired**.** Therefore, Deepak is an assessee under the Black Money Law since he was resident in India in the P.Y.2009-10, when the property was acquired, even though he is a non-resident in the P.Y.2025-26, when notice under Black Money Law was issued. Accordingly, the value of undisclosed asset located outside India of Deepak would be chargeable to be tax under the Black Money Law in the previous year in which such asset comes to the notice of the Assessing Officer i.e., P.Y 2025-26, even though he is a non-resident in India for that previous year.

Computation of value of undisclosed foreign asset

Particulars	USD	₹
Value of residential property in California acquired on 25.6.2009 Value of residential property would be the fair market value, being the higher of - - Cost of acquisition - Price that the property shall ordinarily fetch if sold in the open market on the valuation date, i.e., 1.4.2025	25,000 USD 20,000 USD 25,000	
Converted into Indian currency taking the rate as on 1.4.2025	₹ 71/USD	17,75,000
Bank Deposits in a bank A/c in New York as on 1st April 2025 [The sum of all the deposits made in the account with the bank since the date of opening of the account would be the value of the bank deposits] Converted into Indian currency taking the rate as on 1.4.2025	10,000 ₹ 71/USD	 7,10,000
Total value of undisclosed foreign asset		**24,85,000**

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(i) its cost of acquisition; and

(ii) the price that the property shall ordinarily fetch if sold in the open market on the valuation date

The value of bank deposits would be the sum of all the deposits made in the account with the bank since the date of opening of the account. However, where any deposit is made from the proceeds of any withdrawal from the account, such deposit shall not be taken into consideration while computing the value of the account.

15. The definition of "assessee" under the Black Money Law, *inter alia,* includes a person who, being a non-resident in the previous year when the undisclosed income came to the notice of the Assessing Officer, was resident in India in the previous year in which the undisclosed asset located outside India was acquired**.** Therefore, Deepak is an assessee under the Black Money Law since he was resident in India in the P.Y.2009-10, when the property was acquired, even though he is a non-resident in the P.Y.2025-26, when notice under Black Money Law was issued. Accordingly, the value of undisclosed asset located outside India of Deepak would be chargeable to be tax under the Black Money Law in the previous year in which such asset comes to the notice of the Assessing Officer i.e., P.Y 2025-26, even though he is a non-resident in India for that previous year.

Computation of value of undisclosed foreign asset

Particulars	USD	₹
Value of residential property in California acquired on 25.6.2009 Value of residential property would be the fair market value, being the higher of - - Cost of acquisition - Price that the property shall ordinarily fetch if sold in the open market on the valuation date, i.e., 1.4.2025	25,000 USD 20,000 USD 25,000	
Converted into Indian currency taking the rate as on 1.4.2025	₹ 71/USD	17,75,000
Bank Deposits in a bank A/c in New York as on 1st April 2025 [The sum of all the deposits made in the account with the bank since the date of opening of the account would be the value of the bank deposits] Converted into Indian currency taking the rate as on 1.4.2025	10,000 ₹ 71/USD	 7,10,000
Total value of undisclosed foreign asset		**24,85,000**

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CHAPTER 20

TAX AUDIT AND ETHICAL COMPLIANCES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** the provisions relating to tax audit and other audit reports and certificates under the Income-tax Act, 1961;
- **examine** the cases where the assessee is mandatorily required to get the books of accounts audited;
- **comprehend and apply** the provisions of section 44AD read with Rule 6G to identify Form No. under which tax audit report is to be furnished;
- **comprehend** the clause-by-clause reporting requirements in Form 3CD;
- **analyse** the ethical implications in case of failure to comply with the reporting requirements.

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CHAPTER OVERVIEW

20.1 INTRODUCTION

The provisions relating to tax audit were inserted by the Finance Act, 1984 applicable w.e.f. 01.04.1985, marking a milestone in the history of chartered accountancy profession in the realm of professional opportunity in direct taxes. Since tax audit was introduced to ensure the accuracy of books of accounts maintained, which forms the basis of computation of income, this significant responsibility was entrusted by the Government to chartered accountants.

Time and again changes were made in the reporting requirements of tax audit report widening the scope of tax audit. Considering the significant responsibility entrusted by the Government to

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chartered accountants, the ICAI has issued Guidance Note on Tax Audit u/s 44AB of the Income-tax Act, 1961" offering guidance to members for conduct of tax audit, making of report and related matters.

Audit Reports & Reports and Certificates under the provisions of the Income-tax Act, 1961

In addition to section 44AB, there are other provisions in the Income-tax Act, 1961 which require furnishing of report by a chartered accountant. Section 12A(1)(b) requires audit of accounts of a trust or institution and furnishing of audit report in Form 10B/10BB before the specified date for claiming the benefit of exemption under section 11 or section 12. Also, the provisions permitting deductions in respect of certain incomes under sections 80-IA to 80-IE of Chapter VI-A of the Income-tax Act, 1961 require audit of accounts and furnishing of audit report in Form 10CCB before the specified date, declaring that the undertaking or enterprise has satisfied the conditions stipulated under the respective sections for claim of deduction and the amount of deduction claimed is as per the provisions of the Income-tax Act, 1961.

For claiming deduction under section 80JJAA, report of a chartered accountant in Form 10DA has to be furnished before the specified date certifying the deduction to be claimed. Further, every company to which the provisions of minimum alternate tax under section 115JB applies has to furnish a report in Form 29B from a chartered accountant certifying the correctness of computation of book profit. There is a similar requirement for every person to whom the provisions of alternate minimum tax under section 115JC are applicable. The report, in this case, would be in Form 29C certifying that the adjusted total income and alternate minimum tax have been computed in accordance with the provisions of the Act. In case of slump sale under section 50B, the assessee has to furnish in Form 3CEA, a report of a chartered accountant certifying the correctness computation of the net worth of the undertaking or division.

Also, there are certain provisions under the Income-tax Act, 1961 which require certification by a chartered accountant. For instance, certificate from a chartered accountant in Form 15CB is required in case of remittances to non-residents where the remittance or aggregate of such remittances exceed ₹ 5 lakh during the financial year and the remittances are chargeable under the provisions of the Income-tax Act, 1961.

Government's trust on competence and integrity of Chartered Accountants

The requirement of audit of accounts and furnishing of report of chartered accountant certifying the correctness of computations under different provisions of the Income-tax Act, 1961 indicate the trust reposed by the Government on a chartered accountant. Also, Revenue Authorities rely upon the integrity of the chartered accountant to assist tax authorities. The decision rendered by the

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Delhi High Court in the case of *Additional CIT v. Jay Engineering Works Ltd. (1978) 113 ITR 389* indicates the extent to which the income-tax authorities place reliance on the audit reports -

"It is quite competent for the income-tax authorities not only to accept the auditor's report but also to draw proper inference from the same. The income-tax authorities can, therefore, come to the conclusion that, since the auditors were required by the statute to find out if the deductions claimed by the assessees were supported by the relevant entries in their account books, the auditors must have done so and must have found that the account books supported the claims for deductions.

Where the original account books of the assessee had been destroyed in a fire, it was held that the Appellate Tribunal, in allowing a deduction, could rely upon other material mainly consisting of the auditor's reports from which it could be inferred that the deductions were properly supported by the relevant entries in the account books".

This clearly demonstrates the faith which the Government and the Revenue Authorities have in the competency and integrity of a chartered accountant due to which various statutory duties and responsibilities have been cast upon them under the provisions of the Act. It is in this context that the conduct of the chartered accountant has to be appreciated. Chartered accountants cannot be oblivious to their professional duties and sign audit reports and certificates in a mechanical manner.

Paras 13.3 and 13.4 of the Guidance Note on Tax Audit under section 44AB read as follows -

"The audit report given under section 44AB is to assist the income-tax department to assess the correct income of the assessee. The tax auditor should keep necessary working papers about the evidence on which he has relied upon while conducting the audit and also maintain all the necessary working papers. Such working papers should include the auditor's notes on the following, amongst other matters:

(a) work done while conducting the audit and by whom;

(b) explanations and information given to him during the course of the audit and by whom;

(c) decision on the various points taken;

(d) the judicial pronouncements relied upon by him while making the audit report; and

(e) certificates issued by the assessee/management letters

The requirements of documentation are applicable in respect of tax audit conducted by chartered accountants. For this purpose, attention is also invited to SA 230, Audit Documentation, which

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provides that the tax auditor should prepare documentation that provides a sufficient and appropriate record of the basis for the auditor's report and evidence that the audit was planned and performed in accordance with SA's and applicable legal and regulatory requirements."

A chartered accountant in practice would be deemed to be guilty of professional misconduct under clauses (7) of Part I of the Second Schedule to the Chartered Accountant Act, 1949, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties. Further, as per clause (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.

In this chapter, we would be first discussing the reporting requirements under different clauses of Form 3CD. Thereafter, with the aid of case studies, the ethical aspects to be considered by a chartered accountant while undertaking tax audit and issuing reports and certificates under the different provisions of the Income-tax Act, 1961 and the Rules made thereunder have been explained.

It may be noted that in certain clauses the tax auditor, in addition to the reporting requirements under the said clauses, has to qualify his report in para 3 of Form 3CA or para 5 of Form 3B, as the case may be.

It may also be noted that penalty under section 271J would be attracted in the hands of, *inter alia*, an accountant for furnishing incorrect information in any report or certificate furnished under any provision of the Income-tax Act, 1961 or Income-tax Rules, 1962. The quantum of penalty is ₹ 10,000 for each such report or certificate.

20.2 TAX AUDIT UNDER SECTION 44AB

Under section 44AB, it is obligatory in the following cases for a person carrying on business or profession to get his accounts audited before the "specified date" by a Chartered Accountant:

(i) if the total sales, turnover or gross receipts in business exceeds ₹ 1 crore in any previous year.

However, tax audit is not required in case of such person carrying on business whose total sales, turnover or gross receipts in business ≤ ₹ 10 crore in the relevant previous year (P.Y.), if:-

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- aggregate cash receipts including amount received for sales, turnover, gross receipts in the relevant previous year ≤ 5% of such receipts; **and**
- aggregate cash payments including amount incurred for expenditure in the relevant P.Y. ≤ 5% of such payments.

Payment or receipt by a cheque or by a bank draft which is not account payee, would be deemed to be made in cash.

The twin conditions of paragraph with respect to cash receipts and cash payments is to be satisfied together. Further, if the sales, turnover or gross receipts is > 10 crores, the person is required to get his accounts audited even if these conditions are fulfilled.

(ii) if the gross receipts in profession exceed ₹ 50 lakhs in any previous year.

(iii) where the assessee is covered under section 44AE, 44BB or 44BBB and claims that the profits and gains from business are lower than the profits and gains computed on a presumptive basis in any previous year.

(iv) where the assessee is carrying on a notified profession under section 44AA, and he claims that the profits and gains from such profession are lower than the profits and gains computed on a presumptive basis under section 44ADA and his income exceeds the basic exemption limit in any previous year.

(v) where the assessee is covered under section 44AD(4) and his income exceeds the basic exemption limit in any previous year.

The persons mentioned above has to get his accounts audited by an accountant before one month prior to the due date of filing return of income specified under section 139(1) and furnish by that date, the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed.

Section 44AB is not applicable in case of a person who declares profits or gains for the previous year in accordance with the provisions of section 44AD(1) or 44ADA(1). This section shall also not apply to an assessee, being a non-resident who derives income of the nature referred to in section 44B i.e., from operation of ships or section 44BBA i.e., from operation of aircraft.

For this purpose, the CBDT has prescribed under Rule 6G, Forms 3CA/3CB/3CD containing forms of audit report and particulars to be furnished therewith. In the case of a person who carries on business or profession and who is required by or under any other law to get his accounts audited, Form 3CA has to be furnished. In the case of a person who carries on

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business or profession whose accounts are not required to be audited under any other law, Form 3CB has to be furnished. The particulars required to be furnished under section 44AB is to be furnished in Form 3CD. In a case where the accounts of a person are required to be audited by or under any other law before the specified date, it will be sufficient compliance if the person gets his accounts audited under such other law before the specified date and also furnishes by the said date, the report of audit required under such other law and a further report by an accountant in Form 3CA.

Sales, Turnover and Gross Receipts

The provisions relating to tax audit under section 44AB apply to every person carrying on business, if his total sales, turnover or gross receipts in business exceed the prescribed limit (₹ 1 crore or, in certain specified cases, ₹ 10 crore) and to a person carrying on a profession, if his gross receipts from profession exceed the prescribed limit (₹ 50 lakhs) in the previous year 2025-26. However, the terms "sales", "turnover" or "gross receipts" are not defined in the Act, and therefore, the meaning of the aforesaid terms has to be considered for the applicability of the section.

The words "Sales", "Turnover" and "Gross receipts" are commercial terms, they should be construed in accordance with the method of accounting regularly employed by the assessee. Section 145(1) provides that income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" should be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. The method of accounting followed by the assessee is also relevant for the determination of sales, turnover or gross receipts.

Applying the above generally accepted accounting principles, a few typical cases may be considered:

(i) Discount allowed in the sales invoice will reduce the sale price and, therefore, the same can be deducted from the turnover.

(ii) Cash discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and is not related to turnover. The same should not be deducted from the figure of turnover.

(iii) Turnover discount is normally allowed to a customer if the sales made to him exceed a particular quantity. This being dependent on the turnover, as per trade practice, it is in the nature of trade discount and should be deducted from the figure of turnover even if the same is allowed at periodical intervals by separate credit notes.

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(iv) Special rebate allowed to a customer can be deducted from the sales if it is in the nature of trade discount. If it is in the nature of commission on sales, the same cannot be deducted from the figure of turnover.

(v) Price of goods returned should be deducted from the figure of turnover even if the returns are from the sales made in the earlier year/s.

(vi) Sale proceeds of fixed assets would not form part of turnover since these are not held for resale.

(vii) Sale proceeds of property held as investment property will not form part of turnover.

(viii) Sale proceeds of any shares, securities, debentures, etc., held as investment will not form part of turnover. However, if the shares, securities, debentures etc., are held as stock-in-trade, the sale proceeds thereof will form part of turnover.

The term "gross receipts" is also not defined in the Act. It will include all receipts as per books of account whether in cash or in kind arising from carrying of the business or profession which will normally be assessable under the head “Profit and gains of business and profession”. Broadly speaking, the following items of income and/or receipts would be covered by the term "gross receipts in business":

(i) Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India;

(ii) Any indirect tax re-paid or repayable as drawback to any person against exports under the Customs and Central Excise Duties and Service Tax Drawback Rules, 1995;

(iii) The aggregate of gross income by way of interest received by the money lender;

(iv) Commission, brokerage, service and other incidental charges received in the business of chit funds;

(v) Reimbursement of expenses incurred (e.g. packing, forwarding, freight, insurance, travelling etc.) and if the same is credited to a separate account in the books, only the net surplus on this account should be added to the turnover for the purposes of section 44AB;

(vi) The net exchange rate difference on export sales during the year on the basis of the principle explained in (v) above will have to be added;

(vii) Hire charges of cold storage;

(viii) Liquidated damages;

(ix) Insurance claims - except for fixed assets;

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(x) Sale proceeds of scrap, wastage etc. unless treated as part of sale or turnover, whether or not credited to miscellaneous income account;

(xi) Gross receipts including lease rent in the business of operating lease;

(xii) Finance income to reimburse and reward the lessor for his investment and services;

(xiii) Hire charges and instalments received in the course of hire purchase;

(xiv) Advance received and forfeited from customers;

(xv) The value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession.

Note *- Where the assessee carries on more than one business activity, the results of all business activities should be clubbed together. In other words, the aggregate sales, turnover and/or gross receipts of all businesses carried on by an assessee would be taken into consideration in determining whether the prescribed limit (i.e., ₹ 1 crore & ₹ 10 crore for certain specified cases) as laid down in section 44AB has been exceeded or not.*

However, where the business is covered by section 44B or 44BBA, turnover of such business shall be excluded. Similarly, where the business or profession is covered by section 44AD or 44ADA or 44AE or 44BB or 44BBB and the assessee opts to be assessed under the respective sections on presumptive basis, the turnover thereof shall be excluded.

Example 1. DB Pvt. Ltd. has a total turnover of ₹ 10.25 crore for the F.Y. 2025-26. Its receipts and payment during the P.Y. 2025-26 are made otherwise than by way of cash.

DB Pvt. Ltd has to mandatorily get its books of account audited under section 44AB, since its turnovers for the P.Y. 2025-26 exceed ₹ 10 crores, irrespective of the fact that its entire receipts and payments are in a mode other than cash.

Example 2. DB Ltd. has a total turnover of ₹ 9 crores for the F.Y.2025-26. Out of this, only ₹ 7 crores is received during the previous year 2025-26. These amounts are received through account payee cheque/bank draft and other permissible electronic modes. Apart from this, it also received advance of ₹ 4 crores for the future supply of goods. Out of such advance, it received ₹ 46 lakhs in cash. Assume that all payments are made otherwise than by way of cash. Is DB Pvt. Ltd. mandatorily required to get its accounts audited?

For the purpose of computing the threshold limit of cash receipts, total receipts including the amount received for turnover need to be considered. Since in the present case, ₹ 46 lakhs does not exceed ₹ 55 lakhs i.e., 5% of total receipts of ₹ 11 crores (₹ 7 crores *plus* ₹ 4 crores), DB Pvt. Ltd. is not required to mandatorily get its accounts audited.

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20.3 FORM 3CA & FORM 3CB

	Form 3CA	Form 3CB
Applicability	Tax audit report is to be furnished in Form No. 3CA, in a case where the accounts of the business or profession of a person have been audited under any other law like the Companies Act, 2013 or the Limited Liability Partnership Act, 2008.	Tax audit report is to be furnished in Form No. 3CB, in case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited. In the case of companies having their accounting year which is different from the financial year, accounts of the financial year are required to be prepared and audited. The audit report shall be in Form No. 3CB. This has been clarified *vide Circular No. 561 dated 22.5.1990.*
Requirement	In this case, it is not required for the tax auditor appointed under section 44AB to give his opinion, as to whether or not the accounts give a true and fair view. It would only be necessary for him to annex a copy of the audited accounts as well as a copy of the audit report given by the statutory auditor along with his (tax auditor's) report in Form No. 3CA with statement of particulars required to be furnished under section 44AB is annexed in Form No. 3CD. The tax auditor is required to give his opinion whether the prescribed particulars furnished in Form 3CD by the assessee are true and correct, subject to observations and qualifications, if any.	In this case, the tax auditor is required to give his opinion as to whether or not the accounts audited by him give a true and fair view: (i) in the case of the balance sheet, of the state of affairs as at the last date of the accounting year. (ii) in the case of the profit and loss account, of the profit or loss of the assessee for the relevant accounting year. The second part of the report states that the statement of particulars required to be furnished under section 44AB is annexed to the audit report in Form No. 3CD. The tax auditor is required to give his opinion whether the prescribed particulars furnished by the assessee are true and correct, subject to observations and qualifications, if any The tax auditor may have a difference of opinion with regard to the particulars furnished by the assessee These differences are to be reported in Para 5 of Form 3CB. [Para 18.6 of the Guidance Note on Tax Audit]

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Revision of Tax audit report	As per Rule 6G(3), the report of audit furnished in Form 3CA/3CB along with particulars in Form 3CD may be revised by the person by getting revised report of audit from an accountant, duly signed and verified by such accountant, if there is payment by such person after furnishing of such report which necessitates recalculation of disallowance under section 40 or section 43B. The revised report of audit has to be furnished before the end of the relevant assessment year for which the report pertains. Thus, a scenario may arise where, after issuing the audit report, but before the due date for filing the return u/s 139(1), the assessee may make payment of sums referred to in section 40 and 43B, deduction of which is allowed only on actual payment basis, which may require revision of Tax Audit Report. As per the law, there is no restriction for the number of times for revision of tax audit reports. The same can be revised a number of times, but revision should be done only to meet some technical requirements or amendments in law. It should be ensured that the revised report should carry the reference of old reports and should be signed in the current date. It is recommended that all the revisions required should be done at a time. However, there may reasons, like, a court ruling subsequent to the signing and uploading of the revised tax audit report which may necessitate further revision of tax audit report. In such cases, the auditor may, if he deems fit, amend the tax audit report. The tax auditor must ensure that the latest amended report must contain the reference to the earlier report(s) and he must sign the same on the present date and generate a new UDIN. The tax auditor should also ensure that Guidance Notes and SA-560 as well as the guidelines and the rules specified for revision for tax audit report by the CBDT are being followed. The tax auditor is required to mention in the revised books of account and in the Revised Tax Audit Report that the report is the Revised Tax Audit Report giving the reference of the previous report. The tax auditor is also required to mention the reason for revision both in the revised books of account as well as in the Revised Tax Audit Report. The e-filing portal permits uploading the revised audit reports via CA login id. Further, the e-filing utility permits insertion of comments under the heading OTHERS in the tab, and uploading it on the e-filing portal. The tax auditor should insert the comments or observations in Form No. 3CA/Form 3CB in the space given in the e-form. Revision of tax audit has to be done by the same tax auditor who has done the original tax audit and not by another tax auditor. It is to be noted that a new UDIN is required to be generated for the Revised Tax Audit Report and the same has to be generated each time. The UDIN so generated should also be updated on the online Income-tax Portal.

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20.4 FORM 3CD – STATEMENT OF PARTICULARS REQUIRED TO BE FURNISHED UNDER SECTION 44AB

This form prescribes the statement of particulars required to be furnished under section 44AB of the Income-tax Act, 1961 in case of both corporate and non-corporate assessees carrying on business or profession as Annexure to the audit report in Form 3CA or Form 3CB. This form has been designed to facilitate the determination of assessee's income from business or profession.

As per Para 19.3 of the Guidance Note on Tax Audit, while verifying the particulars in Form No. 3CD, it would be advisable for the tax auditor to consider the following:

(a) Where in respect of any particular aspect, reporting is required at more than one clause, in that case, the tax auditor may ensure that information may be furnished at any one of the clauses and reference may be given in the other clause.

(b) If there is any difference in the opinion of the tax auditor and that of the assessee in respect of any information furnished in Form No. 3CD by the assessee, the tax auditor may consider stating both the view points and also the relevant information related to matter in his report in order to enable the tax authority to take a decision in the matter.

(c) In computing the allowance or disallowance, he should keep in view the law applicable in the relevant year, even though the form of audit report may not have been amended to bring it in conformity with the amended law.

(d) In case the assessee has furnished prescribed particulars in part or piecemeal or relevant form is incomplete or the assessee does not give the information against all or any of the clauses, the auditor should not withhold the audit report. In such a case, he should qualify his report in para 3 of Form 3CA or para 5 of Form 3CB as applicable on matters in respect of which information is not furnished or if furnished, are inadequate/insufficient.

(e) The information in Form No. 3CD should be based on the books of accounts, records, documents, information and explanations made available to the tax auditor for his examination. In case it is not in accordance with the books and documents, he has to mention the same in his observations.

(f) In case the auditor relies on a judicial pronouncement, he may mention the fact as his observations in para 3 of Form No. 3CA or para 5 provided in Form No. 3CB, as the case may be.

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Clause by clause analysis of Form 3CD

Clause	Particulars	Reporting requirements in relation to the relevant clause
		PART A
1.	Name of the assessee	(i) The name of the assessee whose accounts are being audited under section 44AB should be given as specified in PAN. (ii) In case there is a different trade name, the same should be reported. (iii) If the tax audit is in respect of a branch, name of such branch should be mentioned along with the name of the assessee. (iv) In case of change in the name of the assessee, if the change has taken place during the financial year, name at the end of the financial year should be stated. However, if the change in name has taken place after the close of the financial year but before signing of tax audit report, name as at the year ending date should be mentioned. In either case, fact of name change should be suitably clarified by the tax auditor as an observation in audit report.
2.	Address	(i) The address to be mentioned should be the same as has been communicated by the assessee to the Income-tax Department as on the date of signing of the audit report. (ii) If the tax audit is in respect of a branch or a unit, the address of the branch or the unit should be given. (iii) In the case of a company, the address of the registered office should be stated. (iv) In the case of new assessee, the address of the principal place of business should be stated. *The tax auditor should verify the relevant details of the assessee from the available income tax records or from the profile of the assessee on Income-tax portal. In case of difference, the same should be given as an observation in the audit report.*
3.	Permanent Account Number or Aadhaar Number	(i) The permanent account number (PAN) allotted to the assessee should be indicated. (ii) Clause further asks to mention Aadhaar number (in case of Individuals) as an alternative.

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		(iii) It may be noted that in the e-filing format, PAN is a mandatory field and Aadhaar is an optional field.
4.	Whether the assessee is liable to pay indirect tax like excise duty, service tax, sales tax, goods and services tax, customs duty, etc. If yes, please furnish the registration number, GST number or any other identification number allotted for the same	The auditor is required to examine from the appropriate evidence, the registration number or any other identification number, if any. For any indirect tax, if multiple registration numbers are available, all registration numbers should be ensured by the tax auditor are duly reported. *The auditor should obtain from the assessee the list of indirect taxes applicable on him if the different types of indirect taxes are leviable on him and that too in multiple states.* *It is recommended that the tax auditor should obtain from the assessee:* - *list of indirect taxes applicable on him* - *copy of registration certificates issued by the various authorities clearly mentioning the registration number under that relevant law.* *Where indirect tax law does not require any registration, appropriate identification number may be reported in this clause. For example, in Customs Act, 1962, since there is no registration number, a copy of Importer Exporter Code (IEC) may be obtained, and information be accordingly furnished.*
5.	Status	The status of the assessee is to be mentioned as included in the definition of person in section 2(31) namely, individual, Hindu Undivided Family, company, firm, an association of persons or a body of individuals, whether incorporated or not, a local authority or artificial juridical person. It should not be confused with the residential status. In case of proprietorship concern, the status shall be quoted as individual.
6	Previous year	The relevant previous year should be mentioned i.e., starting from 1st April to 31st March. In case of amalgamations, demergers, reconstitution, new business, closure of existing business etc., the date of beginning and ending of the previous year may be different, accordingly, the relevant date of beginning and ending of the previous year may be mentioned.

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7.	Assessment Year	The assessment year relevant to the previous year for which the accounts are to be audited should be mentioned.
8.	Indicate the relevant clause of section 44AB under which the audit has been conducted	The relevant clause of section 44AB under which the audit has been conducted has to be mentioned. In case the assessee is carrying on business and his total sales, turnover or gross receipts as the case may be, exceeds ₹ 1 crore in the relevant previous year, the auditor is required to mention clause (a) of section 44AB. If the assessee is carrying on profession and his gross receipts exceed ₹ 50 lakhs in the relevant previous year, the auditor is required to mention clause (b) of section 44AB. Likewise, if the audit under section 44AB is being conducted by virtue of provisions of section 44AE, 44BB and 44BBB, the auditor is required to mention clause (c). For audit being conducted by virtue of provisions of section 44ADA, clause (d) is to be mentioned. ***For audit being conducted by virtue of provisions of section 44AD(4), clause (e) is to be mentioned.*** Where a person is required by or under any other law to get his accounts audited, say a company, a society etc. then audit under section 44AB is conducted under the third proviso to section 44AB and not under clause (a) or (b) of that section.
8a	Whether the assessee has opted for taxation u/s 115BA/ 115BAA/ 115BAB/ 115BAC[1]/ 115BAD/ 115BAE?	Assessee is required to pay income-tax at the rates specified in the annual Finance Act. However, sections 115BA, 115BAA, 115BAB, 115BAD and 115BAE provide option to the assessee to pay tax at special rates and forego certain deductions, exemptions etc. The assessee can opt to pay tax under the rates prescribed in the Finance Act or the one made available by any of the aforesaid sections. The tax auditor has to mention whether the assessee has opted for taxation under any of the aforesaid sections and in case answer is Yes, then, he has to select the appropriate section. With effect from A.Y. 2024-25, tax shall be payable as per section 115BAC, unless the assessee being an individual, HUF, AOP (other than co-operative society) or BoI or an artificial Juridical person exercises the option to shift out of the default scheme and pay tax under the optional tax regime as per the normal provisions of the Act.

[1] With effect from A.Y. 2024-25, tax shall be payable as per section 115BAC unless the assessee being an individual, HUF, AOPs (other than co-operative society) or BoIs or an artificial Juridical person exercises the option to shift out of the default scheme and pay tax as per the normal provisions of the Act.

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			Companies can pay tax as per the normal provisions of the Income-tax Act, 1961 or opt to pay tax as per section 115BAA, subject to fulfillment of conditions stipulated thereunder and forgoing certain exemptions/deductions. Likewise, Co-operative Societies can pay tax as per the normal provisions of the Income-tax Act, 1961 or opt to pay tax as per section 115BAD, subject to fulfillment of conditions stipulated thereunder and forgoing certain exemptions/deductions. Companies or co-operative societies that have already opted for section 115BAB or 115BAE can continue to pay tax under that section. The tax auditor has to examine the income tax return of the previous year to verify the option which has been exercised by the assessee. *For the purpose of reporting under clause 8a, the tax auditor should verify whether –* ❑ *The application for exercise of option in the prescribed form being 10-IB, 10-IC, 10-ID, 10-IF and 10-IFA has been furnished electronically under section 115BA, 115BAA, 115BAB, 115BAD and 115BAE.* ❑ *In case of opt out of default tax regime under section 115BAC, the auditor should verify whether the assessee has furnished in Form 10-IEA the option to shift out of the default tax scheme under section 115BAC and pay tax under the optional tax regime as per the normal provisions of the Act.* ❑ *In case, the assessee has not filed the relevant form, written representation from the assessee should be obtained whether he will be availing the concessional regime or otherwise and based on written representation, the reporting under this clause should be made.* ❑ *Where reporting is made solely on the basis of assessee's representation, the fact should be stated in paragraph (3) of Form 3CA or paragraph (5) of Form 3CB.*
PART B			
9.	(a)	If firm or association of persons, indicate name of partners/ members and their profit sharing ratios.	Where the assessee is a firm or association of persons (AOP) or body of individuals, the names of partners of the firm or members of the AOPs or BOIs and their profit sharing ratios (%) have to be stated.

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			In case where the partner of a firm or the member of AOP/ BOI acts in a representative capacity, the name of the beneficial partner/member should be stated. Thus, the details of partners or members during the entire previous year will have to be furnished. ❑ *The particulars in this clause should be verified from the instrument or agreement or any other document evidencing partnership or AOPs including any supplementary documents or other documents effecting such changes.* ❑ *The tax auditor should obtain certified copies of the deeds, documents, understanding, notice of changes etc. including certified copies of the acknowledgment, if any, evidencing filing of documents with the concerned authorities, if registered.* ❑ *In case of certain AOPs/BOIs, where shares are not precisely ascertainable during the previous year resulting in a situation wherein the shares of members are indeterminate or unknown, the relevant fact should be stated.*
	(b)	If there is any change in the partners or members or in their profit sharing ratio since the last date of the preceding year, the particulars of such change.	If there is any change in the partners of the firm or members of the AOPs/ BOIs or their profit or loss sharing ratio since the last date of the preceding year, the particulars of such change must be stated. All the changes occurring during the entire previous year must be stated.
10.	(a)	Nature of business or profession (if more than one business or profession is carried on during the previous year, nature of every business or profession).	The principal line of each business is to be reported. If the assessee is in more than one business, the information has to be furnished in respect of all business. i.e., the sector in which the business or profession falls such as manufacturing, trading, commission agent, builder, contractor, professionals, service sector, financial service sector or entertainment industry. In case a person belongs to service sector, the nature of each type of service should be broadly stated. Thereafter it is required to mention the sub-sector pertaining to the sector selected has to be mentioned.

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			Information has to be furnished in respect of each business profession carried on during the previous year based on review of profit and loss account. The code is to be mentioned against the nature of business pertains to the main area of business activity.
	(b)	If there is any change in the nature of business or profession, the particulars of such change.	Any material change in the business should be precisely set out. The change will include change from manufacturer to trader as well as change in principal line of business. Likewise, any addition to or other than temporary discontinuance of, a particular line of business may also amount to change requiring reporting. However, temporary suspension of the business may not amount to change and therefore need not be reported. *A review of business report or the minutes of meetings would enable the tax auditor to note the changes, if any. He may make necessary enquiries on this basis and seek information to determine whether any change has occurred or not. If need be, the tax auditor should get a declaration from the assessee regarding change in the nature of business.* In case of a business reorganization/reconstruction, if there is a similar line of activity, no reference needs to be made. However, if a new line of activity emerges, the same may be stated. If any line of activity is being hived off in case of restructuring, the same may be reported.
11.	(a)	Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.	As per section 2(12A), books or books of account includes ledgers, daybooks, cash books, account-books and other books, whether kept in the written form or in electronic form or in digital form or as print-outs of data stored in such electronic form or in digital form or in a floppy, disc, tape or any other form of electro-magnetic data storage device. Under section 44AA read with Rule 6F, the books of account have been prescribed only in respect of persons carrying on specified profession. No books of account have been prescribed for the persons carrying on business or non-specified profession. This may be considered while verifying the reporting under clause 23(a). Rule 6F has prescribed the books of account and other documents to be kept and maintained by a person carrying on certain professions specified in section 44AA(1). Section 44AA(2) provides that persons carrying on business or profession, other than those specified in

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			section 44AA(1), shall keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act, if his income from business or profession exceeds the monetary limits prescribed under section 44AA(2) or his total sales, turnover or gross receipts in business or profession exceed the monetary limits prescribed under section 44AA(2) in any one of the three years immediately preceding the previous year.
	(b)	Lists of books of account maintained and the address at which the books of account are kept. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system. If the books of account are not kept at one location, please furnish the addresses of locations along with the details of books of account maintained at each location).	The address at which the books so maintained are kept is also required to be mentioned under this clause. In case the books of accounts are kept at more than one location then the details of address of each such location along with the detail of books of account maintained thereof is required to be mentioned. In case, where books of account are maintained and generated through computer system, the details of address of the place where the server is located or the principal place of business/Head office or registered office by whatever name called is to be mentioned under this clause. Where the books of account are stored on cloud or online, IP address (unique) of the same may be reported. It is required by the auditor to verify the specification to which books of account have been maintained in computer system and which of the records have been maintained in hard copy form. *The tax auditor should obtain from the assessee a complete list of books of account and other documents maintained by him (both financial and non-financial records) and make appropriate marks of identification to ensure the identification of the books and records produced before him for audit. The list of books of account maintained by the assessee should be given under this clause.*
	(c)	List of books of account and nature of relevant documents examined.	Books of accounts examined would constitute the books of original entry and the other books of account. In addition to the list of books of accounts examined, the extent of examination is also to be reported. Whereas sub-clause (b) requires furnishing list of books of account maintained by the assessee and address of the place where books of account are kept, sub-clause (c) requires the tax auditor to state a list of books of account

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			and the nature of relevant documents that he has examined. *The list of books of account prescribed, maintained and examined has to be stated under this clause. There may be difference between the three lists. For example, books of account may have been prescribed but all the prescribed books might not have been maintained or the entire books of accounts maintained might not have been produced for examination. The tax auditor should exercise his professional judgment in order to arrive at the conclusion whether such a situation warrants any disclosure or qualifications while forming his opinion on the matters covered by reporting requirements in Form No. 3CB.*
12.		Whether the profit or loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant section [44AD, 44ADA, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, ***44BBC*** Chapter XII-G (provisions relating to shipping business), First Schedule (Insurance business) or any other relevant section].	If the profit and loss account includes any profits and gains assessable on presumptive basis, then, the tax auditor has to verify the amount so included in the profit and loss account. It may be noted that what is required to be stated is the amount of profits and gains of the business or profession covered by presumptive taxation included in the profit and loss account and not the amount assessable on presumptive basis. The tax auditor will have to verify if the assessee is covered by the provisions of any of the sections specified in clause 12 and the assessee will be offering to tax profits under presumptive taxation, where applicable. If the profit and loss account does not include profit assessable on presumptive basis, then, there is no requirement to furnish the particulars under this clause. The amount to be mentioned in this clause means amount included in the profit and loss account. The tax auditor is not required mentioning whether such amount corresponds to the amount assessable under the relevant section relating to presumptive taxation. As such, the report requirement gets satisfied, if the amount as per profit and loss account is reported. *Even where the assessee opts for presumptive taxation, the tax auditor should consider to impress upon the assessee that it would be advisable to maintain some basic records to support the turnover/gross receipts declared for presumptive taxation.*

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13.	(a)	Method of accounting employed in the previous year.	Section 145 provides that the income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" must be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. The hybrid system of accounting, viz. a mixture of cash and mercantile, is not permitted. However, the assessee may adopt a cash system of accounting for one business and mercantile system of accounting for other business. Once the choice of method of accounting is decided, the assessee must follow consistently the method of accounting employed.
	(b)	Whether there had been any change in the method of accounting employed *vis-à-vis* the method employed in the immediately preceding previous year.	If there is any change in the method of accounting, that is to be reported and the effect thereof i.e., increase or decrease in profits has to be stated under this clause. *The tax auditor should apply reasonable checks to the earlier year's accounts to ascertain whether there is any change in the method of accounting as compared to that of the year under audit, after obtaining a written confirmation from the assessee as to the method of accounting followed.* It may be noted that in view of section 128 of the Companies Act, 2013, every company is required to keep books of account on accrual basis. ***Note -*** *A change in an accounting policy does not amount to change in method of accounting. A change in the method of valuation of stock will be a change in accounting policy and hence, such change need not be mentioned in clause 13(b).*
	(c)	If answer to (b) above is in affirmative, give details of such change, and the effect thereof on the profit or loss with increase/ decrease in profits.	In case there is any change in the method of accounting, employed *vis-à-vis* the method employed in the immediately preceding previous year, auditor has to verify whether the details of the same, along with impact on the profit for the year are mentioned. As regards the impact on profit the concept of materiality is the basic governing factor. If it is not possible to quantify the effect of the change in the method of accounting, appropriate disclosure should be made under this clause.
	(d)	Whether any adjustment is required to be made to the profits or loss	In exercise of the powers conferred by section 145(2), the Central Government notified the ICDSs to be followed by all assessees (who are required to get their books of account audited) following the mercantile system of

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		for complying with the provisions of income computation and disclosure standards notified under section 145(2)?	accounting, for the purposes of computation of income chargeable to income-tax under the head "Profits and gains of business or profession" or "Income from other sources". This clause requires the auditor to state whether any adjustment is required to be made to profit and loss for complying with the provisions of income computation and disclosure standards (ICDS). Such adjustment is required to be stated separately. The increase/decrease in profit and net effect should be reported in the absolute terms. The tax auditor should obtain draft computation of the total income and disclosures required under ICDS. *For the purpose of verifying clause 13(d), the tax auditor should obtain draft computation of total income and disclosures required under ICDS. Based on information and books of account, the tax auditor should consider whether any adjustment is required to be made to the profit or loss and accordingly, if the answer is in affirmative, whether 'yes' has been stated; or if otherwise 'no' has been stated.* *While verifying the reporting, the auditor has to consider the draft of income computation provided by the assessee. This fact should be mentioned in the audit report in paragraph 3 of Form No. 3CA and paragraph 5 of Form No. 3CB.*
	(e)	If answer to (d) above is in the affirmative, give details of such adjustments ICDS wise with increase or decrease in profit and net effect.	If answer to 'd' above is in affirmative, the amount of adjustment against each ICDS is required to be quantified in clause 13(e). *Tax auditor may refer to the technical guide on ICDS issued by the ICAI in July, 2017. In the working paper file of ICDS, checklist should be prepared and maintained alongwith computation working for any increase/decrease in income as per ICDS. Also, last year's tax audit report should be reviewed to ascertain any effect in the current year.*
	(f)	Disclosure as per ICDS (to be given ICDS wise)	This clause requires disclosure of significant income computation and disclosure policies adopted by a person for computation of income chargeable under the head "Profits and gains from business or profession" or "Income from other sources".

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			In this clause, if information furnished is based on income computation furnished by the assessee, appropriate disclosure of this fact should be mentioned in Form No. 3CA or 3CB as the case may be.
14.	(a)	Method of valuation of closing stock employed in the previous year.	Ascertain the method of valuation of closing stock employed during the year. Where there is change in the basis of determining cost, market value or net realizable value even though there is no change in the method of valuation. The auditor should study the procedure followed by the assessee in taking the inventory of closing stock at the end of the year and valuation thereof. *The tax auditor should –* ❑ *obtain the inventory of closing stock, indicating the basis of valuation thereof for verifying the reporting on the method of valuation of closing stock.* ❑ *review the methods of valuation adopted for valuation of closing stock and compare the same with the method prescribed under section 145A.* ❑ *obtain from the assessee, the inventory valuation sheet of the stock in trade giving quantitative details, method of valuation, rate and total value of each item.* ❑ *ascertain whether the method of valuation is such that the value of closing stock includes the amount of any tax, duty or cess actually paid or incurred by the assessee to bring the goods to the place of its location and conditions as on the date of valuation.*
	(b)	In case of deviation from the method of valuation prescribed under section 145A, and the effect thereof on the profit and loss	
15.	Give the following particulars of the capital asset converted into stock-in-trade:		For furnishing the particulars required under this clause, the provisions of section 2(47) [meaning of transfer], section 45(2) [conversion of capital asset into stock-in trade deemed to be transfer of the previous year in which conversion took place], proviso below to section 47(iv) & (v) [transfer of capital asset by a holding company to its subsidiary or vice versa not considered as transfer by virtue of clause (iv) or (v) of section 47 if condition specified thereunder are satisfied. However, such benefit would not be available where capital asset is transferred by a subsidiary company to its holding company or *vice versa* as stock-in trade] and section 47A [Where transfer of capital asset by a holding company to its subsidiary *or vice versa* not considered as transfer by virtue of clause
	(a)	Description of capital asset;	
	(b)	Date of acquisition;	
	(c)	Cost of acquisition;	
	(d)	Amount at which the asset is converted into stock-in-trade.	

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			(iv) or (v) of section 47 but such capital asset is converted into stock-in trade within eight years from the date of transfer, such capital gain would be deemed to be capital gains of the previous year in which such transfer took place] have to be kept in mind. The particulars to be stated under this clause should be furnished with respect to the previous year in which the capital asset have been converted into stock in trade. The clause does not require the details regarding the taxability of capital gains or business income arising from deemed transfer. The description of the capital assets is required to be mentioned, for example, shares, securities, land, building, plant, machinery etc. *For ascertaining the correct date, the tax auditor will have to refer the accounts of the financial year in which such capital assets is acquired. The date is important to determine whether assets is long term capital asset or short term capital asset.* In this clause, the cost of acquisition as per books of accounts is to be mentioned. In case of depreciable assets, the carrying cost appearing in the books will be written down value. But the value to be reported should be the original cost of acquisition. The amount recorded in the books at which the asset is converted into stock in trade should be stated. Such an amount may not be fair market value as on the date of conversion. The valuation of stock-in-trade is to be examined with reference to AS-2: Valuation of Inventories or Ind AS-2: Inventories, as applicable.
16.	Amounts not credited to the profit and loss account, being –		
	(a)	The items falling within the scope of section 28;	Under this clause various amounts falling within the scope of section 28 which are not credited to the profit and loss account are to be stated. **Example**. A Ltd., a manufacturing company sponsored the Dubai trip of Mr. B, seller of construction material, along with his spouse, upon achieving of sales target set by the company. Neither any money received in the books, nor any expenses incurred through the books. The same is chargeable to tax as benefit or perquisite arising from business or profession by virtue of section

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			28(iv). Thus, the same is required to be reported though it is not credited in the profit and loss account.
	(b)	The proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax where such credits, drawbacks or refunds are admitted as due by the authorities concerned;	For this clause, the tax auditor should examine all relevant correspondence, records, assessee's particulars on portal of the department and evidence in order to determine whether any particular refund/claim has been admitted as due and accepted during the relevant financial year. The words 'admitted by the concerned authorities' would mean 'admitted by the authorities within the relevant previous year'. If the assessee is following cash basis of accounting, it should be clearly reported by the auditor that acceptance of claim during the relevant year without actual receipt has no significance. Where such amounts have not been credited in the profit and loss account but netted against the relevant expenditure/income heads, such fact should be clearly brought out.
	(c)	Escalation claims accepted during the previous year;	The escalation claim accepted during the previous year but not credited to the profit and loss account has to be stated here. Escalation claims would normally arise pursuant to a contract (including contracts entered into in earlier years), if so permitted by the contract. Only those claims to which the other party has signified unconditional acceptance could constitute accepted claims. Mere making of claims by the assessee or claims under negotiations or claims which are sub-judice *[CIT v. Hindustan Housing & Land Development Trust Ltd. [1986] 161 ITR 524 (SC)]* cannot constitute claims accepted.
	(d)	Any other item of income;	Any other item which is considers as an income based on his verification of records and other documents and information gathered, but which has not been credited to the profit and loss account. If employees contribution to any provident fund or superannuation fund or any other fund is not paid on or before the due date under the respective Act, then it becomes income of the assessee. Such information is to be stated in this clause. Similar information is also furnished in clause 20(b) of Form 3CD, therefore, cross referencing may be required. ***Note -*** *In giving the details under* sub-*clauses (c) and (d), due regard should be given to AS-9: Revenue*

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			Recognition/Ind AS 115: Revenue from Contracts with Customers, as applicable.
	(e)	Capital receipt, if any.	The tax auditor should use his professional expertise and judgement in determining whether a receipt is capital or revenue. The capital receipts are not generally credited to the profit and loss account, hence, the auditor should take enough care to check out any transaction generating receipts of capital nature. ***Note –*** *The information under sub-clauses (a), (d) and (e) of clause (16) is to be given with reference to the entries in the books of account and records made available to the tax auditor for the purpose of tax audit under section 44AB. The auditor should check thoroughly the bank account of the assessee and also the cash book to find out any credits regarding any income earned but not credited to the profit and loss account of the assessee. The tax auditor may obtain a management representation in writing from the assessee in respect of all items falling under this clause.* *The tax auditor may use his professional expertise and judgement in determining whether the receipt is taxable or not for the purpose of verifying the reporting under sub-clauses (a) to (d) of clause 16 and may report in the observation para of audit report, disclosing the basis of the same.*
17.		Where any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of the State Government referred to in section 43CA or 50C, please furnish details of property, consideration received or accrued and value adopted or assessed or assessable.	Where any land or building or both is transferred during the previous year for a consideration less than the value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, the auditor is required to verify the following details: (a) Details of property (b) Consideration received or accrued (c) Value adopted or assessed or assessable. The details about the nature of property i.e., whether the property transferred during the year is land or building along with the address of such property have to be furnished. The tax auditor should obtain the list of all properties transferred by the assessee during the previous year. The tax auditor has to furnish the amount of consideration received or accrued, during the relevant previous year of audit, in respect of land/building transferred during the year as disclosed in the books of account of the

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			assessee. For verifying the value adopted or assessed or assessable, the tax auditor should obtain from the assessee relevant information with regard to sale of Land or Building or both during the previous year. In case the property is not registered, the auditor may verify relevant documents from relevant authorities or obtain third party expert like lawyer, solicitor representation to satisfy the compliance of section 43CA/ section 50C. In exceptional cases where the auditor is not able to obtain relevant documents, he may state the same through an observation in his report in Form 3CA/CB.
18.		Particulars of depreciation allowable as per the Income-tax Act, 1961 in respect of each asset or block of asset, as the case may be, in the following form:-	With respect to this clause, the tax auditor is required to examine the following: (a) Classification of the asset (b) Classification thereof to a block (c) actual cost or written down value (d) The date of acquisition and the date on which it is put to use (e) The applicable rate of depreciation (f) The additions / deductions and dates thereof (g) Adjustments required – specified as well as on account of sale, etc.
	(a)	Depreciation of asset/block of assets	For the purpose of determining the rate of depreciation, the tax auditor has to examine the classification of the assets into various blocks. The tax auditor should ensure that the classification as made by the assessee is in consonance with legal principles. In this connection, he should traverse through judicial pronouncements as well as through the past assessment history of the assessee, and upon an analysis thereof, if he comes to the conclusion that the matter is not free from doubt or controversy, he has to indicate the fact in his report by way of suitable qualification. It may also be necessary to rely upon technical data for determining the proper classification of the block. Since the tax auditor is not a technical expert, he has to obtain suitable certificate from concerned experts.
	(b)	Rate of depreciation	Once the classification has been ascertained and checked properly, the rates applicable as per the Income-tax Rules, 1962 follow as a natural corollary. The tax auditor must have due regard to the Income-tax Rules, 1962, relevant clarifications from the Department and judicial decisions.

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			Under sub-clauses (a) to (b), information in respect of description of assets, block of assets under which the concerned asset is classifiable and the rate of depreciation are to be stated. This will include information about the existing assets. In respect of the existing assets, the computation of depreciation would involve stating the opening written down value of the block of assets which should be taken from the relevant income-tax records. The tax auditor should ensure the opening block of assets matches with the income-tax return filed for the immediately preceding previous year.
	(c)	Actual cost or written down value, as the case may be.	For the purpose of determination of actual cost, the tax auditor has to be guided by the relevant legal provisions. Since determination of actual cost has got accounting implications, he can rely on the relevant Accounting Standards and Guidance Notes. Depreciation is also allowable on intangible assets like know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature. There may be intangible assets like know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature for which the assessee might have incurred costs. From 01.04.2021, intangible asset being goodwill does not qualify for depreciation. The tax auditor should examine this and the basis on which the cost of such intangible assets has been arrived at.
	(d)	Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustment on account of: (i) Central Value Added Tax credits claimed and allowed under the Central Excise Rules, 1944, in respect of assets acquired on or after 1st March 1994,	In case an asset is purchased in foreign currency on deferred payment basis, the auditor should verify the actual cost on the basis of section 43A. Addition or reduction will be limited to the exchange difference actually paid during the previous year. The tax auditor is required to verify that the adjustments in the cost of fixed assets on account of changes in the rate of exchange of currency in the schedule of fixed assets prepared for computation of depreciation as per Income-tax Rules are in accordance with the provisions of section 43A and information about such adjustment is provided under sub-clause (ii) of clause 18(d) of Form 3CD. The provisions of Section 36(1)(iii) and *Explanation 8* to section 43(1) i.e., interest related to the period after asset first put to use should not form part of actual cost of such asset, should be kept in mind for capitalization of interest

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		(ii) change in rate of currency, and (iii) subsidy or grant or reimbursement, by whatever name called.	to the cost of assets. *Explanation* 10 to section 43(1) provides that 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. Subsidy in respect of asset acquired in any earlier year(s) and received during the year has to be deducted from the written down value of such assets in the year of receipt. Any expenditure for acquisition of any asset etc. exceeding ₹ 10,000 otherwise than account payee cheque/draft drawn on a bank or use of electronic clearing system, then such expenditure shall be ignored for determining actual cost. The tax auditor should also verify that the amount of GST input credit deducted from cost of capital goods tallies with the credit availed on this account. The additions/deductions during the year have to be reported, with dates. Where any addition was made, the date on which the asset was put to use is to be reported. In respect of deductions, the sale value of the assets disposed of along with dates should be mentioned. *To ascertain when the asset has been put to use, the tax auditor could call for basic records like production records/installation details/excise records/service tax records/ goods and service tax records/records relating to power connection for operating the machine, title deeds or building completion certificate etc. in case of immovable assets and any other relevant evidence. In the absence of any specific documentation with regard to the effective date from which the asset is put to use, he could get a representation letter from the management, in respect of the assets acquired.*
	(e)	Depreciation allowable.	The amount of depreciation and written down value of the block at the year-end is calculated correctly by taking the relevant figure at the beginning of the year and adjusted in respect of the additions/deductions during the year. The tax auditor shall verify the WDV at the beginning of the year in respect of each block of assets.
	(f)	Written down value at the end of the year.	

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		Wherever a claim for depreciation involves any reliance on any judgement or opinion or other contentions (as to its classification, rate applicable, cost, date on which put to use etc.), it may be advisable for tax auditor to disclose full particulars thereof and the basis on which the depreciation allowable has been determined and vouched by him.
19.	Amounts admissible under sections: 33AB, 33ABA, 35(1)(i), 35(1)(ii), 35(1)(iia), 35(1)(iii), 35(1)(iv), 35(2AA), 35(2AB), 35ABA, 35ABB, 35AD, 35CCA, 35CCC, 35CCD, 35D, 35DD, 35DDA, 35E[2] and any other relevant section	In case the assessee has obtained a separate audit report for claiming deductions under any of these sections, he must make a reference to that report while giving the details under this clause. The Tax Auditor should verify the amount debited to the Profit & Loss Account and the amount actually admissible in accordance with the applicable provisions of law. The amount not debited to the Profit & Loss Account but admissible under any of the sections mentioned in the clause has also to be stated. For example, sections 33AB and 33ABA allow deduction in respect of the amount deposited in designated account for specified purposes which as per the accounting principles are not debited to the Profit and loss A/c. In this connection, on the basis of the conditions prescribed in the concerned section, the amount admissible there under has to be worked out and reported. An assessee may be eligible for deduction under one or more sub sections of section 35. In such a case, the deduction allowable under each sub-section should be stated separately under the applicable part, i.e. the amount deductible in respect of the amount debited in Profit & Loss Account and the amount not debited to the Profit & Loss Account. The tax auditor should also examine the eligibility of the expenditure/payment for deduction and compliance of the conditions prescribed in the sub-section including approval from the relevant/prescribed authority, notification issued by the Central Government, any other guideline circular etc. issued in this behalf. Tax auditor should also refer Rule 6 of Income-tax Rules, 1962. *In case the auditor relies on a judicial pronouncement, he may mention the fact in his observations para provided in Form No. 3CA or Form No. 3CB, as the case may be.*

[2] *Reference to section 32AC, 32AD, 35AC and 35CCB is not given, since no deduction under these sections is available for the current assessment year.*

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20.	(a)	Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend	Section 36(1)(ii) provides for deduction of any sum paid to an employee as bonus or commission for services rendered where such sum would not have been payable to him as profit or dividend, if it had not been paid as bonus or commission. *The tax auditor should obtain the list of employees eligible for bonus or commission for services rendered with amounts and check the basis of calculation of bonus or commission.*
	(b)	Details of contributions received from employees for various funds as referred to in section 36(1)(va) namely, nature of fund, sum received from employees, due date for payment, actual amount paid and the actual date of payment to the concerned authorities.	Section 2(24)(x) includes within the scope of income any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or ESI fund or any other fund for employees welfare. Section 36(1)(va) permits deduction of any sum received by the assessee from any of his employees to which the provisions of section 2(24)(x) are applicable, if it is credited by the assessee to the account of the employees in the relevant statutory fund on or before the due date. In respect of such sum, if any extension is granted by respective authorities, it shall be considered. This can be taken into consideration for determining the due date of payment. Under this clause, details regarding the nature of fund, details of the amount deducted, due date for payment, actual amount paid and actual date of payment to the concerned authorities in respect of provident fund, ESI fund or other staff welfare fund have to be stated. *Under this clause, the requirement is only in respect of the disclosure of the amount and the tax auditor is not expected to express his opinion about its allowability or otherwise. The tax auditor should verify the employment/ contract details of the employees so as to ascertain the nature of payments.* *The tax auditor should get a list of various contributions recovered from the employees which come within the scope of this clause and the date on which it is deposited. He should also verify the documents relating to provident funds and other welfare funds. He should verify the agreement under which employees have to make contributions to provident fund and other welfare funds.* *The ledger account of contributions from employees should be reviewed; the due dates of payments and the actual dates of payment should be verified with the*

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			evidence available. In view of the voluminous nature of the information, the tax auditor can apply test checks and compliance tests to satisfy himself that the system of recovery and remittance is proper.
21.	(a)	Please furnish the details of amounts debited to profit and loss account, being in the nature of capital, personal, advertisement expenditure in any souvenir, brochure, tract, pamphlet or the like published by a political party, expenditure incurred at clubs, expenditure for any purpose which is an offence or is prohibited by law or expenditure by way of penalty or fine for violation of any law (enacted in India or outside India), expenditure by way of other penalty or fine not covered above, expenditure incurred to compound an offence under any law for the time being in force, in India or outside India, expenditure incurred to provide any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or	- Capital expenditure is not allowable in computing business income unless specifically provided in any sections of the Act. The details of capital expenditure, if any, debited to the profit and loss account should be maintained in a classified manner stating the amounts under various heads separately. The total amount of capital expenditure debited to the profit and loss account is to be reported under this clause in the e-filing portal. - Personal expenses debited to the profit and loss account are to be specified under this sub-clause as they are not deductible in the computation of total income under section 37. ***Note*** *- Section 143(1)(e) of the Companies Act 2013 specifically requires the auditor to inquire whether personal expenses have been charged to revenue account. In the case of a person whose accounts of the business or profession have been audited under any other law, the tax auditor will have to report in respect of personal expenses debited in the profit and loss account. In the case of a person who carries on business or profession but who is not required by or under any other law to get his accounts audited, the tax auditor will have to verify the personal expenses. if debited in the expenses account while conducting the audit and verify the amount of expenses mentioned under this clause.* - Section 37(2B) provides that no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. Therefore, the expenditure of this nature should be segregated and reported under this clause. The auditor may also keep in mind the provisions of section 80GGB and 80GGC which allow deduction in respect of contribution made by corporate and non-corporate assessees respectively to political parties and electoral trust, as required to be reported by him in clause 33 of Form no. 3CD.

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		exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guideline, as the case may be, for the time being in force, governing the conduct of such person, ***expenditure incurred to settle proceedings initiated in relation to contravention under such law as notified by the Central Government in the Official Gazette in this behalf.***	- The amount of payments made to clubs by the assessee during the year being cost for club services and facilities used should be indicated under this clause. The fact whether such expenses are incurred in the course of business or whether they are of personal nature should be ascertained. If they are personal in nature, they are to be shown separately under Clause 21(a) referred to earlier. - This clause requires separate reporting of any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law is to be reported. It also requires reporting of expenditure by way of penalty or fine for violation of any law (enacted in India or outside India). The tax auditor should obtain in writing from the assessee, the details of all payments by way of penalty or fine for violation of any laws have been made and paid or incurred during the relevant previous year and how such amounts have been dealt with in the books of accounts produced for audit. This clause covers only penalty or fine for violation of law and not the payment for contractual breach or liquidator damages. The tax auditor should keep in mind the difference between the amount prohibited by law and the amount paid which is compensatory in nature under the relevant statue. Supreme Court in *Mahalakshmi Sugar Mills Co. Ltd. vs CIT 123 ITR 429* and *CIT vs Hyderabad Allwyn Metal Works Ltd 172 ITR 113 (SC)* wherein it was held that when an amount paid by assessee could be regarded as compensatory in character then it would be allowable u/s 37(1) and if it were penal in nature it was not allowable. Tax auditor is not required to express any opinion as to the allowability or otherwise of the amount of penalty or fine for violation of law. He is only required to give the details of such items as have been charged in the books of accounts. - In this clause, the tax auditor has to verify and report any expenditure incurred by the assessee during the year to compound an offence under any law for the time being in force, in India or outside India.

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			- This clause requires specifically to report any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or exercising a profession, where acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guideline, as the case may be, for the time being in force, governing the conduct of such person. The tax auditor should obtain the list of beneficiaries in respect of whom tax has been deducted at source under section 194R to form an opinion as to whether any benefits and perquisites are inadmissible and require reporting under this clause. In case the tax auditor is of the opinion that any amount debited to the profit and loss account is to be disallowed as per section 37 and hence, has to be reported under this clause, then, reporting need not be done under clause 21(b) on amounts inadmissible under section 40(a)(ia) for non-deduction of tax at source. Appropriate disclosure should be made in the audit report in respect of such transactions in the observation in Para 3 of Form No. 3CA or Para 5 of Form No. 3CB, as may be applicable.
	(b)	Amounts inadmissible under section 40(a)(i)/(ia) with details of payment on which tax has not deducted or after deduction, tax has not been paid on or before the due specified under section 139(1) and the amount inadmissible under section 40(a)(iib), 40(a)(iii), 40(a)(iv), 40(a)(v)[3]	Section 40(a) specifies certain amounts which shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession". Under section 40(a)(i), 100% disallowance attracted with respect to sum paid or payable to a non-resident and under section 40(a)(i)/(ia) 30% disallowance attracted with respect to sum paid or payable to a resident payee on tax is deductible at source and such tax has not been deducted or after deduction has not been paid on or before the due date of furnishing return of income under section 139(1). Under this clause, the tax auditor is required to report the details of payment on which tax is not deducted at source and also the details of payment on which tax has been deducted but not paid during the previous year or before due date of filing return of income specified under section 139(1). The tax auditor is advised to give details under this clause for each individual payee.

[3] *Sub-clause (ic) of section 40(a) relates to fringe benefit tax and sub-clause (iia) thereof relates to wealth-tax. Reference to these sub-clauses are not given since these taxes have been abolished.*

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			Sub clause 40(a)(iib) provides that (a) any amount paid by way of a royalty, license fees, service fees, privilege fees, service charge or any other fees 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 is inadmissible expenditure. The Tax auditor should verify any such payment made by State Government undertaking to the State Government and should report under clause. The amount of salary which is paid outside India or to a non-resident in respect of which tax has not been deducted but which is required to be deducted under the applicable provisions of the Income-tax Act,1961 or tax has not been paid after deductione is not allowed as a deduction u/s. 40(a)(iii) and the same is required to be reported under this sub-clause. This information is required to be given for each individual payee. The tax auditor should also furnish the date of payment along with the name and address of the payee. 40(a)(iv) provides that any payment to a provident or other fund established for the benefit of employees of the assessee shall be disallowed, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head "Salaries". The tax auditor is also required to report the same under this sub-clause. Any tax paid by an employer on non-monetary perquisites is exempt in the hands of the employee as per section 10(10CC). Further, as per section 40(a)(v) the tax paid by the employer on non-monetary perquisites provided to employees shall not be deductible in computing profits and gains from business or profession. The tax auditor is required to report the amount of such tax paid by the employer, in case it is debited to the profit and loss account under this sub-clause. *For this purpose the tax auditor may examine the books of accounts and tax deduction returns.* *In case where the assessee submits that any sum debited to profit and loss account is not inadmissible under the provisions of section 40(a), the tax auditor may exercise his judgement in the light of the applicable laws and report*

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			accordingly about the compliance of this provision. The tax auditor may rely upon the judicial pronouncements while taking any particular view. In case of difference of opinion between the tax auditor and the assessee, the tax auditor should state both the view points. In case of voluminous nature of the information, the tax auditor can apply materiality principles, tests checks and compliance tests for verifying the information required to be provided under this clause. ***Note**: Case Studies on the ethical aspects in relation to tax audit under section 44AB and other Audit Reports are presented at the end of this Chapter.* ***Case Study 1** pertains to reporting under Clause 21(b)*
	(c)	Amounts debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof;	Under Clause 21(c) of Form No. 3CD, the amounts debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof have to be reported. Section 40(b) deals with expenditure not allowable in case of a firm/LLP whereas section 40(ba) deals with expenses not allowable in case of an AOP or BOI. The inadmissible remuneration, salary, bonus or commission under section 40(b) has to be determined on the basis of the provisions of sub-clause (v) of section 40(b) read with the limits laid down therein. Such limits are laid down as a percentage of book profits. It is advisable for the auditor to obtain from the assessee a detailed working of the inadmissible remuneration, salary, bonus or commission under section 40(b). He has to verify the computation from the instrument or agreement or any other document evidencing partnership including any supplementary documents or other documents effecting changes which would affect the computation of the inadmissible amounts under section 40(b). Under section 40(b)(iv), any payment of interest to any partner which is authorised by, and is in accordance with, the terms of the partnership deed and relates to any period falling after the date of such partnership deed in so far as such amount exceeds the amount calculated at the rate specified under the Income-tax Act from time to time will not be admissible as a deduction. Section 40(ba) lays down that any interest or remuneration paid by an AOP to its member shall not be allowed as a deduction to the AOP.

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			In order to determine the amount inadmissible under section 40(b), the tax auditor should obtain the computation of total income from the assessee.
	(d)	Disallowance under section 40A(3) / deemed income under section 40A(3A) [On the basis of the examination of books of account and other relevant documents/ evidence, whether the expenditure covered under section 40A(3)/ 40A(3A) read with Rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed. If not, please furnish the details of date of payment, nature of payment, amount and name and PAN or Aadhaar number of the payee, if available].	Disallowance would be made if the payment or aggregate of payments, exceeding ₹ 10,000 (₹ 35,000 in case of plying, hiring or leasing of goods carriage) is made to a person in a day otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed. However, no disallowance would be attracted in respect of cases and circumstances prescribed under Rule 6DD. *The tax auditor should obtain a list of all cash payments in respect of expenditure exceeding the prescribed limit under section 40A(3A). The list should be verified by the tax auditor with the books of accounts in order to ascertain whether the conditions for specific exemption granted under Rule 6DD are satisfied. Details of payments which do not satisfy the above conditions should be stated under this clause. Audit tools are available to find out such payments expeditiously and accurately. These tools may be employed in case data is voluminous.* *Practically, it may not be possible to verify each payment, reflected in the bank statement, as to whether the payment has been made through account payee cheque, demand draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, it is, thus, desirable that the tax auditor should obtain suitable certificate from the assessee to the effect that the payments for expenditure referred to in section 40A(3) and section 40A(3A) were made by account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, as the case may be.* *Where the tax auditor has relied on certificate of the assessee, the fact has to be reported as an observation in clause 3 of Form 3CA and clause 5 of Form 3CB, as the case may be. The tax auditor, in his report, may comment on such violation as under:-*

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			"It is not possible for me/us to verify whether the payments in excess of ₹ 10,000 have been made otherwise than by account payee cheque or bank draft or prescribed electronic modes, as the necessary evidence is not in the possession of the assessee". ***Note**: Case Studies on the ethical aspects in relation to tax audit under section 44AB and other Audit Reports are presented at the end of this Chapter. **Case Study 2** pertains to reporting under Clause 21(d).*
	(e)	Provision for payment of gratuity not allowable under section 40A(7);	As per 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 on termination of their employment for any reason. The deduction, however, shall be allowed in relation to any provision made by the assessee for the purpose of payment of a sum by way of contribution towards an approved gratuity fund or for the purpose of payment of gratuity that has become payable during the previous year. The gratuity fund should be approved for the relevant previous year by the Commissioner of Income-tax. If the gratuity fund is not approved for the time being, the assessee would not be able to avail of deduction for any provision made for the payment of a sum by way of any contribution towards that gratuity fund. *The tax auditor should call for the order of the Principal Commissioner of Income-tax/ Commissioner of Income-tax granting approval to the gratuity fund, verify the date from which it is effective and also verify whether the provision has been made as provided in the trust deed.*
	(f)	Any sum paid by the assessee as an employer not allowable under section 40A(9);	Under section 40A(9), any payment made by an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of person, body of individuals, society registered under Societies Registration Act or other institutions is not allowable. The tax auditor should examine the details of payments which are not allowable under this section. *The tax auditor shall maintain detailed working papers documenting the factual nature of such expenses incurred and debited to the Profit and Loss for the previous year under consideration which are considered disallowable u/s 40A(9). The tax auditor should get the relevant content in working papers*

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			prepared for such disallowance duly confirmed by the assessee as a necessary safeguard. *If any such contribution is made by the assessee in a capacity other than that of an employer, then such contribution is not to be considered as disallowable u/s 40A(9) of the Income-tax Act, 1961. Thus, the tax auditor should carefully examine the capacity of assessee while making such contribution before reaching any conclusions for allowing or disallowing such contribution.* It may be noted that section 40A(9) allows deduction of any contributions made as an employer towards recognized provident fund or approved superannuation fund or notified pension scheme or approved gratuity fund or as required by or under any other law for the time being in force. Thus, any contribution made to Employees' Welfare Co-op Society will not be allowed as a deduction in the case of the employer company under section 40A(9), unless such contribution is required by or under any other law for the time being in force. *Instruction: No. 1799, dated 3-10-1988.*
	(g)	Particulars of any liability of a contingent nature;	The assessee is required to furnish particulars of any liability of a contingent nature debited to the profit and loss account. The tax auditor, for verifying the details of contingent liability debited to the profit and loss account, may conduct a detailed scrutiny of various account heads e.g., outstanding liabilities, provision etc., if required. Accounting policy followed and disclosed would be helpful in ascertaining and verifying details. The tax auditor may also verify reporting under CARO and disclosure in the Notes on accounts. *The tax auditor should verify that the Contingent liability shown in Notes to Accounts is not required to be reported, as the amounts debited to Profit and Loss account are required to be reported in this sub-clause.*
	(h)	Amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income	The expenditure which is relatable to the income which does not form part of total income is not allowed as deduction in terms of Section 14A of the Act. Rule 8D lays down the method for determining the amount of expenditure in relation to income not includable in total income.

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		which does not form part of total income;	An assessee may claim that no expenditure has been incurred by him in relation to income which does not form part of total income, even in such case the provision of section 14A will apply. The tax auditor has to verify the amount of inadmissible expenditure as estimated by the assessee with reference to established principles of allocation of expenditure based on logical parameters like proportion of exempt and taxable income recorded, turnover, man hours spent to earn the relevant income etc. For allocation of interest between taxable and nontaxable income, the quantum of investment, the period and the rate of interest are generally the relevant factors to be considered. It is primarily the responsibility of the assessee to furnish the details of amount of deduction inadmissible in terms of section 14A i.e., in respect of the expenditure incurred in relation to income, which does not form part of the total income. The tax auditor has to examine the details of amount of inadmissible expenditure as furnished by the assessee. While carrying out such examination the tax auditor is entitled to rely on the management representation.
	(i)	Amount inadmissible under the proviso to section 36(1)(iii)	The provisions of section 36(1)(iii) provide that the amount of interest paid in respect of capital borrowed for the purposes of business or profession would be allowed as a deduction in computing the income referred to in section 28. The proviso thereunder provides that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalized in the books or 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 put to use, shall not be allowed *as a deduction.* *The tax auditor, while determining the admissible/ inadmissible amount under section 36(1)(iii) should also keep in mind the requirements of ICDS IX relating to borrowing cost.*
22.	(i)	Amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006; or	The Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act). MSMED is an Act to provide for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto

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	(ii)	***Total amount required to be paid to a micro or small enterprise, as referred to in section 15 of the MSMED Act, during the previous year;***	Notwithstanding anything contained in the Income-tax Act, 1961 (43 of 1961), the amount of interest payable or paid by the buyer, under or in accordance with the provisions of this Act, shall not for the purposes of the computation of income under the Income-tax Act,1961 be allowed as a deduction. The inadmissible interest has to be determined on the basis of the provisions of the MSMED Act. Section 16 of the MSMED Act provides for the date from which and the rate at which the interest is payable. Accordingly, where a buyer fails to make payment of the amount to the supplier, being micro and small enterprise, as required under section 15, the buyer shall, notwithstanding anything contained in any agreement between the buyer and the supplier or any law for the time being in force, be liable to pay compound interest with monthly rests to the supplier on that amount from the appointed date or, as the case may be, from the date immediately following the date agreed upon, at three times of the bank rate notified by the Reserve Bank. Section 24 of MSMED Act provides that sections 15 to 23 shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force. Sections 15 to 24 of the MSMED Act make a buyer liable to pay interest but they, by themselves, do not require the buyer to make payment to the supplier. However, as payment of such interest is considered as penal in nature, no deduction is allowed under section 37 of the Income Tax Act, 1961. *Clause 22 has two limbs – under the first limb, covering sub-clause (i), the amount of interest inadmissible under section 23 of the MSMED Act needs to be stated. Under the second limb covering remaining two sub-clauses, under sub-clause (ii) the total amount required to be paid to a micro or small enterprise, as referred to in section 15 of the MSMED Act during the previous year needs to be stated. In sub-clause (iii) under (a), the amount paid up to the time given under section 15 of the MSMED Act, and under (b) the amount not paid up to time given under section 15 of the MSMED Act and inadmissible for the previous year needs to be stated. Thus, the amount to be reported under (b) is the payment which satisfies the dual conditions, namely, paid beyond the time given under section 15 of the MSMED Act and inadmissible for the previous year.*
	(iii)	***Of amount referred to in (ii) above, amount –*** ***(a) paid up to time given under section 15 of the MSMED Act;*** ***(b) not paid up to time given under section 15 of the MSMED Act and inadmissible for the previous year."***	

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			The tax auditor, while verifying the reporting in respect of clause 22(i) should take the following steps: *(a) obtain a full list of suppliers of the assessee which fall within the purview of the definition of "Supplier" under section 2(n) of the MSMED Act. It is the responsibility of the auditee to correctly classify and identify those suppliers who are covered by this Act.* *(b) In respect of payments made to such suppliers, obtain a list of all instances where there was delay in payment beyond the time limit specified under Section 15 of the MSMED Act, the interest payable for such delay and the interest actually paid.* *(c) Review the list so obtained and verify the accuracy thereof on test check basis including the calculation of interest. Also, cross check the disclosure made in the financial statements in terms of Section 22 of the MSMED Act with the list so obtained. In case of company auditees, reference may also be made to half-yearly Form MSME-1, if any, furnished by such companies to the ROC.* *(d) Verify from the books of account and Financial Statements whether any interest payable or paid to the supplier(s) in terms of section 16 of the MSMED Act has been provided for in the books of account or has been debited to the Profit & Loss Account.* *(e) Verify that only interest paid or payable in terms of Section 16 of the MSMED Act which has been debited to the Profit & Loss account is reported under clause 22(i). Such interest is not allowable as deduction for the purposes of computation of income under the Income-tax Act, 1961 in terms of Section 23 of the MSMED Act.* *Under clause 22, full disclosure is required to be made as required in sub-clauses (ii) and (iii). Accordingly –* *(a) Reporting under Clause 22(ii) should include the amount required to be paid to Micro and Small Enterprises during the previous year (including amounts which are not claimed as a deduction in the*

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			Profit and Loss Account) irrespective of whether they have been paid during the year and whether or not they are outstanding on the Balance Sheet date. Reporting under this sub-clause should also include amounts which have accrued during the year but are not due for payment as on 31st March. *Thus, under clause 22(ii) which requires reporting of "total amount required to be paid to a micro or small enterprise, as referred to in section 15 of the MSMED Act, during the previous year", the total amount required to be paid during the year needs to be stated even if the said amount has been actually paid during the year.* *(b) Under Clause 22(iii) –* • *Under (a), all payments out of that included under 22(ii), which have been settled within the time limit laid down in Section 15 of MSMED Act need to be stated.* • *Under (b), only such amounts which will attract disallowance under section 43B(h) should be reported. This will include only amounts which–* *(i) have been claimed as a deduction during the year;* *(ii) are outstanding on the last date of the previous year; and* *(iii) have not been paid within the time limit specified in section 15 of the MSMED Act.* *While verifying the amounts reported under this clause, the tax auditor should note that the benefit available under the first proviso to section 43B for payments made upto the due date of filing the return is not available for payments covered under clause (h). Hence, any payment beyond the time limit specified u/s 15 of MSMED Act (and which has not been paid during the previous year) will be inadmissible.* In order to promote timely payments to micro or small enterprises, the Finance Act, 2023 includes payments made to such enterprises within the ambit of section 43B of the Income-tax Act. Accordingly, clause (h) in section 43B has been inserted w.e.f. A.Y. 2024-25 to provide that any sum payable by the assessee to a micro or small enterprise beyond the time limit specified in section 15 of the MSMED Act shall be allowed as deduction only on actual payment.

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			Note - *Section 15 of the of the Micro, Small and Medium Enterprises Development Act, 2006 mandates payment of goods or services to supplier, being a micro or small enterprises by the buyer on or before the date agreed upon between them in writing i.e., as per the written agreement, which cannot be more than 45 days. If there is no such written agreement, the payment shall be made before the appointed day i.e., within 15 days.* *If the sum payable by the assessee to a micro or small enterprise is paid as per written agreement (maximum within 45 days) or within 15 days in case of no agreement, the deduction can be claimed on accrual basis if mercantile method of accounting is followed by the assessee.* *However, if the sum payable by the assessee to a micro or small enterprise is not paid as per written agreement or within 15 days in case of no agreement, the deduction would be allowed in the previous year in which it is actually paid.* ***Note –*** *Section 23 of MSMED Act specifically prohibits the assessee from claiming the deduction in respect of interest paid to MSME. Thus, no deduction would be allowed in respect of such interest even if such sum is actually paid by the assessee. However, any sum payable (not being interest referred under section 23 of MSMED Act, 2006) by the assessee to a micro or small enterprise (being a supplier) beyond the time limit specified in section 15 of MSMED Act, 2006 shall be allowed as deduction only on actual payment.*
23.		Particulars of payments made to persons specified under section 40A(2)(b)	The section enjoins on the Assessing Officer, the power to fix the quantum of disallowance. Under this clause, the particulars of payments stated to be made to persons covered under section 40A(2)(b) should be examined. The tax auditor in this connection: (a) Obtain full list of specified persons as contemplated in this section. (b) Obtain details of payments made to the specified persons. (c) Scrutinise all items of payments to the above persons. (d) Call for all the contracts or agreements entered into by the assessee and list out the contracts and agreements entered into with the specified persons and segregate the items of payments made to them under these agreements.

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		Where the transactions are voluminous or the list contains several names, scrutiny to be made to the extent possible. In that case, reliance may be made on the information supplied by the client with adequate disclosure in the report.
24.	Amounts deemed to be profits and gains under section 33AB or 33ABA.	Section 33AB allowed deduction in respect of Tea Development Account, Coffee Development Account and Rubber Development Account. The auditor is required to verify the amount reported as deemed income chargeable as profits and gains of business under the circumstances specified in section 33AB(4)/(5)/(7) and (8). Section 33ABA allowed deduction in respect of Site Restoration Fund. The auditor is required to verify the amount reported as the deemed income chargeable as profits and gains of business under the circumstances specified in section 33ABA(5)/(7) and (8). *Tax auditor has to verify the details regarding the deposit account and site restoration account. He also has to verify the accuracy of details given by the assessee by scrutinizing the books of accounts and other relevant documents and evidence.* *He also has to verify whether the assets acquired through deposit account is not sold or transferred before expiry of eight years from the date of acquisition. Verify the manner of utilization of amount withdrawn from the specified reserve account.*
25.	Any amount of profit chargeable to tax under section 41 and computation thereof.	The tax auditor should obtain a list containing all the amounts chargeable under section 41 with the accompanying evidence, correspondence etc. He should examine the past records to satisfy himself about the correctness of the information provided by the assessee. *The tax auditor has to examine whether the profit chargeable to tax has been stated under this section. This information has to be given irrespective of the fact whether the relevant amount has been credited to the profit and loss account or not. The computation of the profit chargeable under this clause is also to be stated.* *The tax auditor should check whether amounts which have been written back in respect of trading liability by way of remission or cessation thereof or otherwise, is credited to Profit & Loss account. If any such liability credited to profit and loss account is already offered to tax in any prior*

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			period, the same shall not, once again, be considered as income in the year in which it is so credited. In case the amount given in this clause regarding section 41 of the Act is not routed through profit and loss account or income and expenditure account, the auditor may include the said fact in the observation para of the audit report.
26.		In respect of any sum referred to in section 43B, the liability for which:-	As per section 43B, deduction in respect of certain expenditure is allowable only on the basis of actual payment made within the time limits specified in section 43B. Section 43B is applicable in respect of expenditure for which a deduction is otherwise allowable under the Act. Therefore, where any expenditure is reported under any other clause indicating that deduction is otherwise not allowable, there is no need of reporting such expenditure under this clause. If the assessee is maintaining its books of accounts on the mercantile system, the tax auditor should verify the aforesaid particulars of section 43B from the books of account for the year under audit as well as from the books of account, vouchers and documents of the immediately succeeding assessment year and the return of income for the earlier assessment years to ensure that the information about the aforesaid payments made in the subsequent year have been correctly reported. The liability incurred during the year in respect of all the specified sums should be clearly distinguished from the liability that pre-existed on the first day of the relevant previous year. *The liability which pre-existed on the first day of the previous year is allowable as deduction if paid during the previous year. This is required to be reported in clause 26(A)(a). If such liability is not paid during the previous year, then, the same has to be reported in clause 26(A)(b). The liability which is incurred in the previous year (except under clause (h) of section 43B) is allowable to the extent it is paid on or before the due date for furnishing the return of the income under section 139(1). Such items are to be disclosed in clause 26(B)(a). If such liability is not paid before the due date, the same is reported in clause 26(B)(b).*
	(A)	Pre-existed on the first day of the previous year but was not ***allowable*** in the assessment of any preceding previous year and was (a) paid during the previous year; (b) not paid during the previous year;	
	(B)	Was incurred during the previous year and ***(for clauses other than clause (h) of section 43B) was*** (a) paid on or before the due date for furnishing the return of income of the previous year under section 139(1); (b) not paid on or before the aforesaid date	

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		(State whether sales tax, customs duty, excise duty, or any other indirect tax, levy, cess, impost, etc., is passed through the profit and loss account).	*In respect of any sum referred to in clause (h) of section 43B, reported under (A) of this clause as pre-existed on the first day of the previous year, the tax auditor should cross-check the amount so reported with the sum reported as inadmissible in clause 22 during the immediately preceding previous year. If the same is paid during the year it should be reported in (a) and if it is not paid during the year it should be reported in (b). In the next year, tax auditor should cross check the amount reported in Clause 26(A)(a) with the amount reported as inadmissible in clause 22 (iii)(b) and the amount reported in Clause 26A(b) during the immediately preceding previous year. There is no reporting required under (B) in respect of any sum referred to in clause (h) of section 43B.* *In case of GST liability under reverse charge mechanism (RCM), if liability is booked but not paid on or before the due date of filing return under section 139(1), the amount must be reported under this clause. Auditor must obtain and verify the same with GST payable ledger or GSTR-3B reconciliations.*
27.	(a)	Amount of Central Value Added Tax credits availed of or utilised during the previous year and its treatment in the profit and loss account and treatment of outstanding Central Value Added Tax credits in the accounts.	The amount of CENVAT/GST availed or utilized should be reported under this clause. In some cases, CENVAT/GST availed may be lesser than the CENVAT/GST credit utilized during the year on account of opening balance in CENVAT/GST account or vice versa as such it would be advisable, in order to avoid any misleading conclusion and inferences to report the opening and closing balances of CENVAT/GST. Regarding the reporting of accounting treatment of CENVAT/GST credit, the clause requires that its treatment in profit and loss account and the treatment of outstanding CENVAT/GST credit in the account have to be reported upon. The tax auditor should verify that there is a proper reconciliation between balance of CENVAT credit in the accounts and relevant statutory records. .
	(b)	Particulars of income or expenditure of prior period credited or debited to the profit and loss account.	It may be noted that information under this clause would be relevant only in those cases where the assessee follows mercantile system of accounting. Under cash system of accounting, expenses debited/ income credited to the profit and loss account would be current year's expenses/income even though they may relate to earlier years.

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			The tax auditor should obtain the particulars of expenditure or income of any earlier year debited or credited to the profit and loss account of the relevant previous year when mercantile system of accounting is followed. It may be noted that there is a difference between expenditure of any earlier year debited to the profit and loss account and the expenditure relating to any earlier year, which has crystallised during the relevant year. Material adjustments necessitated by circumstances which though related to previous periods but determined in the current period, will not be considered as prior period items. In such cases, though the expenditure may relate to the earlier year, it can be considered as arising during the year on the basis that the liability materialised or crystallised during the year and such cases will not be reported under this clause. Similar consideration will apply in relation to income also.
29A	(a)	Whether any amount is to be included in income chargeable under the head 'income from other sources' as referred to in clause (ix) of sub-section (2) of section 56? (Yes/No)	This clause requires disclosure of whether any amount is chargeable to tax under section 56(2)(ix), and if so, to furnish prescribed details of such income. Section 56(2)(ix) provides for taxability as Income from Other Sources of any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if such sum is forfeited and the negotiations do not result in transfer of such capital asset. Any such forfeited amount if it is in respect of a personal capital asset is not required to be reported, where such asset or the advance or the forfeiture is not recorded in the books of account relating to the business or profession. If an advance has been received and has been outstanding for a considerable period of time or has become time barred, there is no requirement to report such amount unless and until it is forfeited by an act of the assessee. Forfeiture of amounts received as advance towards transfer of a capital asset would become income under sub-clause (ix) of section 56(2) and is is required to be reported under this clause. Any advances received and forfeited towards sale of stock-in-trade would be taxable under section 28(i) and would not be required to be reported since the amount would be credited to profit & loss account.
	(b)	If yes, please furnish the following details: (i) Nature of income (ii) Amount thereof	

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			The tax auditor should obtain a representation from the assessee regarding all such advances received towards transfer of capital assets which have forfeited during the year. He should examine whether any amount of such advances has been written back during the year and examine the basis of such write back was on account of an act of forfeiture.
29B	(a)	Whether any amount is to be included as income chargeable under the head 'Income from other sources' as referred to in clause (x) of sub-section (2) of section 56? (Yes/No)	This clause requires reporting as to whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in section 56(2)(x). Section 56(2)(x) provides that where any person receives in any previous year, from any person or persons money, immovable property, or other property and conditions stated in the clause are satisfied, then, it is treated as income of the recipient. Receipt of assets, other than immovable property or assets included within the purview of property under the said section, would not be covered by the provisions of this section, and would, therefore not be required to be reported. For e.g., Stock-in-trade, not being a capital asset, is not covered by this provision. *The tax auditor should obtain a representation from the assessee regarding any such receipts during the year, either received in his business or profession or recorded in the books of account of such business or profession. He should also scrutinise the books of account to verify whether receipt of any such amount or asset has been recorded therein. Based on such verification, tax auditor has to consider whether the question is to be answered in affirmative or otherwise.* *In case answer to clause 29B(a) is yes, then the following details have to be furnished, namely nature of income and amount. In case of nature of income, it has to be stated whether the income is by way of receipt of any sum of money or from acquisition of any immovable property like land, building etc. or other than immovable property like shares and securities, jewellery, drawings, paintings etc.*
	(b)	If yes, please furnish the following details: (i) Nature of income: (ii) Amount (in ₹) thereof:	
30.		Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount	Details of the amount borrowed on hundi (including interest on such amount borrowed) and details of repayment otherwise than by an account payee cheque, are required to be indicated under this clause. The tax auditor should obtain a complete list of borrowings and repayments of hundi loans otherwise than

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		borrowed) repaid, otherwise than through an account payee cheque [Section 69D]	by account payee cheques and verify the same with the books of account. *The tax auditor should verify the borrowing/repayments with reference to such evidence which may be available and in the absence of conclusive or satisfactory evidence, the auditor may obtain suitable certificate/ management representation in this regard.*
30A	(a)	Whether primary adjustment to transfer price, as referred to in sub-section (1) of 92CE, has been made during the previous year? (Yes/No)	This clause requires reporting of primary adjustments and various other details, for the purpose of making secondary adjustments under section 92CE. *The tax auditor should obtain a certificate from the assessee as to what transfer pricing adjustments has been made during the previous year so that the primary onus should be with the management and then the same should also be verified from the tax records to check whether there is any such occurrence.*
	(b)	If yes, please furnish the following details:- (i) Under which clause of sub-section (1) of 92CE primary adjustment is made? (ii) Amount (in ₹) of primary adjustment (iii) Whether the excess money available with the associated enterprise is to be repatriated to India as per the provisions of sub- section (2) of section 92CE? (Yes/No) (iv) If yes, whether the	Clause 30A requires reporting of whether primary adjustment to transfer price, as referred to in section 92CE(1), has been made during the previous year. Thus the tax auditor is required to verify whether any primary adjustment is 'made' in terms of section 92CE(1) during the previous year under consideration. The primary adjustment made may not necessarily relate to previous year under consideration. It is also necessary that the disclosure under Clause 30A may need to be done is respect of each and every type of primary adjustment made in the relevant financial year, irrespective of the previous year to which this adjustment pertains to. For instance, an assessment order in relation to say, F.Y. 2022-23 may be passed in during F.Y. 2024-25 wherein AO has made a primary adjustment and the same has been accepted by the taxpayer. Such primary adjustment may need to be reported in the tax audit report of F.Y. 2024-25. The relevant clause of section 92CE(1) under which the relevant adjustment falls, and the amount of adjustment have to be reported. Under clause 30A(b)(iii), the requirement is to report whether the excess money available with the associated enterprise is required to be repatriated to India as per the provisions of section 92CE(2). In case any such primary adjustment has taken place, which requires repatriation of

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		excess money has been repatriated within the prescribed time (Yes/No) (v) If no, the amount (in ₹) of imputed interest income on such excess money which has not been repatriated within the prescribed time.	the excess money or part thereof, the tax auditor should verify whether the excess money has been received, and whether it has been received within the prescribed time.. In case the excess money or part thereof has not been repatriated within the prescribed time and the assessee has not opted to pay additional income-tax, the imputed interest income, which would be the secondary adjustment, needs to be computed. Since the reporting is for the previous year, it is advisable for the tax auditor to ensure that the amount of interest imputed till the end of the previous year is furnished. In case the interest up to the date of furnishing of the tax audit report is given, it is advisable to provide a break-up of the amount of interest imputed till end of the relevant previous year and for the period post the end of the relevant previous year ending with the date of furnishing tax audit report. It is possible that interest income may be imputed during the relevant previous year in connection with primary adjustment made during the earlier previous years. Such interest income arising from primary adjustment made in earlier year is also taxable during the previous year under consideration and will be included in the return of income of the concerned previous year. Thus, it may be advisable for the taxpayer to furnish and tax auditor to verify and report the information pertaining to such primary adjustments in respect of interest income which is chargeable under section 92CE(2). *The tax auditor should obtain a certificate from the assessee, as to what transfer pricing adjustments have been made in the return/(s) of income filed during the previous year, whether any advance pricing agreement was entered into during the previous year, whether any transfer pricing adjustment was made/confirmed in an assessment order/appellate authority order passed during the previous year, or whether any agreement has been arrived at under a Mutual Agreement Procedure during the previous year. The tax auditor should also verify tax records to check whether there is any such occurrence. In this regard, the auditor should also obtain a prior management representation on the information obtained to be true and accurate, on the basis which he should verify the amount of adjustment reported. Hence, the primary onus should be with the management.*

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30B	(a)	Whether the assessee has incurred expenditure during the previous year by way of interest or of similar nature exceeding one crore rupees as referred to in sub-section (1) of section 94B? (Yes/No)	This clause requires reporting for the purposes of examining allowability of expenditure by way of interest in respect of debt issued by a non-resident Associated Enterprises under section 94B while computing income under the head "Profits and gains from business and profession". The excess interest is to be calculated as the lower of total interest paid or payable in excess of 30% of earning before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or interest paid or payable to associated enterprises for that previous year. The excess interest which is disallowed, is allowed to be carried forward for a period of 8 assessment years following the year of disallowance, to be allowed as a deduction against profit and gain of any business in subsequent years, to the extent of maximum allowable interest expenditure under this section. In computing the limit of ₹ 1 crore, only interest and expenditure of similar nature which is deductible while computing income under the head "Profits and Gains of Business or Profession" should be considered, and not interest deductible under any other head of income or interest which is otherwise not deductible. Therefore, any interest disallowable under section 14A, under the proviso to section 36(1)(iii), under section 40(a)(i) or section 40A(2) should not be considered as interest for the purposes of section 94B(1). Similarly, interest disallowed on account of transfer pricing under section 92, should also not be considered, since such interest is not allowable in computing income under the head "Profits and Gains of Business or Profession". In case such interest exceeds ₹ 1 crore, details in part (b) of the clause need to be given. In item (i) of sub-clause (b), details of expenditure incurred by way of interest or of similar nature need needs to be provided. The language in the clause creates a doubt whether details that need to be given are of the total amount of interest and similar expenditure claimed as a deduction and not just the interest paid to non-resident AE(s). However, in view of the requirement of clause (a) where a specific question has been asked only with respect to section 94B(1) the subsequent clauses seem to be consequential and flowing from clause (a). Section 94B(1) confines itself to interest
	(b)	If yes, please furnish the following details:- (i) Amount (in ₹) of expenditure by way of interest or of similar nature incurred: (ii) Earnings before interest, tax, depreciation and amortization (EBITDA) during the previous year: (iii) Amount (in ₹) of expenditure by way of interest or of similar nature as per (i) above which exceeds 30% of EBITDA as per (ii) above: (iv) Details of interest expenditure brought forward as per section 94B(4)	

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		(v) Details of interest expenditure carried forward as per section 94B(4)	paid to Non-resident AE and section 94B(2) can be regarded as controlled by section 94B(1) since Section 94B(2) operates "for the purposes of sub-section (1)". The computation of "excess interest" as per section 94B(2) should be within the boundaries of interest referred to in section 94B(1), which is NR AE interest paid. The language of para 46.3 of CBDT Circular No. 2 of 2018 containing Explanatory Notes to Provisions of Finance Act, 2017 (dated 15 February 2018) is similar to the format of reporting prescribed by CBDT in clause 30B of Form No. 3CD. The better view is to disclose interest paid only to non-resident AE(s). Thus in item (i) of sub-clause (b),expenditure incurred by way of interest or of similar nature paid to its non-resident AE or to the lender to whom the AE has provided an implicit or explicit guarantee or has deposited a matching amount of funds, has to be reported, out of the total interest and similar expenditure claimed as deduction. It should be kept in mind that word 'paid' in terms of section 43(2) means actually paid or incurred according to the method of accounting employed.
30C	(a)	Whether the assessee has entered into an impermissible avoidance arrangement, as referred to in section 96, during the previous year? (Yes/No)	This clause requires reporting of impermissible avoidance arrangements as referred to in section 96 entered into by the assessee during the previous year and to quantify the tax benefit arising in the aggregate in the previous year to all parties to such arrangement. The auditor should examine if, in any earlier year, whether any reference has been made for declaring an arrangement as an impermissible avoidance arrangement, if such reference have been made, the auditor should report the fact in Form 3CA/3CB. In the light of the Chapter X-A, provisions of the Income-tax Act relating to GAAR, the rules made thereunder and CBDT Circular thereto, the tax auditor should examine the following: (i) The tax auditor should examine whether the Principal Commissioner or the Commissioner or the Approving Panel has, in any earlier previous year, declared any arrangement as IAA. In case, if any arrangement has been declared to be an IAA in any earlier previous year, the tax auditor should further examine if any transaction pertaining or in connection with such declared IAA has taken place during the previous year under the audit.
	(b)	If yes, please specify: (i) Nature of the impermissible avoidance arrangement: (ii) Amount (in ₹) of tax benefit in the previous year arising, in aggregate, to all the parties to the arrangement";	

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			(ii) The tax auditor should examine if, in any earlier previous year, whether any reference has been made for declaring an arrangement as an impermissible avoidance arrangement, if such references have been made, the auditor should report the fact in Form 3CA or Form 3CB, as the case may be. In both the cases, the auditor should further examine if any transaction pertaining or in connection with such declared IAA or such arrangement in respect of which reference has been made, has taken place during the previous year under the audit. If any transaction pertaining or in connection with such declared IAA or such arrangement has taken place during the previous year under the audit, this fact is expected to be reported along with the tax benefit arising to all parties. If, however, he is unable to ascertain the tax benefit in the previous year arising, in aggregate, to all the parties to the arrangement, he should indicate the same in Form 3CA or Form 3CB, as the case may be. In either case, where the assessee has given response to any show cause notice or has preferred an appeal, along with outcome thereof should be taken into consideration while verifying.
31.	(a)	Particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year - (i) name, address and PAN or Aadhaar Number (if available with the assessee) of the lender or depositor; ***(ii) Amount of each loan or deposit taken or accepted and code of the***	This clause seek certain particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year. *Each individual transaction of receipt of loan or deposit has to be reported separately by selecting the code from the drop down, even if it is from the same person. Tax auditor should obtain and verify the details of Code against each transaction of receipt of loan or deposit.* Reporting is required only where each loan or deposit in an amount of ₹ 20,000 or more severally or in aggregate of the three sums, as specified in the section. This sub-clause requires six specific particulars in respect of each loan or deposit including the permanent account number or Aadhaar number of the lender or depositor, if available with assessee. The tax auditor should obtain the details from the assessee in respect of each reportable loan or deposit and verify if the same amount reported as per the records and evidence available with the assessee.

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		nature of such amount; (iii) whether the loan or deposit was squared up during the year; (iv) maximum amount outstanding at any time during the previous year; (v) whether the loan or deposit was taken or accepted by cheque or bank draft or use of electronic clearing system through a bank account; (vi) in case the loan or deposit was taken or accepted by cheque or bank draft, whether the same was taken or accepted by an account payee cheque or account payee bank draft.	There will be practical difficulties while verifying the loan or deposit taken or accepted by the account payee cheque or an account payee bank draft. In such cases, the tax auditor should verify the transactions with reference to such evidence which may be available. In the absence of satisfactory evidence, for answering, as to whether bank cheque or bank draft was 'account payee', the tax auditors should make a suggested comment in his report. The suggested comment is as follows: *"It is not possible for me/us to verify whether loans or deposits have been taken or accepted otherwise than by an account payee cheque or account payee bank draft, as the necessary evidence is not in the possession of the assessee".*

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	(b)	Particulars of each specified sum in an amount exceeding the limits specified in section 269SS taken or accepted during the previous year: (i) name, address and PAN or Aadhaar number (if available with the assessee) of the person from whom specified sum is received; ***(ii) Amount of each loan or deposit taken or accepted and code of the nature of such amount;*** (iii) whether the specified sum was taken or accepted by cheque or bank draft or use of electronic clearing system through a bank account; (iv) in case the specified sum was taken or accepted by cheque or bank draft, whether the same was taken or accepted by an account payee	Under this clause, particulars of any specified sum taken or accepted in relation to transfer of an immovable property, whether or not the transfer takes place has been dealt with. Such specified sum may be any sum of money receivable whether or not the transfer takes place. *Transaction of specified sum has to be reported separately by selecting the code from the drop down, even if it is from the same person. Tax auditor should obtain and verify the details of Code against each transaction of specified sum.* *The tax auditor should ascertain whether the assessee has any immovable property which has been transferred or was proposed to be transferred during the year and review the relevant agreements, documents etc. in this regard. The auditor should satisfy himself that the proceeds arising from such transfer, based on the review of documents has been duly credited to the bank account by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed.*

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		cheque or account payee bank draft (Particulars at (a) and (b) need not be given in the case of a Government company, a banking company or a corporation established by the Central, State or Provincial Act)	
	(ba)	Particulars of each receipt in an amount exceeding the limit specified in section 269ST, in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person, during the previous year, where such receipt is otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account - (i) Name, address, PAN or Aadhaar Number (if available with the assessee) of the payer; (ii) Nature of transaction;	The sub-clauses (ba), (bb), (bc) and (bd) of clause 31 deal with reporting of transactions of receipts and payments in excess of the specified limit made otherwise than by the modes specified in section 269ST. Section 269ST does not distinguish between receipt on capital account and revenue account. Accordingly, sub-clauses (ba), (bb), (bc) and (bd) of clause 31 do not distinguish between receipts and payments on capital account and revenue account. Once the receipt or the payment, as the case may be, exceeds the limit specified in section 269ST, the particulars of such transactions will have to be reported under these clauses. The tax auditor should bear this in mind while examining the books of account and records of the assessee. Particulars are required to be given if receipts or payments, even though individually are lower than ₹ 2 lakh but in aggregate amount to ₹ 2 lakh or more if such receipts or payments are to or from one person in a day (whether related to a single transaction or otherwise) or relate to a single transaction (even if the receipts or the payments, as the case may be, are on different dates and individual receipts or payments are less than ₹ 2 lakh) or are in respect of more than one transaction but relate to a single event or occasion (even if the receipts or the payments, as the case may be, are on different dates and individual receipts or payments are less than ₹ 2 lakh). Sub-clauses (ba) and (bb) of clause 31 requires particulars to be furnished in respect of transactions exceeding ₹ 2 lakh **where assessee has received the amount** from a person, whereas sub-clauses (bc) and

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		(iii) Amount of receipt (in ₹) (iv) Date of receipt;	(bd) of clause 31 requires information about the transactions exceeding ₹ 2 lakh **where the payment has been made** by the assessee to a person. While it is comparatively simple to work out receipts or payments to or from a single person in a day, the tax auditor will have to exercise care and caution while verifying the particulars of receipts or payments pertaining to a single transaction or relating to a single event or occasion. The tax auditor will need to link all receipts and payments, as the case may be, otherwise than by the modes specified in this section received/ made in respect of single transaction and verify if the aggregate amount exceeds the limits specified in section 269ST. A single invoice may relate to multiple transactions and *vice-a-versa*, multiple bills may relate to a single transaction. The tax auditor will have to exercise his judgement to decide whether the receipts/payments is pertaining to a single transaction. Similarly, the tax auditor will have to exercise judgement in deciding whether receipts/payments though pertaining to more than one transaction, pertain to a single event or occasion. For example, for a function organized by a person, assessee contractor may have been given catering contract as well as contract for flower decoration. In such a case, while the transactions may be different, the occasion or event would be the same and provisions of section 269ST will be attracted if the receipts exceeding the limits specified under section 269ST are by mode other than those specified in the section. It is possible that the assessee may have purchased goods or services while simultaneously he may have sold goods or services to the same party, consideration for which exceeds ₹ 2 lakh. In such a case, if the amount of consideration for purchase is set off against the amount receivable for the sale of goods or services, such set off is not a receipt as contemplated under section 269ST. If the amount of such set off exceeds ₹ 2 lakh, the tax auditor may give appropriate note to the effect that such set-off not being a receipt or payment has not been included in the particulars given and the relevant sub-clause. If such receipts or payments are otherwise than by account payee cheque or an account payee draft or by use of electronic clearing system through a bank account,
	(bb)	Particulars of each receipt in an amount exceeding the limit specified in section 269ST, in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasions from a person, received by a cheque or bank draft, not being an account payee cheque or an account payee bank draft, during the previous year:- (i) Name, address and Permanent Account Number or Aadhaar Number (if available with the assessee) of the payer; (ii) Amount of receipt (in ₹)	
	(bc)	Particulars of each payment made in an amount exceeding the limit specified in section 269ST, in aggregate to a person in a day or in respect of a single transaction or in respect of	

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		transactions relating to one event or occasions to a person, otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year :- (i) Name, address and PAN or Aadhaar number (if available with the assessee) of the payee; (ii) Nature of transaction; (iii) Amount of payment (in ₹); (iv) Date of payment;	then, the tax auditor will have to verify the mode of the receipt or payment, as the case may be. He will have to examine whether the receipt or the payment, as the case may be, has been properly classified as under: (i) otherwise than by cheque or bank draft or use of electronic clearing system through a bank account, into receipt or payment; (ii) by cheque or bank draft not being an account payee cheque or an account payee bank draft. While section 269ST deals only with receipts exceeding ₹ 2 lakh or more otherwise than by the specified modes, sub-clauses (ba), (bb), (bc) and (bd) of clause 31 require details to be furnished of both receipts and payments. The particulars required under these sub-clauses need not be given in case of a receipt by a or payment to a government company, banking company, a post office saving bank, co-operative bank or in the case of transactions referred to in section 269SS.
	(bd)	Particulars of each payment in an amount exceeding the limit specified in section 269ST, in aggregate to a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasions to a person, made by a cheque or bank draft, not being an account payee cheque or an account payee bank draft, during the previous year: (i) Name, address and PAN or	

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		Aadhaar number (if available with the assessee) of the payee; (ii) Amount of payment (in ₹) (Particulars at (ba), (bb), (bc) and (bd) need not be given in the case of receipt by or payment to a Government company, a banking Company, a post office savings bank, a cooperative bank or in the case of transactions referred to in section 269SS or in the case of persons referred to in *Notification No. S.O. 2065(E) dated I3rd July, 2017)*	
	(c)	Particulars of each repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T made during the previous year: (i) Name, address, PAN or Aadhaar number (if available with the assessee) of payee; ***(ii) amount of each repayment of loan or***	This sub-clause requires particulars of each repayment of loan or deposit in an amount exceeding the limit specified in section 269T made during the previous year. Section 269T is attracted where repayment of the loan or deposit is made to a person, where the aggregate amount of loan or deposits held by such person either in his own name or jointly with any other person on the date of such repayment together with interest, if any, payable on such deposit is ₹ 20,000 or more. In the case of company assessee, loan or deposit is defined to mean deposit repayable after notice or loan or deposit repayable after a period. Therefore, in case of a company, loan or deposit repayable on demand will not be considered for the purpose of this section as loan or deposit. However, in the case of non-company assessee, loan or deposit is defined to mean loan or deposit of any nature. This distinction will have to be kept in mind while giving information under this sub-clause. Loan or deposits discharged by means of transfer entries

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		deposit or any specified advance and code of the nature of such amount; (iii) maximum amount outstanding at any time during the previous year; (iv) whether the repayment was made by cheque or bank draft or use of electronic clearing system through a bank account; (v) in case repayment was made by cheque or bank draft, whether the same was repaid by an account payee cheque or an account payee bank draft.	or journal entries in the books of account constitute repayment of loan or deposits otherwise than by account payee cheque or account payee bank draft. Hence, such entries have to be reported under this clause. ***Each individual transaction of loan or deposit or specified advance repaid has to be reported separately by selecting the code from the drop down, even if it is from the same person. Tax auditor should obtain and verify the details of Code against each transaction of repayment of loan or deposit or specified advance, as the case may be.*** The monetary limit of ₹ 20,000 or more is applicable in respect of a banking company or a co-operative bank with reference to each branch and in all other cases, assessee as a whole.
	(d)	Particulars of repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T received otherwise than by a cheque or bank draft or use of ECS through a bank account during the previous year:	Under this clause the details of repayment received by the assessee from a person in respect of loan or deposit or specified advances exceeding the limit specified in section 269ST received otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year based on the examination of books of accounts or other relevant documents have to be provided. In case the repayments are voluminous, it may not possible to verify each repayment, reflected in the bank statement, as to whether the acceptance of deposits or loans or specified advances has been through cheque, bank draft or not.

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		(i) Name, address, PAN or Aadhaar number (if available with the assessee) of the payer, (ii) amount of repayment of loan or deposit or any specified advance received otherwise than by a cheque or bank draft or use of ECS through a bank account during the previous year.	*Tax auditor can obtain a certificate form the assessee as to the repayment received ahd the mode of such repayment. Where tax auditor has verified on the basis of the certificate of the assessee, the same shall be reported as an observation in para 3 of Form No. 3CA or para 5 of Form No. 3CB, as the case may be.*
	(e)	Particulars of repayment of loan or deposit or any specified advance in amount exceeding the limit specified in section 269T received by a cheque or bank draft which is not an account payee cheque or account payee bank draft during the previous year: (i) Name, address, PAN or Aadhar Number (if available with the assessee), of the payer, (ii) amount of repayment of loan or deposit	Under this sub-clause, the tax auditor has to verify details of repayment received by the assessee from a person in respect of loan or deposit or specified advance exceeding the limit specified in section 269T received by cheque or bank draft which is not an account payee cheque or account payee bank draft during the previous year based on the examination of books of accounts and other relevant documents. It may not be possible to verify each repayment, received, reflected in bank statement, as to whether the same has been made through cheque, bank draft which is not an account payee cheque or account payee bank draft. Therefore, certificate may be obtained from the assessee and where the reporting has been done on the basis of the certificate of the assessee, the same shall be reported as an observation in clause (3) of Form No. 3CA or clause (5) of Form No. 3CB.

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		or any specified advance received by a cheque or a bank draft which is not an account payee bank cheque or account payee bank draft during the previous year. (Particulars at (c), (d) and (e) need not be given in the case of a repayment of any loan or deposit or any specified advance taken or accepted from the Government, Government company, banking company or a corporation established by the Central, State or Provincial Act)	
32.	(a)	Details of brought forward loss or depreciation allowance to the extent available containing information relating to assessment year, nature of loss/allowance (in ₹), amount as returned (in ₹)* all losses/allowances not allowed under section 115BAA/ 115BAC/ 115BAD,	The amount of brought forward loss or depreciation allowance is required to be quantified as per return and assessment orders or appellate orders, if any. Depreciation on goodwill will not be available from A.Y. 2021-22. Brought forward losses may relate to different heads of income such as property income, profits and gains of business or profession, speculation business or capital gains. Different provisions are contained in sections 32 and 70 to 79A of the Income-tax Act, 1961, with regard to loss/ depreciation under different heads. In the remarks column, information about the pending assessment or appellate proceedings or about delay in filing loss returns should be given. For giving the above information, the auditors should study the assessment records i.e., the

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		115BAE amount as assessed (give reference to relevant order) and remarks. * If the assessed depreciation is less and no appeal pending then take assessed.	income-tax returns filed, assessment orders, appellate orders, orders giving effect to appellate order and rectification/revisional orders for the earlier years and ascertain if the figures given in the above clause are correct. The tax auditor should keep in mind the provisions of section 71B regarding carry forward and set-off of loss from house property, section 73A regarding carry forward and set-off of losses by specified business and also section 78 regarding carry forward and set-off of losses in case of change in constitution of firm or on succession. ***The tax auditor should also verify whether any revised or updated return has been filed under Section 139(5) or 139(8A) respectively, and its impact on the claim of carry forward of losses.*** ***The tax auditor should examine if there is any pending assessment or appellate proceedings, or any delay in filing the return of income, impacting the carry forward of losses.*** The tax auditor should obtain all the assessment orders or appellate orders completed and pending during the audit. If the consequential order for any revision / appellate order is yet to be passed, the same can be disclosed along with the impact thereof, if material. It means in case of any undisclosed income determined in case of an assessee during any proceedings of search, requisition or survey, then no adjustment or set off shall be allowed against such undisclosed income. The set off shall not be available in case of both brought forward losses as well as the unabsorbed depreciation. From the Assessment Year beginning from 2022-23 onwards, the tax auditor has to confirm and verify whether any search or survey has been taken place or undergoing based on the records of assessment proceedings of the assessee and accordingly shall check if any undisclosed income has been determined in case of assessee. The eligibility of brought forward losses and unabsorbed depreciation against such undisclosed income as computed by the assessee should be checked and based on that, the necessary adjustments should be made to losses to be carried forward by the assessee.
	(b)	Whether a change in the shareholding of the company has	The tax auditor should obtain the details of changes in voting power pattern year-on-year and verify the reasons for any such changes before determining the allowability

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		taken place during the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of section 79.	of losses eligible to be carried forward. The tax auditor should obtain necessary representation to this effect wherever it is not feasible to verify or cross-check the shareholding pattern and changes therein. The comparison of the composition of the shareholding is to be done with reference to the last day of the current previous year and the last day of every previous year in which the loss was incurred. The carry forward of the loss incurred in respect of different previous years is to be determined with respect to the individual previous years. Such comparison of the shareholding can be done by referring to the Register of Memberss and other requisite forms and documents filed with MCA and other statutory authorities. The comparison must be carried out for **each year of loss separately**, and the allowability must be evaluated **year-by-year**, rather than in aggregate.
	(c)	Whether the assessee has incurred any speculation loss referred to in section 73 during the previous year. If yes, please furnish details of the same.	Having regard to the definition of "speculative business", the tax auditor has to verify from the books of account and other relevant documents as to whether the assessee is carrying on any speculation business. On verification if the auditor is of the opinion that the auditee is carrying on speculation business, under this clause, the tax auditor has to furnish the details regarding speculation loss referred to in section 73, if any incurred by the assessee during the previous year. It may be noted that it is not necessary that same speculation business needs to be continued to set off its loss of earlier year(s) against profit of same speculation business. It can be 'any' speculation business i.e., a different speculation business.
	(d)	Whether the assessee has incurred any loss referred to in section 73A in respect of any specified business during the previous year, if yes, please furnish details of the same.	Under clause 32(d), the tax auditor has to verify from the books of accounts and other relevant documents as to whether the assessee is carrying on specified business as referred to under section 35AD. In case the auditor is of the opinion that the assessee is carrying on such specified business, he has to furnish the details of the loss incurred, if any, in respect of any specified business during the previous year. In case the assessee carries on more than one specified businesses and losses have been incurred in both the business, the details of the loss incurred with respect of each business is to be specified separately.
	(e)	In case of a company, please	The *Explanation* to Section 73 provides that where part of the business of a company (other than a company whose

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		state that whether the company is deemed to be carrying on a speculation business as referred in *Explanation* to section 73, if yes, provide details of speculation loss if any incurred during the previous year.	gross total income consists mainly of income which is chargeable under the heads income from securities, income from house property, capital gain and income from other sources or a company the principal business of which is the business of trading in shares or banking or granting of loans and advances consist in the purchase or sale of shares of the other companies shall be deemed to be carrying on a speculation business to the extent to which business consists of purchase and sale of such shares. The tax auditor has to furnish the details regarding the speculation losses incurred, if any, as referred to in *Explanation* to section 73.
33.		Section-wise details of deductions, if any, admissible under Chapter VIA or Chapter III (Section 10AA) specifying the section under which deduction is claimed and the amounts admissible as per the provision of the Income-tax Act, 1961 and fulfils the conditions, if any, specified under the relevant provisions of Income-tax Act, 1961 or Income-tax Rules,1962 or any other guidelines, circular, etc., issued in this behalf.	The tax auditor has to ensure that the assessee fulfils all the conditions specified in the sections under which deduction is claimed. For ascertaining this, the tax auditor has to obtain all necessary evidence which would enable him to express the opinion regarding the admissibility of deductions. In order to ascertain the fulfillment of this condition, the tax auditor may have to check all documentary evidence. There may be cases where there is difference between the amount claimed by the assessee and the amount computed by the tax auditor. In such cases, it is quite possible that the assessee's claim is based on some judicial pronouncement on the subject. In such cases, it may be advisable to report the amount admissible. The amount claimed and the background behind and the basis of the claim of the assessee may form part of the working papers. If the claim of the assessee is well-founded and settled by judicial pronouncement, the tax auditor may accept the claim, but he has to record in his working papers that admissible amount has been reported on the basis of such judicial pronouncement. In appropriate circumstances, such judicial pronouncements etc. should be mentioned in the report. It may be noted that separate audit report or certificate is required to be obtained under section 10AA and certain sections like 80-IA, 80-IB, 80-IC, 80-JJAA under Chapter VI-A. While giving information with regard to the deduction allowable under these sections, the tax auditor should refer to separate audit reports/ certificates obtained by the assessee. These audit reports/ certificates may have been given by the tax auditor or by any other auditor. The figures given

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			in such separate audit reports/certificates should be taken into consideration while giving information with regard to income covered by these sections. ***Note**: **Case Study 3** and **Case Study 4** deal with the ethical aspects which have to be considered while issuing audit report in Form 10CCB.* Some sections in Chapter VIA such as section 80G (donations), Section 80GGB/80GGC (contributions to political parties), section 80JJAA (wages of new workmen) etc. relate to the expenditure incurred by an assessee. There are other sections such as section 80-P (income of cooperative societies), etc. which relate to income of the assessee. In respect of all these sections, the tax auditor should ascertain whether there is any expenditure or income covered by the above sections recorded in the books of accounts audited by him. Section 115BAA, 115BAB, 115BAC, 115BAD and 115BAE provide that no deductions under Chapter VI-A or Chapter III can be claimed by the assessee opting for taxation under any of these sections except deductions mentioned under section 80M and 80JJAA, reply to clause 8a shall be considered and accordingly admissibility of deductions should be examined.
34.	(a)	Whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB, if yes, please furnish details of (1) Tax deduction and collection Account Number (TAN) (2) Section No. (3) Nature of payment (4) Total amount of payment or receipt	While answering the issue of applicability of the provisions of Chapter XVII-B and/or XVII-BB, a number of debatable issues may arise before the assessee as well as the tax auditor. The auditor may have a difference of opinion with regard to the applicability of the provisions of TDS/TCS on a particular payment. In such a case, the tax auditor has to report the difference of opinion appropriately as an observation in the para 3 of Form No. 3CA or para 5 of Form No. 3CB as the case may be. It is essential to note that it is the primary responsibility of the assessee to prepare the information in such a manner that the tax auditor can verify the compliance as required in the clause. The tax auditor is required to verify that no items have been omitted in the information furnished to him and reasonable test checks would reveal whether or not the information furnished is correct. The extent of check undertaken would have to be indicated by the tax auditor in his working papers and audit notes. The tax auditor would be well advised to so design his tax audit programme as would reveal the extent of checking and to ensure adequate documentation in support of the

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		(5) Total amount on which tax was required to be deducted or collected (6) Total amount on which tax was deducted or collected at specified rate (7) Amount of tax deducted or collected (8) Total amount on which tax was deducted or collected at less than specified rate or Amount of tax deducted or collected at less than specified rate and amount of tax deducted or collected not deposited to the credit of Central Government.	information being certified. It may be noted that while determining the amount to be reported in this clause, the tax auditor has to check and verify the payments made by the assessee and should not only restrict to verification of expenses debited to Profit & Loss or the TDS/TCS returns filed and provided by the assessee e.g., an advance payment made to any contractor may also be liable for deduction of tax. In the case of payment to non-residents, the applicable rate of tax deduction at source is to be read along with the Double Taxation Avoidance Agreement. This clause also requires furnishing of the total amount out of the amount deductible or collectible, at which the tax was deducted or collected at the rate less than the specified rate. The lesser deduction is required to be reported in this clause. This will include deduction at a lower rate than what is prescribed, application of wrong section for deduction of tax at source, etc. For example, section 194C requires deduction @2% in case payment is made to a person other than individual or HUF, but the deductor deducts only 1%, the same has to be reported under this clause. The tax auditor should also consider applicability of higher rate of TDS/TCS. The tax auditor should verify the cases where the tax has been deducted at source but not paid to the credit of the Central Government till the date of the audit. It may be seen that tax deducted but deposited late will not be –required to be reported. *Tax auditor should obtain a copy of TDS/TCS returns filed by the assessee and reconcile the same with the books of accounts, which shall form the basis of reporting under this clause. The tax auditor should take into consideration the relevant sections, rules, notifications, circulars and various judicial pronouncements in relation to transactions of relevant payment or collections. If the tax auditor has not agreed with the interpretation/ views taken by the assessee, he should report the same in Form 3CA/3CB.*
	(b)	Whether the assessee is required to furnish the statement of tax deducted, or tax collected. If yes,	This clause deals with the information pertaining to statement of tax deducted and collected at source. The tax auditor has to ascertain whether the assessee is required to furnish the statement of tax deducted or tax collected at source, and if so, whether he has furnished the same within the prescribed time. The tax auditor has

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		please furnish the details of TAN, type of form, due date for furnishing, date of furnishing, if furnished, whether the statement of tax deducted or collected contains information about all transactions which are required to be reported. If not, please furnish list of details/transactions which are not reported.	to verify the details given in the table contained in Clause 34(b) only with regard to the statement required to be furnished by the assessee. The information given in clause 34(a) and (b) should be reconciled with the disallowances reported under section 40(a) in clause 21(b) to the extent applicable for cross checking appropriateness of reporting under both the clauses. Depending upon transactions that require tax deduction or collection, the tax auditor should ascertain which statements, the assessee was required to furnish for the financial year under audit. He should check which statements have been furnished by the assessee for tax deducted as well as collected. The reporting requirement is notwithstanding the fact that the assessee has furnished the statements of tax deducted at source and tax collected at source. *The tax auditor should keep in mind laws relating to tax deductions/collections at source and various case laws so as to detect any case of contravention or default in the provisions of Chapter XVII -B / chapter XVII-BB.* *If the information is voluminous, then the tax auditor should consider reporting significant deficiencies with appropriate remarks in paragraph (3) of Form 3CA or paragraph (5) of Form 3CB.*
	(c)	Whether the assessee is liable to pay interest under section 201(1A) or section 206C(7). If yes, please furnish details of Tax deduction and collection Account Number (TAN), amount of interest under section 201(1A)/ 206C(7) is payable and amount of interest paid along with date of payment.	Under this clause, detailed information has to be furnished in case the assessee is liable to pay interest under section 201(1A) or section 206C(7) of the Act. Where the assessee is liable to pay interest u/s 201(1A) or u/s 206C(7), the tax auditor should verify such amount from the books of account as on 31st March of the relevant previous year and also from PART G of the statement generated by the Department in Form No.26AS. In case the assessee had disputed the levy or calculation of interest under TRACES, in Form No.26AS/AIS/TIS of the assessee, the auditor may re-calculate the amount of interest under section 201(1A) or section 206C(7) up to the date of audit report for reporting under this clause and also mention the fact in his observations paragraph provided in Form No.3CA or Form No.3CB, as the case may be.

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35.	(a)	In the case of a trading concern, give quantitative details of principal items of goods traded: (i) Opening Stock; (ii) purchases during the previous year; (iii) sales during the previous year; (iv) closing stock; (v) shortage / excess, if any	The tax auditor should examine whether the enterprise is a trading concern or not. If yes, the tax auditor should obtain certificates from the assessee in respect of the principal items of goods traded, the balance of the opening stock, purchases, sales and closing stock (alongwith its measurement unit) and the extent of shortage/excess/damage and the reasons thereof. The entire quantitative information should be examined by the auditor from the records.
	(b)	In the case of a manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products: **A. Raw Materials:** (i) opening stock; (ii) purchases during the previous year; (iii) consumption during the previous year; (iv) sales during the previous year; (v) closing stock; (vi) yield of finished products; (vii) percentage of yield; (viii) shortage / excess, if any.	The tax auditor should ascertain whether the enterprise is a manufacturing concern and it is accordingly reported in clause 10(a). If yes, this sub-clause is applicable. The tax auditor should obtain certificate from assessee in respect of principal items of raw materials, finished goods and by-products (alongwith its measurement unit) and quantitative information required to be reported in this sub-clause. ***Note -*** *This clause requires that quantitative details of "principal items" of raw materials and finished goods should be given. Therefore, information about petty items need not be given. What would constitute principal items will depend on the facts of each case. Normally, items which constitute more than 10% of the aggregate value of purchases, consumption or turnover as the case may be, may be classified as principal items.*

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		B. Finished products/by-products: (i) opening stock (ii) purchases during the previous year; (iii) quantity manufactured during the previous year; (iv) sales during the previous year; (v) closing stock; (vi) shortage/ excess, if any.	
36A		(a) Whether the assessee has received any amount in the nature of dividend as referred to in sub- clause (e) of clause (22) of section 2? (Yes/No) (b) If yes, please furnish the following details:- (i) Amount received (in ₹): (ii) Date of receipt	The tax auditor should obtain from the assesseea certificate containing a list of closely held companies in which he is a beneficial owner of shares carrying not less than 10% of the voting power and list of concerns in which he has a substantial interest. The dividend taxable under section 2(22)(e) is restricted to accumulated profits on the date of payment. Thus, the accumulated profits have to be determined as on the date of the payment. Further, if at any time earlier any amount has been considered as income under any of the clauses of section 2(22), the accumulated profits will have to be reduced by such an amount. The tax auditor may not be able to determine the accumulated profits such as on the date of payment of the closely held company making the payment for various reasons. The tax auditor in such a case may arrive at the accumulated profits by appropriating the profit for the year on a time basis. In such a case, the auditor should include appropriate remarks in para 3 of Form No. 3CA or para 5 of Form No. 3CB, as the case may be, about the methodology adopted by him. For attracting section 2(22)(e), it is necessary that the assessee receiving a loan or advance should be a shareholder. Wherever the beneficial shareholder is not the registered shareholder and the closely held company

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		has given loan or advance to the beneficial shareholder or to a concern, the tax auditor should make appropriate remark in Form No. 3CA or Form 3CB, as the case may be. *The tax auditor should also obtain a certificate from the taxpayer giving particulars of any loan or advances received by any concern in which he has substantial interest from any closely held company in which he is a beneficial owner of shares carrying not less than 10% of the voting power. These certificates are necessary since the tax auditor may not be able to verify the above from the books of account of the assessee.* *The tax auditor should verify Form 26AS in the case of the taxpayer to know if the closely held company has deducted tax at source from any payment made to it to the taxpayer or the concern under section 194.*
36B.	***(a) Whether the assessee has received any amount for buyback of shares as referred to in sub-clause (f) of clause (22) of section 2? (Yes/No).*** ***(b) If yes, please furnish the following details:*** ***(i) Amount received (in ₹)*** ***(ii) Cost of acquisition of shares bought back***	*Sub-clause (f) was inserted in section 2(22) of the Income-tax Act, 1961 with effect from 01-10-2024 in order to further broaden the meaning of the term "dividend" so that it can include any payment by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 68 of the Companies Act, 2013.* *While verifying the contents of the reporting under item (i) of sub-clause (b) of clause 36B, it should be verified that only such amount of received in respect of buyback completed on or after 1st October, 2024 is reported and no amount which has been received in respect of buyback completed before such date should be mentioned here.* *Further, the tax auditor should take into consideration whether the amount that has been received as a buyback is forming part of the accounts that is subject to Tax Audit or not. In case of any individual/HUF, there could be a case where there are two separate sets of financials maintained i.e. one set of financials containing the business accounts and the other one which only has personal accounts.* *Hence, if the share and securities forms part of the personal accounts, then, ideally no reporting is required to be made in this clause as it is not subjected to tax audit. However, if the business accounts has the shares and securities reported under it, then, a reporting shall be required to be made, even if the assessee claims that the amount has been earned out of tradable stock i.e. the*

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		assessee is in the business of trading into shares and securities. *The said amount of buyback can be cross verified by the Tax Auditor by referring to the TIS/AIS, wherein certain companies would have reported the transactions that are in the nature of buyback of shares.* *The actual cost incurred to purchase such shares which has been bought back by the company should be mentioned in item (ii) of subclause (b) of clause 36B.*
37.	Whether any cost audit was carried out, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/ quantity as may be reported/identified by the cost auditor.	The tax auditor should ascertain from the management whether a cost audit was carried out and if yes, a copy of the same should be obtained from the assessee. Even though the tax auditor is not required to make any detailed study of such a report, he has to take note of the details of **disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/ identified by the cost auditor.** The information is required to be given in respect of cost audit report which is received upto the date of tax audit report. *The tax auditor should examine the time period for which the cost audit, if any, has been required to be carried out. Information is required to be given only in respect of such cost audit report, the time period of which falls within the relevant previous year. In effect, the information is required to be given in respect of that cost audit report which is received upto the date of tax audit report.*
38.	Whether any audit was conducted under the Central Excise Act, 1944, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the auditor.	The tax auditor should ascertain from the management whether any audit was conducted under the Central Excise Act, 1944 and if such an audit was carried out, obtain a copy of the report. Even though the tax auditor is not required to make any detailed study of such report, he has to take note of the details if any, of disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/ identified by the auditor. The tax auditor need not express any opinion in a case where such audit has been ordered but the same has not been carried out. The information is required to be given in respect of excise audit report which is received upto the date of tax audit report. *The tax auditor should examine the time period for which the excise audit, if any, has been required to be carried out. Information is required to be given only in respect of such excise audit report the time period of which falls within the relevant*

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		previous year. In effect, the information is required to be given in respect of that excise audit report which is received upto the date of tax audit report.
40.	Details regarding turnover, gross profit, etc. for the previous year and preceding previous year: 1. Total turnover of the assessee 2. Gross profit/ turnover 3. Net profit/ turnover 4. Stock-in-trade/ turnover 5. Material consumed/ finished goods produced (The details required to be furnished for principal items of goods traded or manufactured or services rendered)	These ratios have to be calculated only for assessee who are engaged in manufacturing or trading activities. While calculating these ratios, meaning has to be assigned to the terms used in the above ratios having due regard to the generally accepted accounting principles. All the ratios mentioned in this clause are to be calculated in terms of value only. For the purpose of calculating the ratio mentioned in (4), only closing stock is to be considered. The term ` stock-in-trade' used therein does not include stores and spare parts or loose tools. The term "stock-in-trade" would include only finished goods and would not include the stock of raw material and work-in-progress since the objective here is to compute the stock-turnover ratio. Material consumed would, apart from raw material consumed, include stores, spare parts and loose tools. Under this clause, calculation of the ratios is also to be stated. As such, computation of various components based upon which these ratios have been worked out is required to be stated under this clause. There should be consistency between the numerator and the denominator while calculating the above ratios. Any significant deviation thereof should be pointed out in Form 3CA or Form 3CB, as the case may be. The relevant previous year figures are to be taken from last previous year audit report or the reinstated figures, to make the ratios comparable with current year. In case the preceding previous year is not subject to audit, nothing should be mentioned in the relevant column and the same should be disclosed in the observation para of Form No.3CA/Form No.3CB. The ratios has to be given for the business as a whole and need not be given product wise.
41.	Please furnish details of demand raised or refund issued during the previous year under any tax laws other than Income-tax Act,	The assessee may be assessed under various tax laws other than Income-tax Act, 1961 resulting into a demand order or refund order. The tax auditor should obtain copy of all the demand/refund orders issued by the government authorities during the previous year under any tax law other than Income-tax Act, 1961.

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		1961 and Wealth Tax Act, 1957[4] alongwith details of relevant proceedings.	The auditor should exercise his professional judgement in determining the applicability to relevant tax laws for reporting under this clause. *It may be noted that even though the demand/refund order is issued during the previous year, it may pertain to a period other than the relevant previous year. In such cases also, reporting has to be done under this clause. The tax auditor should verify the books of account and the orders passed by the respective Department for ascertaining whether any such demand has been raised or refund order has been issued under any other tax law and accordingly report the same. It is advisable to cross verify the demands from online portal of the respective Department. If there is any adjustment of refund against any demand, the same should be reported under this clause. Management representation should be obtained from the assessee. In case of corporate assessee, the auditor should check the said details with the disclosures of contingent liabilities in the audited financials, disclosures in statutory auditor's report pursuant to CARO, if applicable.*
42.	(a)	Whether the assessee is required to furnish statement in Form No. 61 or Form No. 61A or Form No. 61B? (Yes/No)	This clause has been introduced where the tax payer is required to furnish a statement in Form 61/61A/61B. As per Rule 114D(1), every person referred to in clauses (a) to (k) of Rule 114C(1) and Rule 114(2) and who is required to get his accounts audited under section 44AB who has received any declaration in Form 60 (this form is used by an individual or a person other than a company or a firm who does not have PAN and who enter into any of the transactions specified in rule 114B) is required to furnish statement in Form No. 61 containing particulars of such declaration. The Annual Information Return or Statement of financial transaction required to be furnished under section 285BA(1) is to be furnished in Form No. 61A. Statement of Reportable Account under section 285BA(1)(k) is to be furnished by a reporting financial institution in respect of each account which has been identified pursuant to due diligence procedure as a reportable account. *The tax auditor should verify that whether the assessee is liable to report the transaction in the*
	(b)	If yes, please furnish Income-tax Department Reporting Entity Identification Number, Type of form, Due date for furnishing, Date of furnishing (if furnished), Whether the form contains information about all details/ transactions	

[4] *abolished with effect from the 1st April, 2016*

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		which are required to be reported. If not, please furnish list of the details/ transactions which are not reported.	*prescribed form or not, if yes, whether the assessee has filed the same and he has furnished all the particulars required in the Form.* *The tax auditor is further required to verify whether the Form contains information about all details or furnished transactions which are required to be reported. He may rely on management representation in this regard.* *Form No. 61, 61A and 61B uploaded on the income tax portal should be examined by the tax auditor for purpose of verifying the reporting under this clause. If the forms have been revised, then, the auditor must verify whether all the particulars required to be reported have been reported in the revised form.*
43.	(a)	Whether the assessee or its parent entity or alternate reporting entity is liable to furnish the report as referred to in sub-section (2) of section 286 (Yes/No)	This clause seeks information about applicability to furnish the report as referred to in section 286(2). Section 286(2) casts an obligation on the parent entity or the alternate reporting entity, if it is resident in India to furnish report, in respect of the international group of which it is a constituent, for every accounting year, within a period of 12 months from the end of the said reporting accounting year to the prescribed authority. The reporting requirement under section 286 shall not apply in respect of an international group for an accounting year, if the total consolidated group revenue, as reflected in the consolidated financial statement for the accounting year preceding such accounting year does not exceed ₹ 6,400 crores (Rule 10DB). The obligation to furnish the report referred to in section 286(2) arises under following situations requiring reply in affirmative to clause 43(a): (i) If the assessee itself is the parent entity of the international group and is resident in India, it will have the obligation to furnish the report under section 286(2); (ii) If the assessee is resident in India and has been designated as the alternate reporting entity of the international group; (iii) If the assessee is a constituent of the international group with its parent entity resident in India and the group has not designated any other resident constituent entity as the alternate reporting entity, the parent entity will have the obligation to file the report under section 286(2).

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			(iv) If the assessee is neither the parent entity nor has it been designated as the alternate reporting entity, but other constituent entity resident in India of the international group has been designated as the alternate reporting entity by the group, such other constituent entity resident in India will have obligation to file the report under section 286(2). *The tax auditor should verify in the case of the assessee if any of the above four situations exist. The tax auditor should verify if the assessee whose parent is a non-resident has filed Form No. 3CEAC.Form No.3CEC will indicate if the assessee or another constituent entity resident in India has been designated as the reporting entity for the international group. The tax auditor may obtain necessary certificate from the assessee in respect of constitution of the international group, entities that are resident in India and not resident in India and entity if appointed as the alternate reporting entity.* If none of the above four situations described above exists, the reply to clause 43(a) will be negative.
	(b)	If yes, please furnish the following details: (i) Whether report has been furnished by the assessee or its parent entity or an alternate reporting entity (ii) Name of parent entity (iii) Name of alternate reporting entity (if applicable) (iv) Date of furnishing of report	If the assessee is liable to file Form 3CEAC, the tax auditor has to verify whether the necessary compliance as prescribed in section 286 has been done and the requisite information has been furnished by the assessee. If the assessee has filed a report, the tax auditor should verify acknowledgement for furnishing the same. If the report has been filed either by the parent of the assessee or another constituent entity of the international group, the tax auditor should ask for a copy of the report and acknowledgement for filing the report. The term parent entity is defined in section 286(9)(h). The tax auditor should examine which is the parent entity and verify whether the same has been reported. The term 'alternate reporting entity' is defined in section 286(9)(c). The tax auditor should examine whether any such alternate reporting entity exists and if yes, name of the alternate reporting entity should be stated. From acknowledgement for furnishing report as referred to in section 286(2), date for furnishing of the said report should be stated. The tax auditor may obtain necessary certificate from the assessee in respect of the constituent entity.

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44.	Break-up of total expenditure of entities registered or not registered under the GST. Specifying total amount of expenditure incurred during the year, expenditure in respect of entities registered under GST relating to goods or services exempt from GST, relating to entities falling under composition scheme, relating to other entities and total payment to registered entities. Expenditure relating to entities not registered under GST also need to be specified.	This clause requires to provide details of the expenditure in respect of entities registered under GST, which is further sub-classified into four categories as follows: (a) Expenditure relating to goods or services exempt from GST - Here, the value of all inward supply of goods or services which are exempt from GST is to be given. (b) Expenditure relating to entities falling under composition scheme - Value of all inward supplies from composition dealers is to be mentioned here. (c) Expenditure relating to other registered entities - Value of all inward supplies from registered dealers, other than supplies from composition dealers and exempt supply from registered dealers, are to be mentioned here. (d) Total payment to registered entities - The word 'payment' should harmoniously be interpreted as 'expenditure', as the combined heading is 'Expenditure in respect of entities registered under GST'. Hence, the total expenditure in respect of registered entities i.e., sum total of values reported in (a), (b) and (c) should be reported in (d) above. Under this clause, expenditure relating to entities not registered under GST is also to be given. The value of inward supply of goods and/or services received from unregistered persons should be reported here. It is important to differentiate the 'current status' of supplier's registration from their status as it was at the time of supply. There are several instances where registration may be cancelled with effect from an earlier date which may be prior to the date of supply to assessee. Events occurring after balance sheet date that alter the data relating to year under audit does not alter the nature of the expenditure, that it is from registered suppliers. Auditors may elect to extend their review up to a certain cut-off date or not at all. In either case, disclosure of notes of the position with regard to (i) known cancellations and (ii) treatment in the disclosure considering possibility of such cancellations would go a long way in making the report meaningful and unambiguous. Under clause 44, the language used is "expenditure in respect of". Since, the word used is 'expenditure', it is necessary that the capital expenditure should also be reported in the format prescribed. Separate reporting of capital expenditure will provide ease in reconciliation.

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		In case of multiple GST registrations of an entity, there is likelihood of inter-branch supply, which is eliminated at the consolidated financials. Proper reconciliation for such type of transactions may be kept on record. This report may be prepared for an entity as a whole or for a branch thereof, as may be audited and accordingly the information in these columns may have to be filled up consolidating the expenditure incurred under various GST registrations. ***Note -*** *It may be noted that any expenditure that is incurred, wholly and exclusively for business or profession of the assessee qualifies for the deduction under the Act. Registration or otherwise of the payee under the GST Act has no relevance in considering allowability of expenditure.*

20.5 SUMMARY OF PROVISIONS IN RESPECT OF WHICH INFORMATION TO BE FURNISHED IN FORM 3CD

The following table will give you a bird's eye view of certain provisions for which the information is to be given in Form 3CD

Section of the Income-tax Act, 1961	Clause No. of the Guidance Note	Details to be furnished
44AB	8	Indicate the relevant clause of section 44AB under which the audit has been conducted
115BA,115BAA, 115BAB, 115BAC, 115BAD, 115BAE	8a	Mention whether the individual/HUF/AOP/BOI has opted to shift out of the default regime u/s 115BAC. In case of companies/co-operative societies, mention whether they have opted for concessional rates of taxation under the special regimes under section 115BAA/115BAB or 115BAD/115BAE, as the case may be.
44AA	11(a)	Mention whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.

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44AD,44ADA, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, ***44BBC*** Chapter XII-G (provisions relating to shipping business)	12	Mention whether the profit or loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant section.
145(2)	13(d)	Mention whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards.
145A	14(b)	Review the methods of valuation adopted for valuation of closing stock and compare the same with the method prescribed under section 145A.
45(2)	15	Mention the details of capital asset converted into stock- in-trade
28	16	Indicate the amounts falling within the scope of section 28 which are not credited to the profit and loss account
43CA or 50C	17	Where any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, furnish the following details: (a) Details of property (b) Consideration received or accrued (c) Value adopted or assessed or assessable
32	18	Mention the particulars of depreciation allowable as per the Income-tax Act, 1961 in respect of each asset or block of asset in the mentioned format. Section 43(1) and Explanations thereunder and section 36(1)(iii) also to be kept in mind.
33AB, 33ABA, 35(1)(i), 35(1)(ii), 35(1)(iia), 35(1)(iii), 35(1) (iv), 35(2AA), 35ABA, 35(2AB), 35ABB, 35AD, 35CCA, 35CCC, 35CCD, 35D, 35DD, 35DDA, 35E	19	State the amounts admissible under these sections
36(1)(ii)	20(a)	Indicate the sums paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend

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36(1)(va) read with 2(24)(x)	20(b)	Mention the details of contributions received from employees for various funds as referred to in section 36(1)(va)
37	21(a)	Mention the details of amounts debited to profit and loss account, being in the nature of capital, personal, advertisement expenditure, expenditure incurred at clubs, expenditure for any purpose which is an offence or is prohibited by law or expenditure by way of penalty or fine for violation of any law (enacted in India or outside India), expenditure by way of other penalty or fine not covered above, expenditure incurred to compound an offence under any law for the time being in force, in India or outside India, expenditure incurred to provide any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guideline, as the case may be, for the time being in force, governing the conduct of such person
40(a)(i)/(ia)/(iib)/ (iii)(iv)/(v)	21(b)	Indicate the amounts inadmissible under section 40(a)(i)/(ia) with details of payment on which tax has not deducted or after deduction, tax has not been paid on or before the due specified under section 139(1) and the amount inadmissible under section 40(a)(iib), 40(a)(iii), 40(a) (iv), 40(a)(v)
40(b)/40(ba)	21(c)	State the amounts debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof
40A(3)/ 40A(3A)	21(d)	State the amount of disallowance under section 40A(3)/ deemed income under section 40A(3A)
40A(7)	21(e)	Indicate the provision for payment of gratuity not allowable under section 40A(7)
40A(9)	21(f)	State the amount of payment made to an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of person, body of individuals, society registered under society registration act or other institutions which is not allowable

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ICDS X	21(g)	Examine the particulars of any liability of a contingent nature debited to the profit and loss account.
14A	21(h)	Verify and state the amount of expenditure relatable to the income which does not form part of total income which is not allowed as deduction in terms of section 14A
36(1)(iii)	21(i)	Indicate the amount inadmissible under the proviso to section 36(1)(iii)
Section 23 of MSMED Act, 2006	22	Indicate the amount of interest inadmissible under section 23 of the MSMED Act, 2006.
40A(2)(b)	23	Mention the particulars of payments made to persons specified under section 40A(2)(b)
33AB or 33ABA	24	Report the deemed income chargeable as profits and gains of business under the circumstances specified in section 33AB(4)/(5)/(7)/(8) or in section 33ABA(5)/(7)/(8)
41	25	Indicate the amount of profit chargeable to tax under section 41 and computation thereof
43B(a)/(b)/(c)/(d)/ (e)/ (f)/ (g)/ ***(h)***	26	Indicate the amount of expenditure not allowable as per section 43B.
-	27(a)	Indicate the amount of Central Value Added Tax credits availed of or utilised during the previous year and its treatment in the profit and loss account and treatment of outstanding Central Value Added Tax credits in the accounts.
-	27(b)	Mention the particulars of income or expenditure of prior period credited or debited to the profit and loss account.
56(2)(ix)	29A(a)/(b)	Indicate the sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if such sum is forfeited and the negotiations do not result in transfer of such capital asset.
56(2)(x)	29B(a)/(b)	Mention the amount which is treated as income in the hands of a person who received in any previous year, from any person or persons money, immovable property, or other property and conditions stated in the clause are satisfied.
69D	30	Details of the amount borrowed on hundi (including interest on such amount borrowed) and details of

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		repayment otherwise than by an account payee cheque, are required to be indicated
92CE	30A(a)/(b)	Mention the details of primary adjustment to transfer price and details of excess money available with the AE.
94B	30B(a)/(b)	Mention the details of expenditure incurred during the previous year by way of interest or of similar nature respect of debt issued by a non-resident Associated Enterprises under section 94B.
96	30C(a)/(b)	Mention the details of impermissible avoidance arrangements as referred to in section 96 entered into by the assessee during the previous year and to quantify the tax benefit arising in the aggregate in the previous year to all parties to such arrangement.
269SS	31(a)/(b)	Furnish the particulars of each loan or deposit or specified sum in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year.
269ST	31(ba)/ (bb)/ (bc)/ (bd)	Furnish the particulars of each receipt in an amount exceeding the limit specified in section 269ST.
269T	31(c)/(d)/(e)	Furnish the particulars of each repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T made during the previous year.
	32(a)	Furnish the details of brought forward loss or depreciation allowance to the extent available.
79	32(b)	Furnish the details of change in the shareholding of the company taken place during the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of section 79.
73	32(c)	Furnish the details of speculation loss incurred by the assessee during the previous year.
73A	32(d)	Furnish the details of loss incurred in respect of specified business during the previous year.
Explanation to section 73	32(e)	Mention whether the company is deemed to be carrying on a speculation business as referred in Explanation to section 73.

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Chapter VI-A or section 10AA	33	Provide section-wise details of deductions, if any, admissible under Chapter VIA or Chapter III.
-	34(a)/(b)	Mention whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB.
201(1A)/206C(7)	34(c)	Mention the details of the amount of interest under section 201(1A) or section 206C(7).
-	35(a)/(b)	Provide quantitative details of principal items of goods, in case of a trading or manufacturing concern.
2(22)(e)	36A	Mention whether the assessee has received any amount in the nature of dividend as referred to in section 2(22)(e)
2(22)(f)	***36B***	*Mention whether the assessee has received any amount for buyback of shares as referred to in section 2(22)(f)*
-	37	Mention the details of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the cost auditor.
-	38	Mention the details of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified under audit was conducted under the Central Excise Act, 1944.
-	40	Provide the details regarding turnover, gross profit, etc. for the previous year and preceding previous year.
-	41	Provide the details of demand raised or refund issued during the previous year under any tax laws other than Income-tax Act, 1961.
-	42(a)/(b)	Mention whether the assessee is required to furnish statement in Form No. 61 or Form No. 61A or Form No. 61B.
286(2)	43	Mention whether the assessee or its parent entity or alternate reporting entity is liable to furnish the report as referred to in section 286(2).
-	44	Provide the break-up of total expenditure of entities registered or not registered under the GST.

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20.6 PENALTY FOR FAILURE TO FURNISH TAX AUDIT REPORT [SECTION 271B]

If any person fails to get his accounts audited in respect of any previous year furnish a tax audit report as required under section 44AB, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum equal to

- ½ % of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years or
- ₹ 1,50,000,

whichever is less.

However, according to section 273B, no penalty shall be imposed if reasonable cause for such failure is proved.

Example: DB Ltd.'s turnover for the F.Y. 2025-26 is ₹ 15 crore from textile business and ₹ 3 crore from petrol pump business. All transactions are through banking channels. DB Ltd. prepared its financial statements for textile business and got its accounts audited and furnished the same to the Income Tax department within the prescribed time. The company was of the view that since the turnover from the petrol pump business is ₹ 3 crore and all transactions were through banking channels, the accounts of petrol pump business were not required to be audited. Section 44AB is attracted where the total turnover from business exceeds the threshold of ₹ 10 crore i.e., total turnover indicates that the turnover from all businesses are to be aggregated.

Taking the facts from Example, the Assessing Officer wants to invoke penalty on ₹ 18 crore i.e., ₹ 15 crore plus ₹ 3 crore, considering ½% of the total turnover. Since the assessee has already furnished the report for ₹ 15 crore, the penalty u/s 271B shall be invoked only on turnover of ₹ 3 crore and not on turnover of ₹ 18 crore.

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CASE STUDIES

Case Studies have been included to underline the ethical aspects which have to be considered by a chartered accountant while issuing tax audit report under section 44AB as well as audit reports and certificates under the other provisions of the Income-tax Act, 1961. These case studies are based on the orders passed by the Disciplinary Committee of ICAI and/or the final orders passed by the Appellate Authority constituted by the Central Government under the Chartered Accountants Act, 1949.

Every Case Study begins with "A Word about the Case Study" which, as the phrase suggests, gives an overview as to what the case study is about. Thereafter, each case Study is presented in the following manner, highlighting the -

I. Relevant provisions of income-tax law

II. Relevant clauses of Part I of the Second Schedule to the Chartered Accountants Act, 1949

III. Facts of the case

IV. Contentions/Submissions of the chartered accountant

V. Bases for Conclusion

VI. Key Takeaways

Additional categories have also been included in a Case Study, if found necessary.

CASE STUDY 1

A Word about the Case Study		
This Case Study highlights the ethical aspects which have to be considered by a chartered accountant while issuing tax audit report. The issue involved in this Case Study relates to the responsibility of the chartered accountant in relation to reporting in Clause 34(a) and clause 21(b) of Form 3CD for non-deduction of tax at source and consequent disallowance under section 40(a)(ia).		
I	**Relevant provisions of income-tax law**	
	(1)	**Section 194J** Section 194J requires tax deduction at source@10% on, *inter alia*, fees for professional services, at the time of credit of such sum to the account of the payee or at the time of payment, whichever is earlier. As per clause (a) of the *Explanation* to section 194J, "Professional services" means services rendered by a person in the course of carrying on, *inter alia*, medical profession.

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(2) **Section 40(a)(ia)**

Section 40(a)(ia) provides for disallowance of 30% of the sum payable to a resident, on which tax is deductible at source under Chapter XVII-B of the Income-tax Act, 1961 and such tax has not been deducted or after deduction, has not been paid on or before the due date for filing return of income u/s 139(1).

(3) **Reporting requirement in Clause 21(b) of Form 3CD (Relevant Extract)**

Amounts inadmissible under section 40(a)

(ii) as payment referred to in sub-clause (ia)

(A) Details of payment on which tax is not deducted:

(I) date of payment

(II) amount of payment

(III) nature of payment

(IV) name and address of the payee

(4) **Reporting requirement in Clause 34(a) of Form 3CD (Relevant Extract)**

Whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB, if yes, please furnish –

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
TAN	Section	Nature of payment	Total amt of payment or receipt of the nature specified in column (3)	Total amt on which tax was required to be deducted or collected out of (4)	Total amt on which tax was deducted or collected at specified rate out of (5)	Amt of tax deducted or collected out of (6)	Total amt on which tax was deducted or collected at less than specified rate out of (7)	Amt of tax deducted or collected on (8)	Amt of TDS or TCS not deposited to the credit of the Central Govt. out of (6) & (8)

II **Relevant clause of Part I of the Second Schedule to the Chartered Accountants Act, 1949**

As per clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

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III	**Facts of the case**	
	A survey was conducted on the premises of a hospital consequent to which it was found that the hospital had made payments of consultancy charges to doctors, without deducting tax under section 194J, even though the payments to each doctor exceeded the threshold of ₹ 30,000 *(₹ 50,000 w.e.f 1.4.2025)*. In the tax audit report, the amount inadmissible under section 40(a)(ia) was mentioned as NIL in clause 21(b) of Form 3CD. Also, there was no mention of or reporting of TDS section 194J in clause 34(a).	
IV	**Contentions of the Chartered Accountant**	
	The Chartered Accountant contended that since the doctors did not provide any professional service to the hospital, the provisions of section 194J would **not** be attracted. He explained his contention that sometimes, due to unavoidable reasons/circumstances, the hospital collected the consultation fees on behalf of the doctors and the same is then paid/remitted to the doctors. Such payments were not expenses of the hospital and hence, the question of TDS does not arise. He also contended that as per the decision passed by the Special Bench of the Tribunal (Vishakapatnam) in case of *Merilyn Shipping and Transports v. ACIT*, section 40(a)(ia) is applicable only in respect of the amounts of expenditure which are payable as on 31st March of every year and it cannot be invoked to disallow the amounts which have been actually paid during the previous year, without deduction of tax at source. In this case, all payments were made to the respective doctors before 31st March. Therefore, according to him, the payment made to doctors by way of reimbursement of the fees collected from patients does not fall under the ambit of TDS and even if it does, the same would not be disallowed under section 40(a)(ia) due to the above decision. ***Note*** – *It may be noted that the Supreme Court, in Palam Gas Service v. CIT (2017) 394 ITR 300, observed that when the entire scheme of obligation to deduct the tax at source and paying it over to the Central Government is read holistically, it cannot be held that the word "payable" occurring in section 40(a)(ia) refers only to those cases where the amount is yet to be paid and does not cover the cases where the amount is actually paid. Once the section mandates a person to deduct tax at source not only on the amounts payable but also when the sums are actually paid to the contractor, any person who does not adhere to this statutory obligation has to suffer the consequences which are stipulated in the Act itself*. *Also, the CBDT has, vide Circular No.10/2013 dated 16.12.2013 that the provisions of section 40(a)(ia) are amply clear that the term "payable" would include the "amounts which are paid during the year".* *The case in question relates to a period prior issuance of the Circular and the pronouncement of the Supreme Court ruling.*	
V	**Basis for Conclusion**	
	(1)	As per the Guidance Note on Tax Audit issued by ICAI, the tax auditor is required to report as to whether tax is deductible under any section of Chapter XVII-B and any amount is inadmissible u/s 40(a)(ia) under clauses 34(a) and 21(b), respectively.

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	(2)	**If tax has not been deducted on the basis of Court judgement in a particular case, then, the tax auditor is required to disclose the same in his report so as to enable the Income-tax department to know the reason as to why tax was not deducted by the assessee.**
	(3)	On perusal of the profit and loss account of the hospital *vis-à-vis* the working papers of the CA, it has been noted that consultancy charges were shown as expenses in the Profit and Loss account of the hospital. Thus, the contention that the hospital collected fees on behalf of doctors and payment of such fees is not expenditure for attracting TDS u/s 194J is not correct, since such expenditure has been debited to the profit and loss account
	In this case, the CA had ignored the reporting requirements in Form 3CD and had not exercised due diligence in carrying out his professional duties. Hence, he was held guilty of professional misconduct falling within the meaning of clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.	
VI	**Key Takeaway**	
	The tax auditor should exercise due diligence while reporting under various clauses of Form 3CD. In case he has taken a view that tax is not deductible by virtue of a Court judgement, like in this case, he should disclose the same in his report.	

CASE STUDY 2

A Word about the Case Study		
This Case Study highlights the ethical aspects which have to be considered by a chartered accountant while issuing tax audit report. The issue involved in this Case Study relates to the responsibility of the chartered accountant in relation to reporting in clause 21(d) of Form 3CD of expenditure exceeding ₹ 10,000, for which payment is made otherwise than by way of account payee cheque/bank draft, ECS or other prescribed electronic modes. Such expenditure would attract disallowance under section 40A(3) of the Income-tax Act, 1961.		
I	**Relevant provisions of income-tax law**	
	(1)	**Section 40A(3)**
		Where the assessee incurs any expenditure, in respect of which payment or aggregate of payments made to a person in a day otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft or use of electronic system through bank account or through such other prescribed electronic modes exceeds ₹ 10,000, such expenditure shall not be allowed as a deduction. The prescribed electronic modes are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay. The provision applies to all categories of expenditure involving payments for goods or services which are deductible in computing the taxable income.

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(2) Reporting requirement in Clause 21(d) of Form 3CD

(A) On the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, please furnish the details -

Serial No.	Date of payment	Nature of payment	Amount	Name and PAN/Aadhar No. of the payee, if available

II Relevant clauses of Part I of the Second Schedule to the Chartered Accountants Act, 1949

As per clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

As per clause (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.

III Facts of the case

A search was conducted u/s 132 of the Income-tax Act, 1961 in the case of PQR Jewellers, a leading gold jewellery retail chain, on 30.1.2026. As part of the post search enquiries, data from the billing software was analysed. On analysis of this data, it was found that the concern was involved in violation of section 40A(3) in a major way to the tune of ₹ 30 crores in the purchase of old gold.

The tax audit report of the concern for the P.Y. 2024-25 was issued by a chartered accountant u/s 44AB of the Income-tax Act, 1961. The audit report has a specific clause, namely, clause 21(d), concerning compliance of section 40A(3). However, the chartered accountant had not properly filled up this clause and had failed to highlight the extensive violation of section 40A(3).

IV Contentions of the Chartered Accountant

The chartered accountant submitted that he had done test checks and he did not come across any payment which warrants disclosure in Form 3CD. He also submitted that standing instructions were given by the management of the entity to the employees to make payments above ₹ 10,000 only through account payee cheques and/or bank drafts or other permissible electronic modes. Copy of these instructions were verified by him. He had also taken a representation from the Management that net payment in cash to any person in a day did not exceed ₹ 10,000.

Therefore, the tax auditor submitted that he had taken reasonable professional care and on the basis of test checks, nothing came to his attention to warrant a reporting of violation of section 40A(3).

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V	**Contentions of the Director of Income-tax (Investigation)**	
	The DIT (Investigation) made the following contentions -	
	(1)	As part of the post search enquiries, data from the billing software was analysed and violations u/s 40A(3) to the tune of ₹ 30 crores were noticed. In order to verify the findings culled from digital data, some of the customers whose whereabouts were available from computer records were contacted and their statements were recorded under oath. These customers admitted under oath that they had sold old gold and received the amounts (all exceeding ₹ 10,000) in cash. The fact which emerges from the enquiries is that PQR Jewellers purchase old gold and make payments for these purchases in cash, even if they exceed ₹ 10,000.
	(2)	Though the audit report has a specific clause, namely, clause 21(d) concerning compliance of section 40A(3), it was not properly filled up and the auditor failed to highlight the extensive violation of section 40A(3). He drew reference to the Guidance Note on Tax Audit issued by ICAI which states that there may be practical difficulties in verifying whether each payment is made through account payee cheque or bank draft or ECS or other prescribed electronic modes. Where the reporting has been done on the basis of the certificate of the assessee, the fact has to be reported as an observation in para 3 of Form 3CA and para 5 of Form 3CB, as the case may be. The tax auditor, in his report, may comment on such violation as under:- "It is not possible for me/us to verify whether the payments in excess of ₹ 10,000 have been made otherwise than by account payee cheque or bank draft or prescribed electronic modes, as the necessary evidence is not in the possession of the assessee". However, in this case, the tax auditor had mentioned "Yes" in response to the statement in sub-clause (A) of Clause 21(d) on whether the expenditure covered under section 40A(3) read with Rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft.
	(3)	As per the Guidance Note, for the purpose of furnishing the required particulars, the tax auditor should have obtained a list of all cash payments in respect of expenditure exceeding ₹ 10,000/- made by the assessee during the relevant year which should include the list of payments exempted in terms of Rule 6DD with reasons. This list should have been verified by the tax auditor with the books of accounts in order to ascertain whether the conditions for specific exemption granted under Rule 6DD are satisfied. Details of payments, which do not satisfy the above conditions, should have been stated under this clause. He should have made use of the audit tools which are available to find out such payments expeditiously and accurately where the data is voluminous.
	(4)	Reference was drawn to the CBDT Circular No. 387, dated 06.07.1984, which clarifies the purpose of tax audit. The relevant extract of the circular is given below:- "*A proper audit is for tax purposes would ensure that the books of accounts and other*

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		records are properly maintained, that they faithfully reflect the income of the tax payer and he correctly makes claims for deduction. Such audit would also help in preventing fraudulent practices. It can also facilitate the administration of tax laws by a proper presentation of the accounts before the tax authorities and considerably saving the time of the Assessing Officers in carrying out routine verifications like checking correctness of totals and verifying whether purchases and sales are properly vouched or not. The time of the Assessing Officers thus saved could be utilised for attending to more investigational aspects of the case".
	(5)	In this case, given the massive scale of violation of section 40A(3), the chartered accountant has not exercised reasonable diligence before offering the remarks; and the audit in this case was not carried out as per the Guidance Note of the ICAI and the CBDT Circular.
VI	**Basis for Conclusion**	
	(1)	In Form 3CD, particulars in respect of cash payments made in violation of Section 40A(3) are required to be reported, as such payments are inadmissible as deduction.
	(2)	The contention of the chartered accountant that the test checks conducted by him did not reveal the aforesaid violation was not tenable. Considering the nature of business of the assessee, namely, jewellery business, the onus was on the chartered accountant to verify the same before reporting in Form 3CD. Stating the fact that no such transaction was identified during test check is not acceptable because such payments can be identified independent of bank transaction provided the chartered accountant had extended the verification to cover the same. Mere reliance on certificate issued by the management is not acceptable.
	(3)	The chartered accountant was, thus, required to point out in tax audit report, the violation of the provisions of section 40A(3) thereof involving expenditure to a person in a day exceeding ₹ 10,000 otherwise than by way of account payee cheque/bank draft, ECS and other prescribed electronic modes. However, the chartered accountant has certified that there were no such instance, though such instances aggregate to a large quantum of ₹ 30 crores.
	Thus, in this case, the chartered accountant was held guilty of professional misconduct falling within the meaning of clauses (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.	
VII	**Key Takeaway**	
	The chartered accountant should consider the nature of business of the assessee and accordingly undertake necessary checks to verify whether there are violations in the provisions of the Act, like cash payments in violation of section 40A(3) made, as in this case, by the assessee engaged in jewellery business. He should make use of the audit tools which are available to find out such payments expeditiously and accurately where the data is voluminous.	

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CASE STUDY 3

A Word about the Case Study		
This Case Study highlights the ethical aspects which have to be considered by a chartered accountant while issuing Form 10CCB. While issuing Form 10CCB, the chartered accountant has to ensure compliance with the conditions stipulated under the relevant section (in this case, section 80-IA) for claim of deduction. Since the profit-linked deductions are available for a specified period, ten years in case of deduction u/s 80-IA, the chartered accountant has to ensure that the ten year period has not already elapsed. In case he notices the error after issuing Form 10CCB, he should withdraw the report timely and inform the same to the assessee immediately.		
I	**Relevant provisions of income-tax law**	
	(1)	**Section 80-IA** Section 80-IA provides for deduction of 100% of the profits and gains derived from the business of, *inter alia*, developing or operating and maintaining or developing, operating and maintaining any infrastructure facility for 10 consecutive assessment years. Section 80-IA(7) requires audit of accounts and furnishing of audit report in the prescribed form on or before the specified date i.e., 30th September of the assessment year for claim of such deduction.
	(2)	**Rule 18BBB and Form 10CCB** Rule 18BBB requires the audit report under section 80-IA(7) to be furnished in Form 10CCB along with the copy of the agreement of the enterprise with the Central Government or State Government or the local authority for carrying on the business of developing or operating and maintaining or developing, operating and maintaining the infrastructure facility. In Form 10CCB, the chartered accountant gives a declaration that in his opinion the enterprise satisfies the conditions stipulated in section 80-IA and the amount of deduction claimed thereunder is as per the provisions of the Income-tax Act, 1961 and meets the required conditions.
II	**Relevant clause of Part I of the Second Schedule to the Chartered Accountants Act, 1949**	
	As per clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties	
III	**Facts of the case**	
	M/s. XYZ & Co. is a firm engaged in developing, operating and maintaining a highway project filed its return of income for A.Y.2016-17 on 30th September, 2016 claiming deduction under section 80-IA, on the basis of Form 10CCB issued by the chartered accountant. However, in August, 2017, it came to the notice of the chartered accountant that the ten year period for which the company had been eligible to claim deduction and	

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	had, in fact, claimed deduction had expired in A.Y.2015-16. The chartered accountant withdrew the audit report in Form 10CCB and advised the firm to file a revised return u/s 139(5). At that point of time, the time limit for filing a revised return was one year from the end of the relevant assessment year i.e., upto 31.3.2018. Accordingly, the firm filed a revised return u/s 139(5) for A.Y.2016-17 on September, 2017. The Assessing Officer completed the assessment on the basis of the revised return and issued the assessment order on 1.3.2019.	
IV	**Contentions of the Chartered Accountant**	
	The Chartered Accountant contended that as soon as he came to know about the error, he withdrew his report in Form 10CCB and informed the assessee accordingly. The assessee, accordingly, filed a revised return withdrawing the claim under section 80-IA. He informed the Commissioner of Income-tax about the same in March 2019 at the first available opportunity since he was neither the tax auditor of the company nor was he representing the assessee before the tax authorities. He added that the Assessing Officer had completed the assessment on the basis of the revised return. Further, according to him, his report in Form 10CCB was neither the subject matter at the time of assessment nor at the time of penalty proceedings.	
V	**Basis for Conclusion**	
	(1)	The claim for deduction under section 80-IA was made by the assessee in the original return, supported by Form 10CCB issued by the chartered accountant. However, as soon as the chartered accountant came to know of the error, he withdrew his report and informed the assessee, who also filed a revised return withdrawing the claim under section 80-IA.
	(2)	Therefore, the chartered accountant had withdrawn his audit report in Form 10CCB and informed the assessee, who also had filed a revised return immediately withdrawing the claim for deduction under section 80-IA.
	Accordingly, the chartered accountant was held "not guilty" of professional misconduct under clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.	
VI	**Key Takeaway**	
	The chartered accountant should exercise due care while issuing audit reports and ensure that all the conditions stipulated under the relevant provisions of the Income-tax Act, 1961, including the time period for claim of deduction, are satisfied. In case he notices an error subsequently, he should immediately withdraw his report, and communicate the same to the assessee immediately.	

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CASE STUDY 4

A Word about the Case Study
This Case Study highlights the ethical aspects which have to be considered by a chartered accountant while issuing audit report in Form 10CCB and conducting tax audit. The issue involved in this Case Study relates to the responsibility of the chartered accountant to ensure compliance with the stipulated conditions for claim of profit-linked deduction under Chapter VI-A while issuing audit report. He has to ascertain whether a certain activity carried out by the assessee would constitute "manufacture" for claim of deduction under section 80-IE and whether the conditions for claim of deduction have been satisfied in a case where the assessee is a company which had taken over a sole proprietary concern. The actual case on the basis of which this Case Study is developed was in relation to section 80-IB for the A.Y.2002-03 to A.Y.2008-09, prior to the insertion of definition of "manufacture" in the Income-tax Act, 1961 w.e.f. 1.4.2009. The Case was decided in the year 2014 and reference was invited to the definition of "manufacture" under the Income-tax Act, 1961 by the Assistant Commissioner of Income-tax (ACIT). However, in the final decision, the meaning assigned to "manufacture" under different laws were resorted to considering that there was no definition in the Act during the relevant period (i.e., A.Y.2002-03 to A.Y.2008-09). In this Case Study, the dates have, therefore, been modified to a period post insertion of the definition and reference has been given to section 80-IE, since section 80-IB is no longer relevant for manufacture or production of article or thing.

I	**Relevant provisions of income-tax law**	
	(1)	**Section 80-IE**
		Section 80-IE applies to an undertaking which has begun **to manufacture or produce any eligible article or thing** on or before 1.4.2017. Deduction of 100% of profits and gains from such business would be available for ten consecutive assessment years from the year in which it begins to manufacture or produce eligible article or thing. The conditions to be satisfied for claim of deduction are that the undertaking should **not** be formed by - **(i) splitting up or the reconstruction of a business already in existence and** **(ii) the transfer to a new business, of machinery or plant previously used for any purpose.**
	(2)	**Section 2(29BA)**
		"**Manufacture**" with its grammatical variations, means a change in a non-living physical object or article or thing – (a) resulting in transformation of the object or article or thing into a **new and distinct object or article** or thing having a **different name, character and use**; or (b) bringing into existence of a **new and distinct object or article** or thing with a **different chemical composition or integral structure**.

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	(3)	**Form 10CCB**
		This is the form for audit report, *inter alia,* u/s 80-IE. It requires a chartered accountant to give a declaration that the undertaking satisfies the conditions stipulated under section 80-IE and the amount of deduction claimed is as per the provisions of the Income-tax Act and meets the required conditions.
II	**Relevant clause of Part I of the Second Schedule to the Chartered Accountants Act, 1949**	
	As per clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.	
III	**Facts of the case**	
	Alpha Packaging Services Ltd. located in Guwahati has been claiming deduction under section 80-IE of the Income-tax Act, 1961 since P.Y.2016-17 on the ground that it was engaged in manufacture or production of an eligible article or thing. A survey conducted on the company followed by a scrutiny of the case showed that the company was merely involved in packaging washing powder of a leading brand, Turf, obtained from Unilever Ltd. and giving the same back to them. The tax audit report as well as the report in Form 10CCB for claiming deduction under section 80-IE was issued by the same chartered accountant.	
	A show cause notice was issued by the ACIT to the chartered accountant stating the company got undue relief under section 80-IE for the last seven years on the basis of his report in Form 10CCB to the effect that the concern was involved in manufacturing/production of an eligible article or thing.	
IV	**Contentions of the ACIT** The ACIT contended that the report in Form 10CCB issued by the chartered accountant is **not** correct since – - The company is not in any way involved in manufacturing or production of any article or thing. The company is merely involved in packaging of washing powder that was given by LMN Ltd. It was not involved in manufacturing of any pouch or cover or sachet which was independently saleable as a product in the market. - The company is not a new undertaking because it had taken over a proprietary concern and hired the plant and machinery of the said proprietary concern. Hence, it did not satisfy the condition for claim of deduction u/s 80-IE.	
V	**Submissions of the Chartered Accountant and the ACIT's counter contentions**	

	CA's Submission	ACIT's Contention
1.	The report in Form 10CCB was only a declaration not a certificate	This contention is not acceptable as Form 10CCB is a declaration by the chartered accountant that the undertaking satisfies the stipulated conditions

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			for claim of deduction and the amount claimed is as per the provisions of the Income-tax Act, 1961 and meets the required conditions.	
	2.	Reliance on the Certificate of Directorate of Industry, Assam	The activity(s) which amount to manufacture or production is different under each Act. The chartered accountant issuing Form 10CCB has to ensure that the same amounts to "manufacture" as per the definition given in section 2(29BA) of the Income-tax Act, 1961.	
	3.	Reference to Supreme Court ruling in *ITO v. Arihant tiles and Marbles Pvt. Ltd.* wherein it was held that only when the marble blocks are cut into slabs and there is an activity of polishing and ultimate conversion of block into polished tiles, such slabs and tiles ultimately produced are held to be manufacturing activity because a new product has emerged.	Even according to the Supreme Court ruling, the condition to be fulfilled is that there should be emergence of a new and distinct commodity. In the case of the assessee, the washing powder remains a washing powder. The original product and the end product remained the same. No new and distinct commodity emerges as a result of packaging. Further, the end product is patented by Unilever and it cannot undergo change in any manner.	
	4.	The proprietary business was taken over by the company with all assets and liabilities except plant and machinery pertaining to the old units. The plant and machinery was not transferred to the company but given on hire to it and for using the machines, payment of hire charges was made and shown in the statement of profit and loss. Hence, the company has not violated any condition.	The assessee did not own plant and machinery, and such assets hired by the assessee amounted to transfer and thus, the company was not entitled to deduction u/s 80-IE.	
VI	**Basis for Conclusion in the original case**			
	(1)	The definition of manufacture was inserted with effect from 1.4.2009. Since the case in question actually related to a period prior to insertion of definition of "manufacture" in the Income-tax Act, 1961, it was decided that though packaging or repackaging of a product is not manufacturing activity, the further activity of removing dust, grinding can be treated as manufacturing activity because the said activity changes the quality of the product and makes the product commercially marketable in different form. This		

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		conclusion emerged on the basis of Court ruling in relation to Excise law and other case laws holding that provisions of a taxing statute granting incentive for promoting growth should be construed liberally.
	(2)	Certain Tribunal and High Court rulings have held that in order to constitute an industrial undertaking (which was a requirement under section 80-IB), the industrial unit need not necessarily own its plant and machinery and hiring of plant and machinery would not inhibit the ability of industrial unit or company to claim deduction.
	(3)	Considering the rationale emerging from the Court decisions as regards whether the activity of packaging constituted manufacture/production and whether hiring of plant and machinery from the sole proprietary concern which was taken over by the company would be in violation of the stipulated condition, the benefit of doubt was extended to the chartered accountant and he was held "not guilty of professional misconduct".
VII	**Key Takeaways in the context of the current provisions of Income-tax law**	
	(1)	In the current context, however, the definition of "manufacture" as per section 2(29BA) of the Income-tax Act, 1961 would be relevant. Therefore, the chartered accountant giving a declaration in Form 10CCB has to ensure that the activity carried on by the assessee amounts to "manufacture" as per the said definition. He may rely on judicial rulings based on the definition of manufacture u/s 2(29BA) or a similar definition under any other law for this purpose. It may be noted that "making the product commercially marketable", which was one of the bases for conclusion in the actual case is not included in the definition of manufacture under section 2(29BA).
	(2)	With the introduction of several anti-avoidance provisions in the Income-tax Act, 1961, in the last decade, the action of taking over all assets and liabilities of the sole proprietary concern except plant and machinery and subsequently hiring the plant and machinery from the said concern itself in order to claim deduction under section 80-IE may be viewed as a tax avoidance measure. This may be viewed as an arrangement entered into solely or primarily for the purpose of obtaining a tax advantage and even GAAR provisions may be attracted if the tax benefit is more than ₹ 3 crores. Therefore, the chartered accountant must ensure satisfaction of conditions for claiming deduction under section 80-IE before issuing the audit report under Form 10CCB.

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CASE STUDY 5

A Word about the Case Study	
This Case Study highlights the ethical aspects which have to be considered by a chartered accountant while issuing certificate in Form 15CB. The issue involved in this Case Study relates to the responsibility of the chartered accountant to examine the agreement between the remitter and the beneficiary as well as the relevant documents and books of account to ascertain the nature of remittance and determine the rate of deduction of tax at source.	
I	**Relevant provision of income-tax law**
	Section 195(6) and Rule 37BB The person responsible for paying to a non-corporate non-resident or a foreign company, any sum, whether or not chargeable under the provisions of the Income-tax Act, 1961, has to furnish information relating to payment of such sum in the prescribed form and manner. Rule 37BB(1) provides that the person responsible for paying to a non-corporate non-resident or a foreign company, any sum chargeable under the provisions of the Income-tax Act, 1961, has to furnish the information in Part C of Form No.15CA, if the amount of payment or the aggregate of such payments, as the case may be, during the financial year exceeds ₹ 5 lakh, after obtaining a certificate in Form No.15CB from a chartered accountant.
II	**Relevant clauses of Part I of the Second Schedule to the Chartered Accountants Act, 1949**
	As per clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties. As per clause (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice shall be deemed to be guilty of professional misconduct, fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion.
III	**Facts of the case**
	The Income-tax department collected documents from X Bank which revealed that M/s. Y Travels and Consultancy Services (Y Travels) had remitted substantial amounts abroad. The documents collected include Form 15CB issued by the chartered accountant, list of passengers, copy of their passports, date of travel and invoice raised by the foreign party. On enquiring from the passengers and verifying their passports, it is found that they did not travel abroad during the dates mentioned in the documents. Further, the passengers denied

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	any sort of transactions with Y Travels. The department, therefore, concluded that the amounts were remitted abroad on the basis of false invoices and for wrong reasons, leading to FEMA violations and that the Form 15CB issued by the chartered accountant facilitated such violations. During the six-month period in question, the chartered accountant had issued 80 certificates in Form 15CB approximately involving remittances of ₹ 25 crores in favour of Y Travels.	
IV	**Submissions of the Chartered Accountant**	
	The chartered accountant submitted that he had issued Form 15CB based on invoices produced by the company and verifying the KYC documents of the signatory to the invoices. He submitted that since he was not the statutory auditor of the company, he did not examine the books of account before issue of Form 15CB or conduct due diligence of its business activities. He had charged ₹ 2,000 per certificate. Mostly, the fees was collected in cash. Some part of the fee was credited to his bank account.	
V	**Basis for Conclusion**	
	(1)	Form 3CB is a certificate of an accountant wherein he certifies that he has examined the agreement between the remitter and the beneficiary requiring such remittance as well as the relevant documents and books of account required for ascertaining the nature of remittance and for determining the rate of deduction of tax at source.
	(2)	The CA certifying the form undertakes to have verified the agreement between the remitter and the beneficiary as well as the relevant documents and books of account to ascertain the nature of remittance and determine the rate of TDS.
	(3)	In this case, however, the CA mentioned that he had only verified KYC of signatory to invoice and the invoices thereof. He had not only failed to justify as to how verification of invoices was considered as sufficient compliance for certifying the forms but also failed to bring on record the said invoices. Thus, he failed to provide any basis on which he relied for issuing Form 15CB certificates to the company.
	(4)	The CA issuing certificate in Form 15CB is, therefore, required to examine the agreement between the remitter and the beneficiary along with the relevant documents as well as books of account of the company – (i) for arriving at a conclusion as to the nature of remittance and rate of TDS; and (ii) for ensuring that the particulars mentioned in the certificate were true and correct.
	In this case, since he has failed to do so, he is held guilty of professional misconduct as per clauses (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 for failure to obtain sufficient information and failure to exercise due diligence in discharging his professional responsibilities.	

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VI	**Key takeaway**
	As elucidated in the Guidance Note, while issuing certificates, absolute level of assurance is expected to be provided by the practitioner on the subject matter. Therefore, a CA has to exercise due diligence and discharge the duties expected of him as a professional while issuance of such certificates. Accordingly, in this case, before issuing certificate in Form 15CB, the CA should verify the agreement between the remitter and the beneficiary, along with the relevant documents and books of account of the company for arriving at a conclusion as to the nature of remittance and rate of TDS. Only after ensuring that the particulars mentioned in the certificate were true and correct, should he issue such certificate. In case after issuing the certificate in Form 15CB, he comes to know that the remittance was not genuine, he has to withdraw the same within 7 days.

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TEST YOUR KNOWLEDGE

Questions

1. *Sunlight & Co., a partnership firm engaged in trading of electronic goods, has a turnover of ₹ 265 lakhs for the F.Y. 2025-26. Examine whether Sunlight & Co. is required to get its books of account audited mandatorily as per section 44AB from the information given below–*

	Particulars	***₹***
(i)	*Total turnover of F.Y.2025-26*	*2,65,00,000*
(ii)	*Aggregate of all receipts during the year (including amount received for turnover mentioned in (i) above)*	*3,25,00,000*
(iii)	*Cash receipts out of (i) above*	*14,00,000*
(iv)	*Cash receipts out of (ii) above (This is inclusive of the figure mentioned in (iii) above)*	*16,00,000*
(v)	*Aggregate of all payments during the year*	*1,35,00,000*
(vi)	*Cash payments out of (v) above*	*6,95,000*

Would your answer change if the cash receipts indicated in (iii) is ₹ 13 lakh instead of ₹ 14 lakh?

2. *Mr. Abhinav Ahuja runs a travel agency business since the year 2010. His total commission receipts for the F.Y. 2025-26 is ₹ 287 lakhs. The details of receipts and payments made by him during the year 2025-26 are as follows:*

Particulars	Amount (₹)	Mode of receipt/ payment
Date of Receipt		
15.4.2025	15,65,000	BHIM UPI
27.4.2025	13,80,000	A/c payee cheque
7.5.2025	13,35,000	Bearer cheque
6.6.2025	18,21,000	A/c payee cheque
15.8.2025	15,25,000	NEFT
19.9.2025	16,72,000	NEFT
18.10.2025	15,35,600	UPI
15.2.2026	16,25,350	UPI
17.3.2026	18,19,450	NEFT

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Other aggregate receipts not exceeding ₹ 2,000 per person on certain occasions from various customers. Out of this, receipts of ₹ 52,500 are received in cash.	1,44,21,600	A/c payee cheques, NEFT and UPI
Payments		
Aggregate all payments made during the P.Y. 2025-26	2,58,00,000	
Amount incurred for expenditure in cash (not exceeding ₹ 10,000 per person in each case)	20,58,000	

Mr. Abhinav contended that he is not required to get his accounts audited since his turnover does not exceed ₹ 3 crores and he is eligible to declare his income as per presumptive provisions of section 44AD. Examine the contention of Mr. Abhinav Ahuja.

3. *X Ltd., an Indian company, paid interest of ₹ 95 lakhs to X Inc., a non-resident associated enterprise in the P.Y.2025-26 on loan borrowed from it. X Ltd. also obtained loan of ₹ 5 crore@10% p.a. on 1.4.2025 from Y Inc., a foreign company in which it holds 20% voting power. X Inc. deposits ₹ 2 crore with Y Inc. X Ltd. contends that the provisions of section 94B are not attracted in its case, since the interest paid to non-resident associated enterprise does not exceed ₹ 1 crore in the P.Y.2025-26. The tax auditor is, however, of the opinion that the interest of ₹ 20 lakh (i.e., 10% of ₹ 2 crore) also has to be considered for the purpose of section 94B. X Ltd. contends that X Inc. has not deposited a corresponding and matching amount of ₹ 5 crore with Y Inc, and hence, the provisions of section 94B will **not** be attracted in this case. Examine the reporting requirement, if any, of the tax auditor in this case.*

4. *ABC Ltd. is engaged in transportation of building material and transportation of goods to contractors. It made payment for hiring dumpers for this purpose. The company has not deducted tax at source on the ground that since the payment was for transportation of goods and not renting out machinery and equipment, such payments could not be termed as rent paid for use of machinery under section 194-I and hence, no tax was deductible at source.*

   The tax auditor is, however, of the view that the transactions being in the nature of contracts for shifting of goods from one place to another would be covered under works contracts, thereby attracting the provisions of section 194C. He relied upon the Gujarat High Court ruling in CIT (TDS) v. Shree Mahalaxmi Transport Co. (2011) 339 ITR 484.

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What is the reporting responsibility of the tax auditor in such a case and the consequent ethical implications? Examine.

5. *A search was conducted u/s 132 of the Income-tax Act, 1961 in the case of LMN Jewellers (P) Ltd., a gold jewellery retail chain, on 28.2.2025. As part of the post search enquiries, data from the billing software was analysed. On analysis of this data, it was found that the company was involved in violation of section 40A(3) in a major way to the tune of ₹ 20 crores in the purchase of old gold.*

   In order to verify the findings culled from digital data, some of the customers whose whereabouts were available from computer records were contacted and their statements were recorded under oath. These customers admitted under oath that they had sold old gold and received the amounts (all exceeding ₹ 10,000) in cash. The fact which emerged from the enquiries is that LMN Jewellers (P) Ltd. purchase old gold and make payments for these purchases in cash, even if they exceed ₹ 10,000.

   However, the tax auditor had mentioned "Yes" in response to the statement in sub-clause (A) of Clause 21(d) on whether the expenditure covered under section 40A(3) read with Rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. The tax auditor submitted that standing instructions were given by the management of the entity to the employees to make payments above ₹ 10,000 only through account payee cheques and/or bank drafts or other permissible electronic modes; and copy of these instructions were verified by him. He further submitted that he had also taken a representation from the Management that net payment in cash to any person in a day did not exceed ₹ 10,000. Also, he mentioned that the test checks conducted by him did not reveal any violation.

   Examine the ethical implications in this case and the consequences thereof.

6. *XYZ & Co, a firm engaged in interior decoration business, employed 20 new employees on 1.4.2025 on a monthly salary of ₹ 25,000 to be paid by account payee cheque. In addition, each employee was entitled to 10% employer contribution to recognised provident fund. The employees were also entitled to transport allowance of ₹ 3,000 p.m. paid in cash. The gross total income of XYZ & Co. included profits and gains from business of ₹ 62 lakhs.*

   The firm claimed deduction under section 80JJAA of ₹ 18 lakh, being 30% of 60 lakh (20 new employees x ₹ 25,000 p.m. x 12) on the basis of the report of the chartered accountant

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issued in Form 10DA. The same chartered accountant was also the tax auditor of the firm. The chartered accountant contended that "emoluments" do not include employer contribution to PF. Also, cash payments were not to be considered as "additional employee cost" for the purpose of section 80JJAA. Hence, only ₹ 25,000 p.m. per employee paid by account payee cheque has to be treated as additional employee cost. Since the same does not exceed the limit of ₹ 25,000 p.m. and the employees have been employed for more than 240 days in the P.Y.2025-26, the employees would qualify as "additional employees" for the purpose of deduction under section 80JJAA for A.Y.2026-27.

Is his contention correct? Examine the ethical implications in this case.

7. *The Income-tax department collected documents from ABC Bank which revealed that M/s. Alpha Travels and Consultancy Services (Alpha Travels) had remitted substantial amounts abroad. The documents collected include Form 15CB issued by the chartered accountant, list of passengers, copy of their passports, date of travel and invoice raised by the foreign party. On enquiring from the passengers and verifying their passports, it is found that they did not travel abroad during the dates mentioned in the documents. Further, the passengers denied any sort of transactions with Alpha Travels. The department, therefore, concluded that the amounts were remitted abroad on the basis of false invoices and for wrong reasons, leading to FEMA violations and that the Form 15CB issued by the chartered accountant facilitated such violations. During the nine-month period in question, the chartered accountant had issued 120 certificates in Form 15CB approximately involving remittances of ₹ 30 crores in favour of Alpha Travels.*

   The chartered accountant submitted that he had issued Form 15CB based on invoices produced by the company and verifying the KYC documents of the signatory to the invoices. He however, failed to bring on record the invoices. He further submitted that since he was not the statutory auditor of the company, he did not examine the books of account before issue of Form 15CB or conduct due diligence of its business activities. He had charged ₹ 3,000 per certificate. Mostly, the fees was collected in cash. Some part of the fee was credited to his bank account.

   Examine the ethical implications in this case.

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Answers

1. As per section 44AB, every person carrying on business or profession is required to get his accounts audited before the "specified date" by a Chartered Accountant, if the total sales, turnover or gross receipts in business exceeds ₹ 1 crore in any previous year.

However, tax audit is not required in case of such person carrying on business whose total sales, turnover or gross receipts in business ≤ ₹ 10 crore in the relevant previous year (P.Y.), if:-

- aggregate cash receipts including amount received for sales, turnover, gross receipts in the relevant previous year ≤ 5% of such receipts; **and**
- aggregate cash payments including amount incurred for expenditure in the relevant P.Y. ≤ 5% of such payments or

In this case, the turnover of Sunlight & Co. exceeds ₹ 1 crore but does not exceed ₹ 10 crore. Accordingly, it has to be seen whether cash receipts exceed 5% of aggregate receipts and cash payments exceed 5% of aggregate payments, to determine whether tax audit is compulsory.

In this case, the percentage of cash receipts of ₹ 16 lakhs to aggregate receipts of ₹ 325 lakhs is 4.92% and the percentage of cash payments to aggregate payments is 5.148%.

Since the cash payments made during the year exceed 5% of aggregate payments, the firm is required to get its accounts audited under section 44AB and furnish audit report before the specified date, irrespective of the fact that its turnover does not exceed ₹ 10 crores and its cash receipts do not exceed 5% of total receipts.

It may be noted that, in this case, Sunshine & Co. cannot declare profits as per the presumptive provisions of section 44AD, since the percentage of turnover receipts in cash of ₹ 14 lakhs to the total turnover of ₹ 265 lakhs is 5.28%.

If the cash receipts indicated in (iii) is ₹ 13 lakhs instead of ₹ 14 lakhs, the percentage of turnover receipts in cash of ₹ 13 lakhs to the total turnover of ₹ 265 lakhs would be 4.91%. In such a case, Sunshine & Co. can declare profits as per the presumptive provisions of section 44AD, in which case, it need not get its books of account audited under section 44AB.

2. As per section 44AB, every person *inter alia* carrying on business or profession is required to get his accounts audited before the "specified date" by an accountant, if total sales, turnover or gross receipts in business exceeds ₹ 1 crore in any previous year.

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However, tax audit is not required in case of such person carrying on business whose total sales, turnover or gross receipts in business ≤ ₹ 10 crore in the relevant previous year (P.Y.), if -

- aggregate cash receipts including amount received for sales, turnover, gross receipts in the relevant previous year ≤ 5% of such receipts; **and**
- aggregate cash payments including amount incurred for expenditure in the relevant P.Y. ≤ 5% of such payments or

As per section 44AD, a resident individual, HUF or Partnership firm (but not LLP) engaged in eligible business and who has not claimed deduction under section 10AA or Chapter VIA under "C – deductions in respect of certain incomes" whose total turnover/ gross receipts in the P.Y. ≤ ₹ 200 lakhs (where cash receipts do not exceed 5% of total turnover, higher threshold limit of ₹ 300 lakhs applicable) can declare 8%/6%, as the case may be, of total turnover/ sales/gross receipts or a sum higher than the aforesaid sum claimed to have been earned by the assessee. However, a person *inter alia* carrying on any agency business are not eligible for presumptive provisions of section 44AD.

In the present case, since Mr. Abhinav Ahuja is carrying on travel agency business, he is not eligible for presumptive provisions of section 44AD, though his turnover does not exceed ₹ 3 crores.

In this case, the turnover of Mr. Abhinav Ahuja exceeds ₹ 1 crore but does not exceed ₹ 10 crore. Accordingly, it has to be seen whether cash receipts exceed 5% of aggregate receipts and cash payments exceed 5% of aggregate payments, to determine whether tax audit is compulsory. During the P.Y. 2025-26, his cash receipts are ₹ 13,35,000 plus ₹ 52,500 totalling to ₹ 13,87,500, which is 4.83% of total receipts of ₹ 2,87,00,000. Cash payments made during the P.Y. 2025-26 are ₹ 20,58,000 which is 7.98% of aggregate payments of ₹ 2,58,00,000. Since his cash payments during the P.Y. 2025-26, exceed 5% of aggregate payments made during the year, he is required to get the accounts audited under section 44AB and furnish tax audit report on or before the specified date i.e., one month prior to the due date of filing return of income under section 139(1).

3. **Relevant provision of law** - Section 94B provides that where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise.

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In this case, the debt issued by Y Inc. is ₹ 5 crore and the deposit made by the associated enterprise, X Inc. with Y Inc. is ₹ 2 crore. Since the deposit is not of a matching amount, the X Ltd. contends that provisions of section 94B will not be attracted in respect of interest payable by it to Y Inc. The tax auditor is of the opinion that interest on ₹ 2 crore amounting to ₹ 20 lakhs will have to be considered for the purpose of section 94B. Accordingly, the interest payable/paid by X Ltd. to non-resident associated enterprises during the year would be ₹ 115 lakhs and hence, the provisions of section 94B would be attracted, since the same exceeds the threshold of ₹ 1 crore. This appears to be the legislative intent, since otherwise it is possible to escape the application of this provision by even by depositing a marginally lower amount than the loan taken.

Relevant clause of Form 3CD - Clause 30B(a) of Form 3CD requires the tax auditor to state whether the assessee has incurred expenditure during the previous year by way of interest or of similar nature exceeding one crore rupees as referred to in sub-section (1) of section 94B.

Relevant paras of the Guidance Note on Tax Audit - As per para 18.6 of the Guidance Note on Tax Audit, the tax auditor may have a difference of opinion with regard to the particulars furnished by the assessee. These differences are to be reported in para 3 of Form No. 3CA or para 5 of Form 3CB. As per para 19.3, if there is any difference in the opinion of the tax auditor and that of the assessee in respect of any information furnished in Form No. 3CD by the assessee, the tax auditor may consider stating both the view points and also the relevant information related to matter in order to enable the tax authority to take a decision in the matter.

Therefore, the tax auditor has to report the difference of opinion appropriately as an observation in para 3 of Form No. 3CA or para 5 of Form No. 3CB as the case may be.

Accordingly, in this case, the tax auditor may state both the view points in Clause 30B as well as report the difference of opinion appropriately as an observation in para 3 of Form 3CA to enable the tax authority to take a decision in the matter.

4. In clause 34(a) of Form 3CD, the tax auditor is required to report whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB, and if yes, to furnish the details mentioned thereunder. While answering the issue of applicability of the provisions of Chapter XVII-B and/or XVII-BB, a number of debatable issues may arise before the assessee as well as the tax auditor. The tax auditor may have a difference of opinion with regard to the applicability of the provisions of TDS/TCS on a particular payment. In such a case, the tax auditor has to report the difference of opinion

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appropriately as an observation in para 3 of Form 3CA. This requirement is contained in the Guidance Note on Tax Audit.

Also, in clause 21(b)(ii) of Form 3CD, the amount inadmissible under section 40(a)(ia) has to be mentioned.

In case the tax auditor does not comply with the reporting requirements under these clauses and fails to mention the difference of opinion appropriately as an observation in para 3 of Form 3CA, clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 for not exercising due diligence may be invoked.

5. As per section 40A(3), where the assessee incurs any expenditure, in respect of which payment or aggregate of payments made to a person in a day otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft or use of electronic system through bank account or through such other prescribed electronic modes exceeds ₹ 10,000, such expenditure shall not be allowed as a deduction.

Clause 21(d) of Form 3CD requires the tax auditor to report, on the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft; and if not, to furnish details mentioned thereunder, namely, date of payment, nature of payment, amount etc.

The Guidance Note on Tax Audit issued by ICAI states that there may be practical difficulties in verifying whether each payment is made through account payee cheque or bank draft or ECS or other prescribed electronic modes. Where the reporting has been done on the basis of the certificate of the assessee, the fact has to be reported as an observation in para 3 of Form 3CA.

The tax auditor is required to point out in tax audit report, the violation of the provisions of section 40A(3) thereof involving expenditure to a person in a day exceeding ₹ 10,000 otherwise than by way of account payee cheque/bank draft, ECS and other prescribed electronic modes. However, in this case, the tax auditor has certified that there was no such instance, though such instances aggregate to a large quantum of ₹ 20 crores.

The tax auditor should have considered the nature of business i.e., jewellery business of the assessee and accordingly undertaken necessary checks to verify whether there are cash payments in violation of section 40A(3). He should have made use of the audit tools which are available to find out such payments expeditiously and accurately where the data is voluminous.

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In this case, considering the nature of business of the assessee, namely, jewellery business, the onus was on the tax auditor to verify the same before reporting in Form 3CD. Mere reliance on certificate issued by the management is not acceptable in such a case. Also, even in a case where the reporting has been done on the basis of the certificate of the assessee, the fact has to be reported as an observation in para 3 of Form 3CA, which he had failed to do.

Thus, in the case, the tax auditor had failed to exercise due diligence in the conduct of his professional duties. He had also failed to obtain sufficient information which is necessary for expression of opinion. On account of such failure, clauses (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 may be invoked.

6. Deduction under section 80JJAA is allowable to an assessee to whom section 44AB applies and whose gross total income includes any profits and gains derived from business, in respect of employment of new employees. The amount of deduction is 30% of additional employee cost incurred in the course of such business in the previous year, for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

"Additional employee cost" means the total emoluments paid or payable to additional employees employed during the previous year. However, in the case of an existing business, the additional employee cost shall be nil, if emoluments are paid otherwise than by an account payee cheque or account payee bank draft or use of ECS through bank account or other prescribed electronic mode.

"Emoluments" means any sum paid or payable to an employee in lieu of his employment by whatever name called but does not include, *inter alia*, contribution by employer to provident fund.

"Additional employee" means an employee who has been employed during the previous year and whose employment has the effect of increasing the total number of employees employed by the employer as on the last day of the preceding year, but does not include, inter alia, an employee whose total emoluments are more than ₹ 25,000 p.m.

In this case, the contention of the chartered accountant that the emoluments do not include employer contribution to PF is correct. However, emoluments include ₹ 3,000 paid in cash by way of transport allowance to the employee. Hence, the total emoluments per employee is ₹ 28,000 p.m. Due to this reason, the 20 employees employed on 1.4.2025 will not qualify as "additional employees" for the purpose of deduction under section 80JJAA, since

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their total emoluments are more than ₹ 25,000 p.m. Hence, XYZ & Co. is not eligible for any deduction under section 80JJAA due to failure to fulfil the condition for being treated as an "additional employee". In this case, the chartered accountant has failed to ensure compliance with the condition stipulated for claim of deduction under section 80JJAA and has wrongly issued the report in Form 10DA certifying the deduction claimed by the assessee under section 80JJAA.

Also, clause 33 of Form 3CD requires section-wise details of deductions, if any, admissible under Chapter VIA. Here again, the tax auditor has to ensure that the assessee fulfils all the conditions specified in the section under which the deduction is claimed. However, in this case, the tax auditor has failed to do so.

On account of such failure, clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 may be invoked.

7. Form 15CB is a certificate of an accountant wherein he certifies that he has examined the agreement between the remitter and the beneficiary requiring such remittance as well as the relevant documents and books of account required for ascertaining the nature of remittance and for determining the rate of deduction of tax at source. The chartered accountant certifying the form undertakes to have verified the agreement between the remitter and the beneficiary as well as the relevant documents and books of account to ascertain the nature of remittance and determine the rate of TDS. In this case, however, the chartered accountant mentioned that he had only verified KYC of signatory to invoice and the invoices thereof. He had not only failed to justify as to how verification of invoices was considered as sufficient compliance for certifying the forms but also failed to bring on record the said invoices. Thus, he failed to provide any basis on which he relied for issuing Form 15CB certificates to the company.

On account of such failure, clauses (7) and (8) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 for failure to exercise due diligence in discharging his professional responsibilities and failure to obtain sufficient information may be invoked.

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QUESTIONS BASED ON SIGNIFICANT SELECT CASES

You are required to answer the following questions on the basis of decided case laws, bringing out the following -

(a) Issue involved

(b) Relevant provisions of law

(c) Analysis and Conclusion

1. ABC Construction Pvt. Ltd. is engaged in the construction of bridges and flyovers. During the previous year 2025-26, it made payment to various parties and deducted tax amounting to ₹ 22 lakhs. However, the company failed to deposit the said amount with the income-tax department within the time prescribed under the Act. The company submitted that it is facing financial hardship since a large sum of money has been stuck-up with its debtors and also with the income-tax department in the form of tax refunds. It is further submitted that inspite of financial crisis, the company has *suo-moto* deposited the TDS amount along with interest u/s 201(1A), before receiving any notice from the income-tax department in this regard. However, prosecution proceedings were initiated under section 276B against the company and its directors. The company has approached you to advise in the matter.

2. XYZ Limited entered into a contract for purchase of patented process with M/s. Delta Inc, a non-resident company based in Country X. It filed an application u/s 195(2) before the Assessing Officer to make payment to the non-resident company for purchase of patented process without deducting tax at source.

   The assessee, XYZ Limited, contended that said non-resident company had no Permanent Establishment in India and in terms of the DTAA between India and Country X, no tax was to be deducted in India on same. The Assessing Officer rejected the assessee's application on grounds that consideration for patented process constituted royalty u/s 9(1)(vi) and was liable to be taxed in India and, accordingly, assessee was directed to deduct tax at source at rate of 10% on said royalty payment.

   On Appeal, the Commissioner (Appeals) passed an order in favour of the assessee. On further appeal, the Tribunal upheld the order passed by the Assessing Officer on grounds that payments made for purchase of patented processes were in the nature of royalty and tax at source to be deducted on such payment.

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The assessee company filed a miscellaneous application for rectification under section 254(2) before the Tribunal. The assessee had also filed an appeal before the High Court.

The Tribunal allowed said application in exercise of his powers under section 254(2) and reheard entire appeal on merits and recalled its original order and passed an order in favour the assessee. Thereafter, the writ petition filed by the assessee with High Court was also withdrawn. Is Tribunal justified in recalling its original order?

3. The assessee, being an Indian branch of US Company, LMN Inc, was engaged in contract research activities and cultivation of parent seeds in India. It had been claiming exemption by treating its entire income as agricultural income.

On scrutiny assessment for the period from year 2018 to 2022, the Assessing Officer treated entire income of the assessee as business income and attributed deemed income from research activity holding the assessee to the Permanent Establishment (PE) of LMN Inc. However, the assessee company disputed the matter for resolution under Mutual Agreement Procedure (MAP) under the DTAA agreement between India and USA. The MAP was culminated in the year 2024. The assessment was finalized and taxes alongwith interest were paid by the assessee u/s 220(2).

However, the assessee disputed the amount of interest u/s 220(2) for the period from 2022 to 2024.

Thereafter, the assessee filed an application before Jurisdictional Commissioner of Income-tax under section 220(2A) for waiver of interest levied u/s 220(2). The Commissioner dismissed application of the assessee.

The assessee is a part of LMN Inc, a global conglomerate which had in 2022 ₹ 86,000 crores in net sales and ₹ 15,000 crores as operating profit. The amount paid by it towards interest u/s 220(2) of the Act was ₹ 1.75 crores.

Discuss whether the Commissioner of Income-tax is justified in rejecting the claim of assessee or not.

4. During the scrutiny assessment of Refresh Me Ltd., a company engaged in manufacture and distribution of packaged juices, the Assessing Officer increased the income passed an order of demand. Aggrieved by the order, the assessee filed an appeal to CIT(A), who confirmed the order of Assessing Officer. The assessee further appealed to Appellate Tribunal requesting for the stay of collection of tax, which the Tribunal provided initially for 180 days on deposit of 20% of the amount of tax by Refresh Me Ltd. Thereafter, the Bench was functioning intermittently and therefore, the disputed matter could not be disposed off. The

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company applied for extension of stay and was granted extension upto 365 days. The Appellate Tribunal did not dispose off the appeal before the time extended for collection of tax. The revenue served an order of demand citing the reason that the order of stay automatically gets vacated post the expiry of 365 days. The assessee seeks your opinion as to whether the contention of the revenue is justified.

5. On 31.07.2025, a search under section 132 was conducted in the business and residential premises of Mr. Y and some gold bars were seized from the locker. Mr. Y voluntarily disclosed ₹ 12.50 crores of income during the course of search. Later on, he filed an application for sale of the gold bars weighing 5 kgs for adjustment towards the tax liability, even before the completion of the assessment by the Assessing Officer. However, the Assessing Officer rejected the application and observed that such action can be taken only after the assessment is completed and a demand has been quantified. Is the Assessing Officer justified in rejecting the application? Examine.

6. Mr. X filed his return of income for A.Y. 2025-26 by declaring a total income of ₹ 10 lakhs. His case was selected for scrutiny assessment and an addition of ₹ 4 lakhs was made by the Assessing Officer on account of disallowances of certain expenses. During the course of the assessment proceedings, Mr. X found that he erroneously failed to claim the set-off of brought forward losses under section 72 amounting to ₹ 3 lakhs, which he was otherwise entitled to. By the time the error was discovered by Mr. X, the time-limit for filling revised return had also expired. Hence, during the course of the proceedings, Mr. X approached the Assessing Officer to allow the set-off of the brought forward losses which was erroneously not claimed in the return of income filed under section 139(1). Whether the Assessing Officer is bound to accept the request of Mr. X? Examine.

7. M/s LMN Travels is a Travel Agent engaged in sale of air tickets of AirGo and AirJet Airlines. It earns standard commission @ 5% as well as supplementary commission. AirGo and AirJet have deducted tax at source under section 194H on the standard commission, which is a fixed percentage designated by the International Air Transport Association (IATA). However, they have not deducted tax on the supplementary commission, which is the additional amount LMN Travels charges over and above the net fare quoted by AirGo and AirJet and retained by LMN Travels as its own income.

   The details of the amounts at which the tickets were sold are transmitted by LMN Travels to an organization known as the Billing and Settlement Plan ("BSP") which functions under the aegis of the IATA. This auxiliary amount charged on top of the net fare was portrayed on the BSP as a "supplementary commission" in the hands of LMN Travels. The contract between

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LMN Travels and the airlines stated that "all monies" received by LMN Travels were held as the property of the air carrier until they were recorded on the billing and settlement plan and properly gauged.

AirGo and AirJet contended that tax is not deductible on supplementary commission which LMN Travels retains out of the sale proceeds of the air tickets, since there is no agency relationship between the airlines and LMN Travels and that the supplementary commission is not within the control of the airlines. Discuss the correctness of the above contention.

8. "The arm's length price (ALP) determined by the Tribunal, which is the final fact-finding authority, is final and cannot be the subject matter of scrutiny by the High Court as it does not give rise to a substantial question of law; accordingly, in an appeal u/s 260A, the High Court is precluded from examining the correctness of determination of the ALP" – Examine the correctness of this statement with reference to a recent Supreme Court ruling.

9. In the case of M/s HKHR Ltd., the Income-tax Appellate Tribunal decided against the assessee and issued order under section 254. The assessee filed an appeal to the jurisdictional High Court by framing the substantial question of law under section 260A(2)(c). The High Court, without framing the substantial question of law u/s 260A(3) at the time of admission of appeal, issued notices, heard both the parties and decided the appeal affirming the order of the Tribunal on the questions raised by the assessee appellant. Discuss whether the High Court was justified in not formulating the substantial question of law as required under section 260A(3) and adjudicating merely on the questions put forth by the appellant under section 260A(2)(c).

10. The assessment of Mr. Arora was completed u/s 143(3) of the Income-tax Act 1961 with an addition of income of ₹ 9 lakh to the returned income. Mr. Arora contends that the order of assessment is bad in law as no notice was issued u/s 143(2) even though he had participated in the assessment proceedings. The Assessing Officer, relying on section 292BB, contends that since Mr. Arora has participated in assessment proceedings, he cannot raise such objection.

    Examine the validity of the contentions of both Mr. Arora as well as the Assessing Officer.

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ANSWERS – SIGNIFICANT SELECT CASES

1. **Issue Involved**: The issue under consideration is whether prosecution proceedings can be initiated where tax deducted has been deposited by the assessee *suo moto*, after the time prescribed under the Act but before receiving notice from the income-tax department, along with interest under section 201(1A) and the assessee has shown reasonable cause for such delay.

   Relevant provisions of law: Prosecution proceedings are attracted under section 276B, if a person fails to pay to the credit of the Central Government, the tax deducted at source by him as required under the provisions of the Act. The punishment is rigorous imprisonment for not less than 3 months but which may extend to 7 years and with fine.

   Section 278AA, however, provides that no person would be punishable for such failure if he proves that there was reasonable cause for the same.

   Analysis & Conclusion: The CBDT has, *vide Circular No. 24/2019 dated 9.9.2019*, in exercise of the powers under section 119, listed out the offences covered under Chapter XXII of the Income-tax Act, 1961 in respect of which prosecution proceedings shall be launched by Approving Authority being the Sanctioning Authority where the quantum of offences exceeds the prescribed monetary threshold. Accordingly, in case of failure to pay TDS under section 276B or failure to pay TCS u/s 276BB, no prosecution will be processed if the TDS/TCS amount does not exceed ₹ 25 lakhs and delay in deposit is less than 60 days.

   In this case, the company has reasonable and sufficient cause since it was facing financial hardship on account of large sum of money stuck up with the debtors and also with the income-tax department on account of refunds. Inspite of the financial crisis, the company has *suo moto* deposited the TDS along with interest under section 201(1A) of the Act, before receiving any notice from the income-tax department in this regard.

   Since it has deposited the TDS along with interest *suo moto* before receiving any notice from the department and it has also shown reasonable cause for such delay in deposit, the company cannot be punishable for the delay in deposit of TDS. The initiation of prosecution proceedings under section 276B against the company and the directors is, therefore, **not** correct.

   Note *- The facts given in the question are similar to the facts in ACIT v. AT-Dev Prabha (JV) and others (2023) 454 ITR 59, wherein the above issue came up before the Supreme Court.*

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The above answer is based on the rationale of the Supreme Court in the said case read along with the CBDT Circular.

2. **Issue Involved**: The issue under consideration is whether the powers under section 254(2) can be exercised by the Tribunal to recall an order and rehear the entire appeal on merits.

Relevant provision of law: Section 254(1) empowers the Appellate Tribunal to pass such order thereon as it thinks fit, after giving both the parties to the appeal an opportunity of being heard.

Under section 254(2), the Appellate Tribunal, may amend an order passed by it u/s 254(1) with a view to rectifying any mistake apparent from the record.

Analysis & Conclusion: The power u/s 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters.

A detailed order was passed by the Tribunal upholding the order passed by the Assessing Officer. While allowing the application u/s 254(2) and recalling its earlier order, the Tribunal had reheard the entire appeal on the merits as if the Tribunal was deciding the appeal against the order passed by the Commissioner (Appeals). The subsequent order passed by the Tribunal recalling its earlier order was beyond the scope and ambit of the powers u/s 254(2) and is not tenable in law.

Note *– The facts given in the question are similar to the facts in Reliance Telecom Ltd./Reliance Communications Ltd. (2022) 440 ITR 1 wherein the issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court in the said case.*

3. **Issue Involved:** The issue under consideration is whether pendency of dispute resolution under MAP is a valid ground for waiver of interest under section 220(2A).

Relevant provision of law: Section 220(2) provides for levy of simple interest for delay in paying the sum specified in the notice of demand within the period specified thereunder.

Section 220(2A) provides for reduction or waiver of interest payable under section 220(2) if, *inter alia*, the Commissioner is satisfied that payment of such amount has caused or would cause genuine hardship to the assessee.

Analysis & Conclusion: Merely raising the dispute before any authority cannot be a ground for waiver of interest under section 220(2A). Otherwise, each and every assessee may raise a dispute and thereafter, may contend that since the litigation was *bona fide*, no interest is leviable.

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Further, in this case, the assessee is a part of a global conglomerate which had in the 2022 ₹ 86,000 crores in net sales and ₹ 15,000 crores as operating profit. In comparison to the profitability over the years, the amount paid by it towards interest under section 220(2) was merely ₹ 1.75 crores. This fact is relevant in concluding that no 'genuine hardship' can be said to have been caused to the assessee on account of payment of interest.

The Commissioner of Income-tax is, therefore, justified in rejecting the claim of assessee.

***Note** – The facts given in the question are similar to the facts in Pioneer Overseas Corporation USA (India Branch) v. CIT (International Taxation) (2022) 449 ITR 186, wherein the issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court in the said case.*

4. **Issue Involved:** The issue under consideration is whether the stay order can be automatically vacated upon expiry of extended period of stay of 365 days, where the delay in disposing of the appeal is not attributable to the assessee.

Relevant provision of law: The third proviso to section 254(2A) provides that where the appeal filed before the Appellate Tribunal is not disposed of within the period of stay or extended period of stay granted by the Tribunal, the order of stay shall stand vacated after the expiry of 365 days, even if the delay in disposing of the appeal is not attributable to the assessee.

Analysis & Conclusion: This provision would result in the automatic vacation of a stay upon the expiry of 365 days, even if the Appellate Tribunal could not take up the appeal in time for no fault of the assessee. Thus, the vacation of stay in favour of the Department would ensue even if the Department is itself responsible for the delay in hearing the appeal. This will cause undue hardship to the assessee, even where he is not at fault. In this sense, the provision is arbitrary and disproportionate so far as the assessee is concerned.

The contention of the revenue is **not** justified. Any order of stay shall stand vacated after the expiry of the period or periods mentioned in the section, only if the delay in disposing of the appeal is attributable to the assessee.

***Note –** The facts given in the question are similar to the facts in DCIT v. Pepsi Foods Ltd (2021) 433 ITR 295, wherein the above issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court ruling in that case.*

5. **Issue Involved:** The issue involved in this case is whether Mr. Y's application, for adjustment of tax liability on income surrendered during search by sale of seized gold bars, can be entertained where assessment has not been completed.

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Relevant provision of law: The provision contained in section 132B(1) lays down the manner in which the assets seized under section 132 may be dealt with. An assessee is entitled to make an application to the Assessing Officer for adjustment of seized assets towards existing tax liability.

Analysis & Conclusion: Here, the application by the assessee is not for adjustment of any existing liability, but towards the tax liability. In the said provision, the expression used is "the amount of the liability determined". "A liability is determined" only on completion of the assessment. Until the assessment is complete, it cannot be postulated that a liability has been crystallized.

Accordingly, the action of the Assessing Officer rejecting the application on the ground that such action can be taken only after the assessment is completed and a demand has been quantified, is justified.

Note - *The facts given in the question are similar to the facts in Hemant Kumar Sindhi & Another v. CIT (2014) 364 ITR 555 wherein the issue came up before the Allahabad High Court. The above answer is based on the rationale of the Allahabad High Court in the said case.*

6. **Issue Involved:** The issue under consideration is whether the Assessing Officer is bound to allow the set-off of brought forward losses under section 72 even if the assessee, Mr. X, in this case, has not claimed the same in the return filed by him and the time limit for filing revised return has expired.

Relevant provision of law: Under section 72, business losses shall be carried forward and shall be set-off against the profits and gains of any business in the next assessment year. It is assumed that the assessee has filed the return of income within the time stipulated u/s 139(1) and hence is eligible for set off of the unabsorbed loss in the subsequent year.

The wording used in section 72 is "shall", indicating that the provisions relating to set off of brought forward business loss are mandatory provided the loss was determined in pursuance of a return filed under section 139(3) in any earlier previous year.

Analysis & Conclusion: As per *CBDT Circular No.14 (XL-35) of 1955 dated 11.04.1955,* it is the duty of the Assessing Officer to assist a taxpayer in every reasonable way, particularly in the matter of claiming and securing reliefs and in this regard, they should take the initiative in guiding a taxpayer where proceedings or other particulars before them indicate that some refund or relief is due to him.

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Thus, it is the duty of the Assessing Officer to apply the relevant provisions of the Act for the purpose of determining the true figure of Mr. X's total income and consequential tax liability. Merely because Mr. X has not claimed the set-off of brought forward losses of ₹ 3 lakh in the original return filed and the time limit for filing revised return has expired, it cannot relieve the Assessing Officer of his duty to apply section 72 in the appropriate case.

The Assessing Officer is bound to accept the request of Mr. X and allow the set-off of brought forward losses of ₹ 3 lakh under section 72, even if Mr. X has not claimed the same in the return filed, and the time limit for filing the revised return has expired.

Note *– The facts given in the question are similar to the facts in CIT v. Mahalakshmi Sugar Mills Co. Ltd. (1986) 160 ITR 920, wherein the above issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court ruling in that case, taking note of the CBDT Circular No.14 (XL-35) of 1955 dated 11.04.1955.*

7. **Issue Involved**: The issue under consideration in this case is whether TDS under section 194H is attracted in respect of both standard and supplementary commission paid by AirGo and AirJet Airlines to LMN Travels.

Relevant provision of law: TDS is attracted on income by way of commission or brokerage payable to a resident, where the amount or aggregate amount credited or paid to a person during the financial year exceeds ₹ 20,000.

Analysis & Conclusion: Section 194H does not distinguish between direct and indirect payments. Both standard commission and supplementary commission fall within the meaning of "commission" under clause (i) of the *Explanation* thereto.

Section 194H is to be read with section 182 of the Contract Act, 1872. If a relationship between two parties as culled out from their intentions as manifested in the terms of the contract between them indicates the existence of a principal-agent relationship as defined under section 182 of the Contract Act, the definition of "commission" under section 194H stands attracted and the requirement to deduct tax at source arises.

There was no transfer in terms of the title in the tickets and they remained the property of the airline company throughout the transaction. Every action taken by the travel agents is on behalf of the air carriers and the services they provide is with express prior authorization. Accordingly, the contract is one of agency that does not distinguish in terms of stages of the transaction involved in selling flight tickets. The accretion of the supplementary commission to the travel agents was an accessory to the actual principal-agent relationship. Notwithstanding the lack of control over the actual fare, the contract definitively stated that

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"all monies" received by the agent were held as the property of the air carrier until they were recorded on the billing and settlement plan and properly gauged. The billing and settlement plan also demarcated "supplementary commission" under a separate heading.

Hence, once the IATA made the payment of the accumulated amounts shown on the billing and settlement plan, it would be feasible for the assessees, being the airlines to deduct tax at source on this additional income earned by the agent.

The contention of AirGo and AirJet is **not** correct and they are required to deduct tax at source under section 194H on both the standard commission and supplementary commission paid to LMN Travels.

Note *– The facts given in the question are similar to the facts in Singapore Airlines Ltd / KLM Royal Dutch Airlines v. CIT / British Airways Plc v. CIT (TDS) (2022) 49 ITR 203, wherein the above issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court ruling in that case.*

8. **Issue Involved**: The issue under consideration is whether the arm's length price (ALP) determined by the Tribunal, which is the final fact-finding authority, is final and cannot be the subject matter of scrutiny by the High Court as it does not give rise to a substantial question of law.

Relevant provision of law: As per section 260A(1), 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.

Analysis & Conclusion: The Apex Court, in *SAP Labs India Pvt. Ltd. v. ITO [2023] 454 ITR 121*, laid down the following with respect to the powers of High Court to consider the substantial question of law involving determination of arm's length price (ALP):

- While determining the ALP, the Tribunal has to follow the guidelines stipulated under Chapter X of the Income-tax Act, 1961, namely, sections 92 to 92F of the Act and Rules 10A to 10E of the Income-tax Rules, 1962. Any determination of the ALP under Chapter X not in accordance with the relevant provisions of the Income-tax Act, 1961 and Rules can be considered as perverse and it may be considered as a substantial question of law as perversity itself can be said to be a substantial question of law. Therefore, there cannot be any absolute proposition of law that in all cases where the Tribunal has determined the ALP, the same is final and cannot be the subject matter of scrutiny by the High Court in an appeal under section 260A.

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When the determination of the ALP is challenged before the High Court, it is always open for the High Court to consider and examine whether the ALP has been determined while taking into consideration the relevant guidelines under the Act and the Rules.

- The High Court can examine the question of comparability of two companies or selection of filters and examine whether the same is done judiciously and on the basis of the relevant material/evidence on record. The High Court can also examine whether the comparable transactions have been taken into consideration properly or not, i.e., to the extent as to whether non-comparable transactions are considered as comparable transactions or not.

Therefore, in an appeal challenging the determination of the arm's length price, it is always open for the High Court to examine in each case, within the parameters of section 260A, whether while determining the ALP, the guidelines laid down under the Income-tax Act, 1961 and the Income-tax Rules, 1962 are followed or not and whether the determination of the ALP and the findings recorded by the Tribunal while determining the ALP are perverse or not.

The statement is, therefore**, not** correct.

9. **Issue Involved**: The issue under consideration is whether the High Court is justified in not framing any substantial question of law itself and adjudicating merely on the questions put forth by the appellant.

Relevant provision of law: Section 260A(1) 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. As per section 260A(3) and 260A(4), if the High Court is so satisfied, it shall formulate that question and the appeal shall be heard only on the question so formulated.

Analysis & Conclusion: There lies a distinction between the questions proposed by the appellant for admission of the appeal to the High Court and the questions framed by the High Court. The questions, which are proposed by the appellant, fall under section 260A(2)(c) whereas the questions framed by the High Court fall under section 260A(3). Section 260A(4) provides that the appeal is to be heard on merits only on the questions formulated by the High Court under section 260A(3**)** and not on the questions proposed by the appellant.

In case the High Court is of the view that the appeal did not involve any substantial question of law, it should have recorded a categorical finding to that effect that the questions proposed by the appellant either do not arise in the case or/and are not substantial questions of law so

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as to attract the rigour of section 260A for its admission and accordingly, should have dismissed the appeal at the preliminary stage itself. However, this was not done in this case. Instead, the appeal was heard only on the questions urged by the appellant u/s 260A(2)(c).

The High Court was, therefore, not justified since it did not decide the appeal in conformity with the mandatory procedure prescribed in section 260A.

Note *– The facts given in the question are similar to the facts in CIT v. A.A. Estate Pvt. Ltd. [2019] 413 ITR 438, wherein the issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court in the said case.*

10. **Issue Involved:** The issue under consideration is whether the participation by the assessee in assessment proceedings would make the omission to issue notice under section 143(2) a curable defect on account of the deeming provision under section 292BB.

Relevant provision of law: As per section 292BB, any notice which is required to be served upon an assessee shall be deemed to have been duly served and the assessee would be precluded from taking any objection that the notice was -

(a) not served upon him; or

(b) not served upon him in time; or

(c) served upon him in an improper manner,

if he had appeared in any proceedings or co-operated in any enquiry relating to assessment or re-assessment.

Analysis & Conclusion: Issue of notice under section 143(2) is mandatory for making a regular assessment under section 143(3). Section 292BB is a deeming provision that seeks to cure defects in any notice issued under any provision of the Income-tax Act, 1961, if the assessee has participated in the proceedings.

For section 292BB to apply, the notice must have emanated from the Department. It is only the infirmities in the manner of service of notice that the section seeks to cure. The section is not intended to cure the complete absence of notice itself.

Accordingly, non-issuance of notice under section 143(2) is not a curable defect under section 292BB inspite of participation by the assessee in assessment proceedings.

In the present case, since the assessment of Mr. Arora was completed u/s 143(3) without issuing notice u/s 143(2), the assessment is bad in law and not a curable defect u/s 292BB.

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Therefore, the contention of Mr. Arora is valid and the contention of the Assessing Officer is invalid in spite of the fact that Mr. Arora participated in the assessment proceedings.

Note *– The facts given in the question are similar to the facts in CIT v. Laxman Das Khandelwal (2019) 417 ITR 325, wherein the issue came up before the Supreme Court. The above answer is based on the rationale of the Supreme Court in the said case.*

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Final Course
Study Material
(Modules 1 to 4)

Paper 4

Direct Tax Laws & International Taxation

[Direct Tax Laws as amended by the Finance Act, 2025]
Assessment Year 2026-27

Module – 4

(Relevant for May 2026, September 2026 and January 2027 examinations)

BOARD OF STUDIES (ACADEMIC)
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CHAPTER 21

NON RESIDENT TAXATION

LEARNING OUTCOMES

After studying this Chapter, you will be able to –

- **determine** the residential status of Individuals, HUF, AOPs/ BOIs, Firms & Companies etc;
- **examine** the scope of income chargeable to tax in respect of different persons, after ascertaining their residential status;
- **examine** when income arising in the hands of non-resident from a transaction is deemed to accrue or arise in India;
- **appreciate** the circumstances when the presence of eligible fund manager in India would not constitute business connection in India for an eligible investment fund;
- **identify** whether a particular income is exempt in the hands of a non-resident based on the provisions of the Income-tax Act, 1961;
- **compute** the profits and gains for non-resident assessees from shipping business, business of operation of cruise ships, business of operation of aircraft, business of civil construction etc. in certain turnkey power projects applying the presumptive tax provisions under the Income-tax Act, 1961;
- **determine** the quantum of head office expenditure allowable as deduction to non-residents;
- **determine** the tax payable by the non-residents on dividend, royalty and fees for technical service applying the special provisions of Chapter XII;
- **determine** the tax payable by non-residents applying the special provisions relating to certain incomes of non-residents prescribed under Chapter XII-A;
- **examine** the withholding tax provisions to determine the tax, if any, required to be deducted at source on certain payments made to non-residents;
- **compute** the total income of non-residents and tax payable thereon, applying the general provisions and special provisions applicable to non-residents under the Income-tax Act, 1961.

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21.1 INTRODUCTION

Taxation of cross-border transactions are generally based on the two concepts:

1. Residence based taxation
2. Source based taxation

Residence based taxation: The concept of residence-based taxation asserts that natural persons or individuals are taxable in the country or tax jurisdiction in which they establish their residence or domicile, regardless of the source of income. In case of companies, the place of incorporation or the place of effective management is generally considered as its place of residence.

Source based taxation: According to this concept, a country considers certain income as taxable income, if such income arises within its jurisdiction. Such income is taxed in the country of source regardless of the residence of the taxpayer.

21.2 RESIDENTIAL STATUS AND SCOPE OF TOTAL INCOME

(1) Residential Status [Section 6]

The incidence of tax on any assessee depends upon his residential status under the Act. For all purposes of income-tax, taxpayers (individuals and HUF) are classified into three broad categories on the basis of their residential status viz.

(1) Resident and ordinarily resident

(2) Resident but not ordinarily resident

(3) Non-resident

Taxpayers (other than individuals and HUF) are classified into two broad categories on the basis of their residential status viz.

(1) Resident

(2) Non-resident

The residential status of an assessee must be ascertained with reference to each previous year. A person who is resident and ordinarily resident in one year may become non-resident or resident but not ordinarily resident in another year or *vice versa.*

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The provisions for determining the residential status of assessees are:

(1) Residential status of Individuals

Residential status on the basis of number of days of stay in India

Under section 6(1), an individual is said to be resident in India in any previous year, if he satisfies **any one** of the following conditions:

(i) He has been in India during the relevant previous year for a total period of 182 days or more, or

(ii) He has been in India during the 4 years immediately preceding the relevant previous year for a total period of 365 days or more and has been in India for at least 60 days in the relevant previous year.

If both the above conditions are not satisfied, the individual is a non-resident.

Notes:

(a) The term "stay in India" includes stay in the territorial waters of India (i.e., 12 nautical miles into the sea from the Indian coastline). Even the stay in a ship or boat moored in the territorial waters of India would be sufficient to make the individual resident in India.

(b) It is not necessary that the period of stay must be continuous or active nor is it essential that the stay should be at the usual place of residence, business or employment of the individual.

(c) For the purpose of counting the number of days stayed in India, both the date of departure as well as the date of arrival are considered to be in India.

(d) The residence of an individual for income-tax purpose has nothing to do with citizenship, place of birth or domicile. An individual can, therefore, be resident in more countries than one even though he can have only one domicile.

Exceptions:

The following categories of individuals will be treated as resident in India only if the period of their stay during the relevant previous year amounts to 182 days or more. The condition of presence in India for 60 days or more in the relevant previous year is not applicable for such individuals.

(i) Indian citizen, who leaves India during the relevant previous year as a member of the crew of an Indian ship or for purposes of employment outside India, or

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(ii) Indian citizen or person of Indian origin[1] who, being outside India comes on a visit to India during the relevant previous year.

However, such person having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled from or profession set up in India) and which is not deemed to accrue or arise in India], exceeding ₹ 15 lakhs during the previous year will be treated as resident in India if -

- the period of his stay during the relevant previous year amounts to 182 days or more, or
- he has been in India during the 4 years immediately preceding the previous year for a total period of 365 days or more and has been in India for at least 120 days in the previous year.

Note - Stay in India for 120 days in the relevant P.Y. is not a standalone condition. This condition requires stay in India for 120 days in the relevant P.Y. + 365 days in the 4 years immediately preceding the P.Y.

How to determine period of stay in India for an Indian citizen, being a crew member?

In case of foreign bound ships where the destination of the voyage is outside India, there is uncertainty regarding the manner and the basis of determining the period of stay in India for an Indian citizen, being a crew member.

To remove this uncertainty, *Explanation 2* to section 6(1) provides that in the case of an individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the prescribed manner and subject to the prescribed conditions.

Accordingly, the CBDT has vide, *Notification No. 70/2015 dated 17.8.2015*, inserted Rule 126 in the Income-tax Rules, 1962 to compute the period of stay in such cases.

According to Rule 126, for the purposes of section 6(1), in case of an individual, being a citizen of India and a member of the crew of a ship, the period or periods of stay in India shall, in respect of an eligible voyage, not include the following period:

---

[1]*A person is said to be of Indian origin if he or either of his parents or either of his grandparents were born in undivided India.*

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Period to be excluded

Period commencing from		Period ending on
the date entered into the Continuous Discharge Certificate in respect of joining the ship by the said individual for the eligible voyage	**And**	the date entered into the Continuous Discharge Certificate in respect of signing off by that individual from the ship in respect of such voyage.

Meaning of certain terms:

Terms		Meaning
(a)	Continuous Discharge Certificate	This term has the meaning assigned to it in the Merchant Shipping (Continuous Discharge Certificate-cum Seafarer's Identity Document) Rules, 2001 made under the Merchant Shipping Act, 1958.
(b)	Eligible voyage	A voyage undertaken by a ship engaged in the carriage of passengers or freight in international traffic where – (i) for the voyage having originated from any port in India, has as its destination any port outside India; and (ii) for the voyage having originated from any port outside India, has as its destination any port in India.

ILLUSTRATION 1

Mr. Ajay is an Indian citizen and a member of the crew of a Mauritius bound Indian ship engaged in carriage of passengers in international traffic departing from Mumbai port on 16th July, 2025. From the following details for the P.Y.2025-26, determine the residential status of Mr. Ajay for A.Y.2026-27, assuming that his stay in India in the last 4 previous years (preceding P.Y.2025-26) is 415 days and last seven previous years (preceding P.Y.2025-26) is 745 days:

Particulars	*Date*
Date entered into the Continuous Discharge Certificate in respect of joining the ship by Mr. Ajay	*16th July, 2025*
Date entered into the Continuous Discharge Certificate in respect of signing off the ship by Mr. Ajay	*19th January, 2026*

SOLUTION

In this case, since Mr. Ajay is an Indian citizen and leaving India during P.Y. 2025-26 as a member of the crew of an Indian ship, he would be resident in India, only if he stayed in India for 182 days or more.

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The voyage is undertaken by an Indian ship engaged in the carriage of passengers in international traffic, originating from a port in India (i.e., the Mumbai port) and having its destination at a port outside India (i.e., the Mauritius port). Hence, the voyage is an eligible voyage for the purposes of section 6(1).

Therefore, the period beginning from 16th July, 2025 and ending on 19th January, 2026, being the dates entered into the Continuous Discharge Certificate in respect of joining the ship and signing off from the ship by Mr. Ajay, an Indian citizen who is a member of the crew of the ship, has to be excluded for computing the period of his stay in India. Accordingly, 188 days [16+31+30+31+30+31+19] have to be excluded from the period of his stay in India. Consequently, Mr. Ajay's period of stay in India during the P.Y.2025-26 would be 177 days [i.e., 365 days – 188 days]. Since his period of stay in India during the P.Y.2025-26 is less than 182 days, he is a non-resident for A.Y.2026-27.

Note *- Since the residential status of Mr. Ajay is "non-resident" for A.Y.2026-27 consequent to his number of days of stay in P.Y.2025-26 being less than 182 days, his period of stay in the earlier previous years become irrelevant.*

Deemed resident [Section 6(1A)]

An individual, being an Indian citizen, having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled from or profession set up in India) and which is not deemed to accrue or arise in India], exceeding ₹ 15 lakhs during the previous year would be deemed to be resident in India in that previous year, if he is not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

However, this provision will not apply in case of an individual who is a resident of India in the previous year as per section 6(1).

Meaning of "liable to tax" – Liable to tax, in relation to a person and with reference to a country, means that there is an income-tax liability on such person under the law of that country for the time being in force. It also includes a person who has subsequently been exempted from such liability under the law of that country [Section 2(29A)].

Notes – *(1) Only Indian citizen can be deemed resident. An individual who is not an Indian citizen but a person of Indian Origin cannot be deemed resident u/s 6(1A).*

(2) Stay in India is not necessary for being a deemed resident u/s 6(1A).

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Resident and ordinarily resident/ Resident but not ordinarily resident

Only individuals and HUF can be resident but not ordinarily resident in India. All other classes of assessees can be either a resident or non-resident. An individual and HUF would be not-ordinarily resident if they satisfy any one of the conditions specified under section 6(6).

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or

(ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less, or

(iii) If such individual is an Indian citizen or person of Indian origin (who, being outside India, comes on a visit to India in any previous year) having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (other than income derived from a business controlled in or profession set up in India) and which is not deemed to accrue or arise in India], exceeding ₹ 15 lakhs during the previous year, who has been in India for 120 days or more but less than 182 days during that previous year, or

(iv) If such individual is an Indian citizen who is deemed to be resident in India under section 6(1A) [It may be noted that a deemed resident will always be a resident but not ordinarily resident].

ILLUSTRATION 2

Chris Gayle, a West Indies cricket player visits India for 102 days in every financial year. This has been his practice for the past 10 financial years.

(a) Find out his residential status for the A.Y. 2026-27.

(b) Would your answer change if the above facts relate to Srinath, an Indian citizen who resides in West Indies and represents the West Indies cricket team?

(c) What would be your answer if Srinath had visited India for 120 days instead of 102 days every year, including P.Y.2025-26?

SOLUTION

(a) Determination of Residential Status of Mr. Chris Gayle for the A.Y. 2026-27:

Period of stay during the P.Y. 2025-26 = 102 days

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Calculation of period of stay during 4 preceding previous years (102 days x 4=408 days)

P.Y. 2024-25	102 days
P.Y. 2023-24	102 days
P.Y. 2022-23	102 days
P.Y. 2021-22	102 days
Total	**408 days**

Mr. Chris Gayle has been in India for a period of more than 60 days during P.Y. 2025-26 and for a period of more than 365 days during the 4 immediately preceding previous years. Therefore, since he satisfies one of the basic conditions under section 6(1), he is a resident for the A.Y. 2026-27.

Computation of period of stay during 7 preceding previous years = 102 days x 7=714 days

2024-25	102 days
2023-24	102 days
2022-23	102 days
2021-22	102 days
2020-21	102 days
2019-20	102 days
2018-19	102 days
Total	**714 days**

Since his period of stay in India during the past 7 previous years is less than 730 days, he is a not-ordinarily resident during the A.Y. 2026-27. **(See Note below)**

Therefore, Mr. Chris Gayle is a resident but not ordinarily resident during the previous year 2025-26 relevant to the A.Y. 2026-27.

Note: *An individual, not being an Indian citizen, would be not-ordinarily resident person if he satisfies any one of the conditions specified under section 6(6), i.e.,*

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or

(ii) If such individual has during the 7 previous years preceding the relevant previous year been in India for a period of 729 days or less.

In this case, since Mr. Chris Gayle satisfies condition (ii), he is a not-ordinary resident for the A.Y. 2026-27.

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(b) If the above facts relate to Mr. Srinath, an Indian citizen, who residing in West Indies, comes on a visit to India, he would be treated as non-resident in India for previous year 2025-26, irrespective of his total income (excluding income from foreign sources), since his stay in India in the current financial year is, in any case, less than 120 days.

(c) In this case, if Mr. Srinath's total income (excluding income from foreign sources) exceeds ₹ 15 lakh, he would be treated as resident but not ordinarily resident in India for P.Y.2025-26, since his stay in India is 120 days in the P.Y.2025-26 and 480 days (i.e., 120 days x 4 years) in the immediately four preceding previous years.

If his total income (excluding income from foreign sources) does not exceed ₹ 15 lakh, he would be treated as non-resident in India for the P.Y.2025-26, since his stay in India is less than 182 days in the P.Y.2025-26.

(2) Residential status of HUF

Resident: A HUF would be resident in India if the control and management of its affairs is situated wholly or partly in India.

Non-resident: If the control and management of the affairs is situated wholly outside India it would become a non-resident.

Meaning of the term "control and management"

- The expression 'control and management' referred to under section 6 refers to the central control and management and not to the carrying on of day-to-day business by servants, employees or agents.
- Control and management means de facto control and management and not merely having the right to control or manage.
- The business may be done from outside India and yet its control and management may be wholly within India. Therefore, control and management of a business is said to be situated at a place where the head and brain of the adventure is situated. Merely because the family has a house in India, where some of the members reside in the previous year, does not constitute that place as the seat of control and management of the affairs of the HUF unless important decisions concerning the affairs of the HUF are taken at that place.

Resident and ordinarily resident/ Resident but not ordinarily resident

If Karta of resident HUF satisfies both the following additional conditions (as applicable in case of individual) then, resident HUF will be "Resident and ordinarily resident" (ROR), otherwise it will be "Resident but not ordinarily resident" (RNOR).

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Additional conditions:

1. Karta of resident HUF should be resident in at least 2 previous years out of 10 previous years immediately preceding relevant previous year.

2. Stay of Karta during 7 previous years immediately preceding relevant previous year should be 730 days or more.

(3) Residential status of firms, AoPs and BoIs

Resident: A firm, AoP and BoI would be resident in India if the control and management of its affairs is situated wholly or partly in India.

Non-resident: Where the control and management of the affairs is situated wholly outside India, the firm, AoP and BoI would become a non-resident.

Note - *The residential status of the partners/ members is immaterial while determining the residential status of a Firm/AOP/BOI.*

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The term "Non-resident" is defined under section 2(30) of the Income-tax Act, 1961 as a person who is not a "resident". However, for the purposes of sections 92B, 93 and 168, non-resident would include a person who is not ordinarily resident within the meaning of section 6(6).

(4) Residential status of local authorities and artificial juridical persons

Resident: Local authorities and artificial juridical persons would be resident in India if the control and management of its affairs is situated wholly or partly in India.

Non-resident: Where the control and management of the affairs is situated wholly outside India, they would become non-residents.

(5) Residential status of a Company

A company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India.

***"Place of effective management** "means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made [Explanation to section 6(3)].*

DETERMINATION OF RESIDENTIAL STATUS OF A COMPANY

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Guiding Principles for determination of Place of Effective management ('POEM') of a Company, other than an Indian company – [Circular No. 6/2017, dated 24.01.2017 & Circular No. 8/2017, dated 23-02-2017]:

Place of effective management' (POEM) is an internationally recognised test for determination of residence of a company incorporated in a foreign jurisdiction. Most of the tax treaties entered into by India recognises the concept of 'place of effective management' for determination of residence of a company as a tie-breaker rule for avoidance of double taxation.

The CBDT has laid down the following guiding principles to be followed for determination of POEM.

Concept of Substance over form

The determination of the POEM will depend upon the facts and circumstances of a given case. The POEM concept is one of substance over form. It may be noted that an entity may have more than one place of management, but it can have only one place of effective management at any point of time. Since "residence" is to be determined for each year, POEM will also be required to be determined on year to year basis.

Whether the company is engaged in active business outside India? - An important criterion for determination of POEM

The process of determination of POEM would be primarily based on the fact as to **whether or not the company is engaged in active business outside India.**

A company shall be said to be engaged in 'active business outside India'

- if passive income is not more than 50% of its total income, and
- less than 50% of its total asset are situated in India; and
- less than 50% of total number of employees are situated in India or are resident in India; and
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Meaning of certain terms:

Term	Meaning
Income	(a) As computed for tax purpose in accordance with the laws of the country of incorporation; or (b) As per books of account, where the laws of the country of incorporation does not require such a computation.

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Value of assets	**(a) In case of an individually depreciable asset**	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year; and
	(b) In case of pool of fixed asset, being treated as a block for depreciation	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;
	(c) In case of any other asset	Value as per books of account
Number of employees	The average of the number of employees as at the beginning and at the end of the year and shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees.	
Payroll	This term includes the cost of salaries, wages, bonus, and all other employee compensation including related pension and social costs borne by the employer.	
Passive income	It is the aggregate of, - (i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and (ii) income by way of royalty, dividend, capital gains, interest, or rental income; However, any income by way of interest shall not be considered to be passive income in case of a company which is engaged in the business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation	

Place of Effective Management:

(i) In case of Companies engaged in Active Business outside India

POEM of a company engaged in active business shall be presumed to be outside India if the majority of the board meeting are held outside India.

However, in case the Board is not exercising its powers of management and such powers are being exercised by either the holding company or any other person, resident in India, then POEM shall be considered to be in India.

For this purpose, merely because the Board of Directors (BOD) follows general and objective principles of global policy of the group laid down by the parent entity which may be in the field of Payroll functions, Accounting, Human resource (HR) functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific

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to any entity or group of entities per se; would not constitute a case of BoD of companies standing aside.

CBDT Circular No. 25/2017, dated 23.10.2017 clarifies that so long as the Regional Headquarter operates for subsidiaries/ group companies in a region within the general and objective principles of global policy of the group laid down by the parent entity in the field of Payroll functions, Accounting, HR functions, IT infrastructure and network platforms, Supply chain functions, Routine banking operational procedures, and not being specific to any entity or group of entities per se; it would, in itself, not constitute a case of BoD of companies standing aside and such activities of Regional Headquarter in India alone will not be a basis for establishment of POEM for such subsidiaries/ group companies.

It is further mentioned in the said Circular that the provisions of General Anti-Avoidance Rule contained in Chapter X-A of the Income-tax Act, 1961 may get triggered in such cases where the above clarification is found to be used for abusive/ aggressive tax planning.

For the purpose of determining whether the company is engaged in active business outside India, the average of the data of the previous year and two years prior to that shall be considered. In case the company has been in existence for a shorter period, then data of such period shall be considered. Where the accounting year for tax purposes, in accordance with laws of country of incorporation of the company, is different from the previous year, then, data of the accounting year that ends during the relevant previous year and two accounting years preceding it shall be considered.

It has been clarified that mere following of global policies laid down by the Indian holding company would not constitute that Board is standing aside.

(ii) In case of Companies not engaged in active business outside India

The guidelines provide a two-stage process for determination of POEM in case of companies not engaged in active business.

(a) **First stage**: Identifying the person(s) who actually make the key management and commercial decisions for the conduct of the company as a whole.

(b) **Second stage**: Determine the place where these decisions are, in fact, being made.

The place where these management decisions are taken would be more important than the place where such decisions are implemented. For the purpose of determination of POEM, it is the substance which would be conclusive rather than the form.

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The conditions specified in the circular are depicted in the flow charts below:

The determination of POEM is based on the following categorization of foreign companies:

Active Business Outside India (Business Test)

Companies fulfilling the test of ABOI

- *POEM outside India, if majority BOD meetings are held outside India*
- *If de facto decision making authority is not BOD but Indian parent or resident, POEM shall be in India*

Companies other than those fulfilling the test of ABOI

Stage 1: *Identification of persons who actually make the key management and commercial decision for conduct of the company's business as a whole*

Stage 2: *Determination of place where these decisions are, in fact, made*

What is ABOI test?

A company is said to be engaged in ABOI, if it fulfills the cumulative conditions of:

- Its passive income* (wherever earned) is 50% or less of its total income
- Less than 50% of its total assets situated in India
- Less than 50% of the total number of employees are situated in India or are residents in India
- Payroll expenses incurred on such employees are less than 50% of its total payroll expenditure

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** Passive income of a company shall be aggregate of:*

(i) Income from the transactions where both the purchase and sale of goods is from/ to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest (except for banking companies and public financial institutions) or rental income whether or not involving associated enterprises.

Some of the guiding principles which may be taken into account for determining the POEM are as follows:

(a) Location where the Board of Directors meet and makes decisions: This location may be the place of effective management of a company provided, the Board –

(i) retains and exercises its authority to govern the company; and

(ii) does, in substance, make the key management and commercial decisions necessary for the conduct of the company's 'business as a whole'.

It may be mentioned that mere formal holding of board meetings at a place would by itself not be conclusive for determination of POEM being located at that place. If the key decisions by the directors are in fact being taken in a place other than the place where the formal meetings are held then such other place would be relevant for POEM.

As an example this may be the case where the board meetings are held in a location distinct from the place where head office of the company is located or such location is unconnected with the place where the predominant activity of the company is being carried out.

If a Board has *de facto* delegated the authority to make the key management and commercial decisions for the company to the senior management or any other person including a shareholder, promoter, strategic or legal or financial advisor etc. and does nothing more than routinely ratifying the decisions that have been made, the company's place of effective management will ordinarily be the place where these senior managers or the other person make those decisions.

"Senior Management" in respect of a company means the person or persons who are generally responsible for developing and formulating key strategies and policies for the company and for ensuring or overseeing the execution and implementation of those

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strategies on a regular and on-going basis. While designation may vary, these persons may include:

(i) Managing Director or Chief Executive Officer;

(ii) Financial Director or Chief Financial Officer;

(iii) Chief Operating Officer; and

(iv) The heads of various divisions or departments (for example, Chief Information or Technology Officer, Director for Sales or Marketing).

(b) **Location of Executive Committee in case powers are delegated by the Board:** A company's board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. In these situations, the location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board will often be considered to be the company's place of effective management.

The delegation of authority may be either *de jure* (by means of a formal resolution or Shareholder Agreement) or *de facto* (based upon the actual conduct of the board and the executive committee).

(c) **Location of Head Office**: The location of a company's head office will be a very important factor in the determination of the company's place of effective management because it often represents the place where key company decisions are made. The following points need to be considered for determining the location of the head office of the company: -

If the company's senior management and their support staff are based in a single location and that location is held out to the public as the company's principal place of business or headquarters then that location is the place where head office is located.

If the company is more decentralized (for example where various members of senior management may operate, from time to time, at offices located in the various countries) then the company's head office would be the location where these senior managers,-

(i) are primarily or predominantly based; or

(ii) normally return to following travel to other locations; or

(iii) meet when formulating or deciding key strategies and policies for the company as a whole.

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Members of the senior management may operate from different locations on a more or less permanent basis and the members may participate in various meetings via telephone or video conferencing rather than by being physically present at meetings in a particular location. In such situation the head office would normally be the location, if any, where the highest level of management (for example, the Managing Director and Financial Director) and their direct support staff are located.

In situations where the senior management is so decentralized that it is not possible to determine the company's head office with a reasonable degree of certainty, the location of a company's head office would not be of much relevance in determining that company's place of effective management.

"Head Office" of a company would be the place where the company's senior management and their direct support staff are located or, if they are located at more than one location, the place where they are primarily or predominantly located. A company's head office is not necessarily the same as the place where the majority of its employees work or where its board typically meets.

(d) **Use of modern technology:** The use of modern technology impacts the place of effective management in many ways. It is no longer necessary for the persons taking decision to be physically present at a particular location. Therefore, physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. In such cases the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor.

(e) **Decision *via* circular resolution or round robin voting:** In case of circular resolution or round robin voting the factors like, the frequency with which it is used, the type of decisions made in that manner and where the parties involved in those decisions are located etc. are to be considered. It cannot be said that proposer of decision alone would be relevant but based on past practices and general conduct; it would be required to determine the person who has the authority and who exercises the authority to take decisions. The place of location of such person would be more important.

(f) **Decisions made by shareholders are not relevant factor in determination of POEM:** The decisions made by shareholder on matters which are reserved for shareholder decision under the company laws are not relevant for determination of a company's place of effective management. Such decisions may include sale of all or substantially all of the company's

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assets, the dissolution, liquidation or deregistration of the company, the modification of the rights attaching to various classes of shares or the issue of a new class of shares etc. These decisions typically affect the existence of the company itself or the rights of the shareholders as such, rather than the conduct of the company's business from a management or commercial perspective and are therefore, generally not relevant for the determination of a company's place of effective management.

However, the shareholder's involvement can, in certain situations, turn into that of effective management. This may happen through a formal arrangement by way of shareholder agreement etc. or may also happen by way of actual conduct. As an example if the shareholders limit the authority of board and senior managers of a company and thereby remove the company's real authority to make decision then the shareholder guidance transforms into usurpation and such undue influence may result in effective management being exercised by the shareholder.

Therefore, whether the shareholder involvement is crossing the line into that of effective management is one of fact and has to be determined on case-to-case basis only.

(g) Day to day routine operational decisions are not relevant for determination of POEM: It may be clarified that day to day routine operational decisions undertaken by junior and middle management shall not be relevant for the purpose of determination of POEM. The operational decisions relate to the oversight of the day-to-day business operations and activities of a company whereas the key management and commercial decision are concerned with broader strategic and policy decision. For example, a decision to open a major new manufacturing facility or to discontinue a major product line would be examples of key commercial decisions affecting the company's business as a whole. By contrast, decisions by the plant manager appointed by senior management to run that facility, concerning repairs and maintenance, the implementation of company-wide quality controls and human resources policies, would be examples of routine operational decisions. In certain situations, it may happen that person responsible for operational decision is the same person who is responsible for the key management and commercial decision. In such cases it will be necessary to distinguish the two type of decisions and thereafter assess the location where the key management and commercial decisions are taken.

If the above factors do not lead to clear identification of POEM, then the final guidelines provide that following secondary factors may be considered:

- Place where main and substantial activity of the company is carried out; or

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- Place where the accounting records of the company are kept.

It needs to be emphasized that the determination of POEM is to be based on all relevant facts related to the management and control of the company, and is not to be determined on the basis of isolated facts that by itself do not establish effective management, as illustrated by the following examples:

(i) The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(ii) The fact that there exists a Permanent Establishment of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(iii) The fact that one or some of the Directors of a foreign company reside in India will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

(iv) The fact of, local management being situated in India in respect of activities carried out by a foreign company in India will not, by itself, be conclusive evidence that the conditions for establishing POEM have been satisfied.

(v) The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

It is reiterated that the above principles for determining the POEM are for guidance only. No single principle will be decisive in itself. The above principles are not to be seen with reference to any particular moment in time rather activities performed over a period of time, during the previous year, need to be considered.

In other words, a "snapshot" approach is not to be adopted. Further, based on the facts and circumstances if it is determined that during the previous year the POEM is in India and also outside India then POEM shall be presumed to be in India if it has been mainly /predominantly in India.

The CBDT also clarified that the Assessing Officer (AO) shall, before initiating any proceedings for holding a company incorporated outside India, on the basis of its POEM, as being resident in India, seek prior approval of the Principal Commissioner or the Commissioner, as the case may be.

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Further, in case the AO proposes to hold a company incorporated outside India, on the basis of its POEM, as being resident in India then any such finding shall be given by the AO after seeking prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners, as the case may be, to be constituted by the Principal Chief Commissioner of the region concerned, in this regard. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

Example 1: *Company A Co. is a sourcing entity, for an Indian multinational group, incorporated in country X and is 100% subsidiary of Indian company (B Co.). The warehouses and stock in them are the only assets of the company and are located in country X. All the employees of the company are also in country X. The average income wise breakup of the company's total income for three years is, -*

(i) 30% of income is from transaction where purchases are made from parties which are non-associated enterprises and sold to associated enterprises.

(ii) 30% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises.

(iii) 30% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises. and

(iv) 10% of the income is by way of interest.

Interpretation: In this case, passive income is 40% of the total income of the company. The passive income consists of, -

(i) 30% income from the transaction where both purchase and sale is from/to associated enterprises; and

(ii) 10% income from interest.

The A Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of A Co. are in India the other requirements of the test is also satisfied. Therefore, company is engaged in active business outside India.

Example 2: *The other facts remain same as that in Example 1 with the variation that A Co. has a total of 50 employees. 47 employees, managing the warehouse, storekeeping, and accounts of the company, are located in country X. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 50 employees*

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is of ₹ 5 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of ₹ 3 crore.

Interpretation: Although the first limb of active business test is satisfied by A Co. as only 40% of its total income is passive in nature. Further, more than 50% of the employees are also situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employee's resident in India exceeds 50% of the total payroll expenditure. Therefore, A Co. is not engaged in active business outside India.

Example 3: *The basic facts are same as in Example 1. Further facts are that all the directors of the A Co. are Indian residents. During the relevant previous year 5 meetings of the Board of Directors is held of which two were held in India and 3 outside India with two in country X and one in country Y.*

Interpretation: The A Co. is engaged in active business outside India as the facts indicated in Example 1 establish. The majority of board meetings have been held outside India. Therefore, the POEM of A Co. shall be presumed to be outside India.

Example 4:*The facts are same as in Example 3 but it is established by the Assessing Officer that although A Co.'s senior management team signs all the contracts, for all the contracts above ₹ 10 lakh the A Co. must submit its recommendation to B Co. and B Co. makes the decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the contracts are above ₹ 10 lakh and over past years also the same trend in respect of value contribution of contracts above ₹ 10 lakh is seen.*

Interpretation: These facts suggest that the effective management of the A Co. may have been usurped by the parent company B Co. Therefore, POEM of A Co. may in such cases be not presumed to be outside India even though A Co. is engaged in active business outside India and majority of board meeting are held outside India.

Example 5: *An Indian multinational group has a local holding company A Co. in country X. The A Co. also has 100% downstream subsidiaries B Co. and C Co. in country X and D Co. in country Y. The A Co. has income only by way of dividend and interest from investments made in its subsidiaries. The Place of Effective Management of A Co. is in India and is exercised by ultimate parent company of the group. The subsidiaries B, C and D are engaged in active business outside India. The meetings of Board of Director of B Co., C Co. and D Co. are held in country X and Y respectively.*

Interpretation: Merely because the POEM of an intermediate holding company is in India, the POEM of its subsidiaries shall not be taken to be in India. Each subsidiary has to be examined

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separately. As indicated in the facts since B Co., C Co., and D Co. are independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India. The POEM of B Co., C Co., and D Co. shall be presumed to be outside India.

Further, the CBDT vide Circular no. 8/2017 dated 23.02.2017 also clarified that POEM guidelines shall not apply to a company having turnover or gross receipts of ₹ 50 crores or less in a financial year.

ILLUSTRATION 3

ABC Inc., a Swedish company headquartered at Stockholm, not having a permanent establishment in India, has set up a liaison office in Mumbai in April, 2025 in compliance with RBI guidelines to look after its day to day business operations in India, spread awareness about the company's products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Directors at Sweden. Determine the residential status of ABC Inc. for A.Y. 2026-27.

SOLUTION

Section 6(3) provides that a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India.

In this case, ABC Inc. is a foreign company. Therefore, it would be resident in India for P.Y.2025-26 only if its place of effective management, in that year, is in India.

Explanation to section 6(3) defines "place of effective management" to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. In the case of ABC Inc., its place of effective management for P.Y.2025-26 is not in India, since the significant management and commercial decisions are, in substance, made by the Board of Directors outside India in Sweden.

ABC Inc. has only a liaison office in India through which it looks after its routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.

Hence, ABC Inc., being a foreign company is a non-resident for A.Y.2026-27, since its place of effective management is outside India in the P.Y.2025-26.

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Transition Mechanism for a company incorporated outside India and has not been assessed to tax earlier [Chapter XII-BC – Section 115JH]

A transition mechanism has been provided in Chapter XII-BC comprising of section 115JH for a company which is incorporated outside India, which has not been assessed to tax in India earlier and has become resident in India for the first time due to application of POEM.

(a) Section 115JH empowers the Central Government to notify exception, modification and adaptation subject to which, the provisions of the Act relating to computation of income, treatment of unabsorbed depreciation, set-off or carry forward and set off of losses, special provision relating to avoidance of tax and the collection and recovery of taxes shall apply in a case where a foreign company is said to be resident in India due to its POEM being in India for the first time and the said company has never been resident in India before.

(b) In a case where the determination regarding foreign company to be resident in India has been made in the assessment proceedings relevant to any previous year, then, these transition provisions would also cover any subsequent previous year, if the foreign company is resident in India in that previous year and the previous year ends on or before the date on which such assessment proceeding is completed. In effect, the transition provisions would also cover any subsequent previous year upto the date of determination of POEM in an assessment proceeding. However, once the transition is complete, then, normal provisions of the Act would apply.

(c) In the notification issued by the Central Government, certain conditions including procedural conditions subject to which these adaptations shall apply can be provided for and in case of failure to comply with the conditions, the benefit of such notification would not be available to the foreign company.

Accordingly, where in a previous year, any benefit, exemption or relief has been claimed and granted to the foreign company in accordance with the notification, and subsequently, there is failure to comply with any of the conditions specified therein, then –

(i) the benefit, exemption or relief shall be deemed to have been wrongly allowed.

(ii) the Assessing Officer may re-compute the total income of the assessee for the said previous year and make the necessary amendment as if the exceptions, modifications, and adaptations as per the notification does not apply; and

(iii) the provisions of section 154 shall, so far as may be, apply thereto and the period of four years for rectification of mistake apparent from the record has to be reckoned

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from the end of the previous year in which the failure to comply with the condition stipulated in the notification takes place.

(d) Every notification issued in exercise of this power by the Central Government shall be laid before each house of the Parliament.

(e) Accordingly, in exercise of the power under section 115JH(1) of the Income-tax Act, 1961,the Central Government has, vide notification No. 29/2018, dated 22nd June, 2018, specified the exceptions, modifications and adaptions subject to which, the provisions of the Act relating to computation of income, treatment of unabsorbed depreciation, set-off or carry forward and set off of losses, special provision relating to avoidance of tax and the collection and recovery of taxes shall apply in a case where a foreign company is said to be resident in India in any previous year on account of its POEM being in India and the such foreign company has not been resident in India before the said previous year.

Particulars	Provisions
Determination of opening WDV	**<u>If the foreign company is assessed to tax in the foreign jurisdiction</u>** **Where depreciation is required to be taken into account for the purpose of computation of its taxable income**, the WDV of the depreciable asset as per the tax record in the foreign country on the 1st day of the previous year shall be adopted as the opening WDV for the said previous year. **Where WDV is not available as per tax records,** the WDV shall be calculated assuming that the asset was installed, utilised and the depreciation was actually allowed as per the provisions of the laws of that foreign jurisdiction. The WDV so arrived at as on the 1st day of the previous year shall be adopted to be the opening WDV for the said previous year. **<u>If the foreign company is not assessed to tax in the foreign jurisdiction</u>** WDV of the depreciable asset as appearing in the books of account as on the 1st day of the previous year

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	maintained in accordance with the laws of that foreign jurisdiction shall be adopted as the opening WDV for the said previous year.
Brought forward loss and unabsorbed depreciation	**<u>If the foreign company is assessed to tax in the foreign jurisdiction</u>** Brought forward loss and unabsorbed depreciation as per the tax record shall be determined year wise on the 1st day of the said previous year. **<u>If the foreign company is not assessed to tax in the foreign jurisdiction</u>** Brought forward loss and unabsorbed depreciation as per the books of account prepared in accordance with the laws of that country shall be determined year wise on the 1st day of the said previous year.
	<u>Other provisions</u> Such brought forward loss and unabsorbed depreciation shall be deemed as loss and unabsorbed depreciation brought forward as on the 1st day of the said previous year and shall be allowed to be set off and carried forward in accordance with the provisions of the Act for the remaining period calculated from the year in which they occurred for the first time taking that year as the first year. However, the losses and unabsorbed depreciation of the foreign company shall be allowed to be set off only against such income of the foreign company which has become chargeable to tax in India on account of it becoming resident in India due to application of POEM. In cases where the brought forward loss and unabsorbed depreciation originally adopted in India are revised or modified in the foreign jurisdiction due to any action of the tax or legal authority, the amount of the loss and

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	unabsorbed depreciation shall be revised or modified for the purposes of set off and carry forward in India.
Period of profit and loss account and balance sheet in cases where accounting year of foreign company does not end on 31st March	The foreign company is required to prepare profit and loss account and balance sheet for the period starting from the date on which the accounting year immediately following said accounting year begins, upto 31st March of the year immediately preceding the period beginning with 1st April and ending on 31st March during which the foreign company has become resident. The foreign company is also required to prepare profit and loss account and balance sheet for succeeding periods of twelve months, beginning from 1st April and ending on 31st March, till the year the foreign company remains resident in India on account of its POEM. **Examples:** **Example 1:** If the accounting year of the foreign company is a calendar year and the company becomes resident in India during P.Y. 2025-26 for the first time due to its POEM being in India, then, the company is required to prepare profit and loss account and balance sheet for the period 1st January, 2025 to 31st March, 2025. It is also required to prepare profit and loss account and balance sheet for the period 1st April, 2025 to 31st March, 2026. For the purpose of carry forward of loss and unabsorbed depreciation in this case, since the period 1st January, 2025 to 31st March, 2025 is less than 6 months, it is to be included in the accounting year immediately preceding the accounting year in which the foreign company is held to be resident in India for the first time. Accordingly, the profit and loss and balance sheet of the Fifteen (15) month period from 1st January, 2025 to 31st March, 2026 is to be prepared.

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	Example 2: If the accounting year of the foreign company is from 1st July to 30th June and the company becomes resident in India during P.Y. 2025-26 for the first time due to its POEM being in India, then, the company is required to prepare profit and loss account and balance sheet for the period 1st July, 2024 to 31st March, 2025. It is also required to prepare profit and loss account and balance sheet for the period 1st April 2025 to 31st March 2026. For the purpose of carry forward of loss and unabsorbed depreciation in this case, since the period is more than 6 months, it is to be treated as a separate accounting year. The loss and unabsorbed depreciation as per tax record or books of account, as the case may be, of the foreign company shall, be allocated on proportionate basis.
Applicability of provisions of Chapter XVII-B (TDS provisions)	Where more than one provision of Chapter XVII-B of the Act applies to the foreign company as resident as well as foreign company, the provision applicable to the foreign company alone shall apply. Compliance to those provisions of Chapter XVII-B of the Act as are applicable to the foreign company prior to it becoming Indian resident shall be considered sufficient compliance to the provisions of said Chapter. The provisions of section 195(2) relating to application to Assessing Officer to determine the appropriate proportion of sum chargeable to tax shall apply in such manner so as to include payment to the foreign company.
Availability of deduction under section 90 or 91 (Foreign tax credit)	The foreign company shall be entitled to relief or deduction of taxes paid in accordance with the provisions of section 90 or section 91 of the Act.

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	Where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India in respect of the income to which it relates and shall be in accordance with the provisions of rule 128 of the Income-tax Rules, 1962.
Non applicability of the notification	The above exceptions, modifications and adaptations shall not apply in respect of such income of the foreign company which otherwise would have been chargeable to tax in India, even if the foreign company had not become Indian resident.
Applicability of the notification where foreign company becomes resident in the subsequent previous year also	In a case where the foreign company is said to be resident in India during a previous year, immediately succeeding a previous year during which it is said to be resident in India; the exceptions, modifications and adaptations shall apply to the said previous year subject to the condition that the WDV, the brought forward loss and the unabsorbed depreciation to be adopted on the 1st day of the previous year shall be those which have been arrived at on the last day of the preceding previous year in accordance with the provisions of this notification.
No effect on other transactions	Any transaction of the foreign company with any other person or entity under the Act shall not be altered only on the ground that the foreign company has become Indian resident.
Applicability of other provisions relating to foreign company	Subject to the above exceptions, modifications and adaptions specifically provided vide this notification, the foreign company shall continue to be treated as a foreign company even if it is said to be resident in India and all the provisions of the Act shall apply accordingly. Consequently, the provisions specifically applicable to—

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	(i) a foreign company, shall continue to apply to it; (ii) non-resident persons, shall not apply to it; and (iii) the provisions specifically applicable to resident, shall apply to it.
Applicability of tax rate on foreign company	In case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the later shall generally prevail. Therefore, the rate of tax in case of foreign company i.e., 35% shall remain the same, i.e., rate of income-tax applicable to the foreign company even though residency status of the foreign company changes from non-resident to resident on the basis of POEM.
Applicability of notification	This notification shall be deemed to have come into force from 1st April 2017.
Meaning of foreign jurisdiction	The place of incorporation of the foreign company.
Applicability of rule 115 of the Income-tax Rules, 1962.	The rate of exchange for conversion into rupees of value expressed in foreign currency, wherever applicable, shall be in accordance with provision of Rule 115 of the Income-tax Rules, 1962. [Rule 115 is given as Annexure 1 at the end of this module]

Determination of Residential Status: A summary

Abbreviations used in the Flow Charts in pages 21.31 & 21.32

IC	=	**Indian Citizen**	**RPY**	=	**Relevant Previous Year**
R	=	**Resident**	**NR**	=	**Non-resident**
IPPYs	=	**Immediately Preceding Previous Years**	**AOP**	=	**Association of Persons**
N & OR	=	**Resident but Not Ordinarily Resident**	**HUF**	=	**Hindu Undivided Family**
ROR	=	**Resident and Ordinarily Resident**			

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Determination of Residential Status of Individual

Deemed resident [Section 6(1A)] An individual, being an Indian citizen, having total income (other than the income from foreign sources) > ₹ 15 lakhs during the RPY would be deemed to be resident in India in that PY, if he is not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature. A deemed resident u/s 6(1A) would always be a RNOR.

Note *– If an individual is a resident in India in the PY as per section 6(1), then, the provision of deemed resident u/s 6(1A) would not apply to him.*

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Determination of Residential Status of HUF/ Firm/ AOP/ BOI/Local Authority/ Artificial Juridical Person/Company

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(2) Scope of Total Income [Section 5]

Section 5 provides the scope of total income which depends on the residential status of the assessee. The scope of total income of an assessee depends upon the following three important considerations:

(i) the residential status of the assessee;

(ii) the place of accrual or receipt of income, whether actual or deemed; and

(iii) the point of time at which the income had accrued to or was received by or on behalf of the assessee.

The ambit of total income of the three classes of assessees would be as follows:

(1) Resident and ordinarily resident (ROR)

The total income of an ROR would, under section 5(1), consist of:

(i) income received or deemed to be received in India during the previous year;

(ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year; and

(iii) income which accrues or arises outside India even if it is not received or brought into India during the previous year.

In simpler words, the global income of a ROR is chargeable to tax in India.

(2) Resident but not ordinarily resident (RNOR)

Under section 5(1), the total income of an RNOR would consist of –

(i) income received or deemed to be received in India during the previous year;

(ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year; and

(iii) income derived from a business controlled in or profession set up in India, even though it accrues or arises outside India.

Note – All other income accruing or arising outside India which is not received or deemed to be received or deemed to accrue or arise in India would not be included in his total income.

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(3) Non-resident

A non-resident's total income under section 5(2) includes:

(i) income received or deemed to be received in India in the previous year; and

(ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year.

Note: All assessees, whether resident or not, are chargeable to tax in respect of their income accrued, arisen, received or deemed to accrue, arise or to be received in India whereas a resident alone (resident and ordinarily resident in the case of individuals and HUF) is chargeable to tax in respect of income which accrues or arises outside India.

Clarification regarding liability to income-tax in India of a non-resident seafarer receiving remuneration in NRE (Non-Resident External) account maintained with an Indian Bank [Circular No.13/2017, dated 11.04.2017 and Circular No.17/2017, dated 26.04.2017]

Income by way of salary, received by non-resident seafarers, for services rendered outside India on foreign ships, is being subjected to tax in India for the reason that the salary has been received by the seafarer into the NRE bank account maintained in India by the seafarer. On receiving representations in this regard, the CBDT examined the matter and noted that section 5(2)(a) of the Income-tax Act, 1961 provides that only such income of a non-resident shall be subjected to tax in India that is either received or is deemed to be received in India.

Accordingly, the CBDT has, vide this circular, clarified that salary accrued to a non-resident seafarer for services rendered outside India on a foreign going ship (with Indian flag or foreign flag) shall not be included in the total income merely because the said salary has been credited in the NRE account maintained with an Indian bank by the seafarer.

.Summary of scope of Total Income

Particulars	Resident and Ordinarily Resident	Not ordinarily Resident	Non-Resident
Income received or deemed to be received in India whether earned in India or elsewhere	Yes	Yes	Yes
Income which accrues or arises or is deemed to accrue or arise in India during the previous year whether received in India or elsewhere	Yes	Yes	Yes

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Income which accrues or arises outside India and received outside India from a business controlled from India	Yes	Yes	No
Income which accrues or arises outside India and received outside India in the previous year from any other source	Yes	No	No
Income which accrues or arises outside India and received outside India during the year(s) preceding the relevant previous year and remitted to India during the relevant previous year	No	No	No

Meaning of "Income received or deemed to be received"

All assessees are liable to tax in respect of the income received or deemed to be received by them in India during the previous year irrespective of -

(i) their residential status, and

(ii) the place of its accrual.

Income is to be included in the total income of the assessee immediately on its actual or deemed receipt. The receipt of income refers to only the first occasion when the recipient gets the money under his control. Therefore, when once an amount is received as income, remittance or transmission of that amount from one place or person to another does not constitute receipt of income in the hands of the subsequent recipient or at the place of subsequent receipt.

Meaning of income 'accruing' and 'due'

Accrue refers to the right to receive income, whereas due refers to the right to enforce payment of the same. For e.g. salary for work done in December will accrue throughout the month, day to day, but will become due on the salary bill being passed on 31st December or 1st January.

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Similarly, on Government securities, interest payable on specified dates arise during the period of holding, day to day, but will become due for payment on the specified dates.

Example:

Interest on Government securities is usually payable on specified dates, say on 1st January and 1st July. In all such cases, the interest would be said to accrue from 1st July to 31st December and on 1st January, it will fall due for payment.

It must be noted that income which has been taxed on accrual basis cannot be assessed again on receipt basis, as it will amount to double taxation.

Explanation 1 to section 5 specifically provides that an item of income accruing or arising outside India shall not be deemed to be received in India merely because it is taken into account in a balance sheet prepared in India.

Further, *Explanation 2* to section 5 makes it clear that once an item of income is included in the assessee's total income and subjected to tax on the ground of its accrual/ deemed accrual, it cannot again be included in the person's total income and subjected to tax either in the same or in a subsequent year on the ground of its receipt - whether actual or deemed.

Income deemed to accrue or arise in India [Section 9]

Under section 9, certain types of income are deemed to accrue or arise in India even though they may actually accrue or arise outside India.

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The categories of income which are deemed to accrue or arise in India are:

(1) Any income accruing or arising to an assessee in any place outside India whether directly or indirectly

(i) through or from any business connection in India,

(ii) through or from any property in India,

(iii) through or from any asset or source of income in India or

(iv) through the transfer of a capital asset situated in India

would be deemed to accrue or arise in India **[Section 9(1)(i)].**

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(i) What is Business Connection?

'Business connection' shall include any business activity carried out through a person acting on behalf of the non-resident [*Explanation 2* to section 9(1)(i)]

For a business connection to be established, the person acting on behalf of the non-resident –

(a) must have an authority, which is habitually exercised in India, to conclude contracts on behalf of the non-resident or

habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and such contracts are

- in the name of the non-resident; or
- for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
- for the provision of services by that non-resident, or

(b) in a case, where he has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident, or

(c) habitually secures orders in India, mainly or wholly for the non-resident.

Further, there may be situations when the person acting on behalf of the non-resident secure order for other non-residents. In such situation, business connection for other non-residents is established if,

i. such other non-resident controls the non-resident or

ii. such other non-resident is controlled by the non-resident or

iii. such other non-resident is subject to same control as that of non-resident.

In all the three situations, business connection is established, where a person habitually secures orders in India, mainly or wholly for such non-residents.

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Agents having independent status are not included in Business Connection: Business connection, however, shall not be established, where the non-resident carries on business through a broker, general commission agent or any other agent having an independent status, if such a person is acting in the ordinary course of his business.

A broker, general commission agent or any other agent shall be deemed to have an independent status where he does not work mainly or wholly for the non-resident.

Where a business is carried on in India through a person referred to in (a), (b) or (c) of (i) above, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India *[Explanation 3 to Section 9(1)(i)]*.

Significant economic presence [Explanation 2A to section 9(1)(i)]

Significant economic presence of a non-resident in India shall also constitute business connection in India.

Significant economic presence means-

	Nature of transaction	Condition
(a)	in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India	Aggregate of payments arising from such transaction or transactions during the previous year should exceed **₹ 2 crores.**

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(b)	systematic and continuous soliciting of business activities or engaging in interaction with users in India	The number of users should be atleast **3 lakhs**.

The above transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) the agreement for such transactions or activities is entered in India;

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

However, transactions or activities of a non-resident in India which are confined to the purchase of goods in India for the purpose of export shall not constitute significant economic presence of such non-resident in India.

Further, where a business connection is established by reason of significant economic presence in India, only so much of income as is attributable to the transactions or activities referred to in (a) or (b) above shall be deemed to accrue or arise in India.

In the case of a non-resident the following shall not, however, be treated as business connection in India *[Explanation 1* to section 9(1)(i)*]:*

(a) In the case of a business, in respect of which all the operations are not carried out in India [*Explanation 1(a)* to section 9(1)(i)]: In the case of a business, other than the business having business connection in India on account of significant economic presence, of which all the operations are not carried out in India, the income of the business deemed to accrue or arise in India shall be only such part of income as is reasonably attributable to the operations carried out in India. Therefore, it follows that such part of income which cannot be reasonably attributed to the operations in India, is not deemed to accrue or arise in India.

Income attributable to the operations carried out in India includes:

- Income from advt. targetting customers residing in India or accessing advt. thro IPA located in India
- Income from sale of data collected from persons residing in India or using IPA located in India
- Income from sale of goods and services using data collected from persons residing in India or using IPA located in India

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The above provisions would also apply to the income attributable to the transactions or activities referred to in *Explanation 2A* to section 9(1)(i).

(b) **Purchase of goods in India for export [Explanation *1(b)* to section 9(1)(i)]:** In the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.

(c) **Collection of news and views in India for transmission out of India [*Explanation 1(c)* to section 9(1)(i)]:** In the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India.

(d) **Shooting of cinematograph films in India [*Explanation 1(d)* to section 9(1)(i)]:** In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is :

- an individual, who is not a citizen of India or
- a firm which does not have any partner who is a citizen of India or who is resident in India; or
- a company which does not have any shareholder who is a citizen of India or who is resident in India.

(e) **Activities confined to display of rough diamonds in SNZs [*Explanation 1(e)* to section 9(1)(i)]**: In case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut and unassorted diamonds in any special zone notified by the Central Government in the Official Gazette in this behalf.

(ii) & (iii) Income from property, asset or source of income in India

Any income which arises from any property in India (movable, immovable, tangible and intangible property) would be deemed to accrue or arise in India.

Examples:

- *Hire charges or rent paid outside India for the use of the machinery or buildings situated in India*
- *deposits with an Indian company for which interest is received outside India etc.*

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(iv) Income through transfer of a capital asset situated in India

Capital gains arising through or from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether

- The capital asset is movable or immovable, tangible or intangible;
- The place of registration of the document of transfer etc., is in India or outside; and
- The place of payment of the consideration for the transfer is within India or outside.

Accordingly, the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of" ***[Explanation 4* to section 9(1)(i)*].***

Further, an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India ***[Explanation 5* to section 9(1)(i)*].***

Cases where an asset or capital asset held by a non-resident is not deemed to be situated in India

(1) An asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 prior to their repeal, made under the Securities and Exchange Board of India Act, 1992, shall not deemed to be or deemed to have been situated in India [Second proviso to *Explanation 5* to section 9(1)(i)]

(2) An asset or a capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019, made under the Securities and Exchange Board of India Act, 1992 shall also not deemed to be or deemed to have been situated in India [Third proviso to *Explanation 5* to section 9(1)(i)]

The CBDT has, vide Circular No. 28/2017, dated 07.11.2017, clarified that the provisions of section 9(1)(i) read with *Explanation 5*, shall not apply in respect of income accruing or arising to a non-resident on account of redemption or buyback of its share or interest held indirectly (i.e. through upstream entities registered or incorporated outside India) in the specified funds (namely, investment funds, venture capital company and venture capital funds) if such income accrues or

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arises from or in consequence of transfer of shares or securities held in India by the specified funds and such income is chargeable to tax in India.

However, the above benefit shall be applicable only in those cases where the proceeds of redemption or buyback arising to the non-resident do not exceed the pro-rata share of the non-resident in the total consideration realized by the specified funds from the said transfer of shares or securities in India. It is further clarified that a non-resident investing directly in the specified funds shall continue to be taxed as per the extant provisions of the Act.

Declaration of dividend by a foreign company outside India does not have the effect of transfer of any underlying assets located in India. *Circular No. 4/2015, dated 26-03-2015*, therefore, clarifies that, the dividends declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would **NOT** be deemed to be income accruing or arising in India by virtue of the provisions of section 9(1)(i).

***Explanation 6* to section 9(1)(i)** provides that the share or interest in a company or entity registered or incorporated outside India, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of Indian assets, -

- exceeds the amount of ₹ 10 crore; and
- represents at least 50% of the value of all the assets owned by the company or entity, as the case may be;

Meaning of certain terms:

Term	Meaning
Value of an asset	The **fair market value as on the specified date**, of such asset **without reduction of liabilities**, if any, in respect of the asset, determined in prescribed manner.
Specified date	The date on which the **accounting period** of the company or, as the case may be, the entity **ends** preceding the date of transfer of a share or an interest. However, the date of transfer shall be the specified date of valuation, in a case where the book value of the assets of the company or entity on the date of transfer exceeds by at least 15%, the book value of the assets as on the last balance sheet date preceding the date of transfer.
Accounting period	Each period of 12 months ending with 31st March. However, where a company or an entity, referred to in *Explanation 5*, regularly adopts a period of 12 months ending on a day other than 31st March for the purpose of—

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	(a) complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or (b) reporting to persons holding the share or interest, then, the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity:
First Accounting Period	First accounting period of the company or, as the case may be, the entity shall **begin from the date of its registration or incorporation** and **end with the 31st March** or such other day, as the case may be, following the date of such registration or incorporation.
Later accounting period	Later accounting period shall be the **successive periods of twelve months**
Accounting period of an entity which ceases to exist	If the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist.

Note - The manner of determination of fair market value of the assets of the foreign company is given in Rule 11UB. Determination of income attributable to assets in India is given in Rule 11UC[2].

***Explanation 7* to section 9(1)(i)** provides that **no income shall be deemed** to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, in the following cases;

(1)	Foreign company or entity **directly** owns the assets situated in India	**AND**	**the transferor** (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, **does not hold** • the right of management or control in relation to foreign company or entity; or • the voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the foreign company or entity; or
(2)	Foreign company or entity **indirectly** owns the assets situated in India	**AND**	**the transferor** (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer, **does not hold** • the right of management or control in relation to foreign company or entity; or

[2] For detailed reading of Rule 11UB and 11UC of the Income-tax Rules, 1962, students may visit https://incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx

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			• any right in, or in relation to, such foreign company or entity which would entitle him to the right of management or control in the company or entity that directly owns the assets situated in India; or • such percentage of voting power or share capital or interest in foreign company or entity which results in holding of (either individually or along with associated enterprises) a voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest, as the case may be, of the company or entity that directly owns the assets situated in India;

In effect, the exemption shall be available to the transferor of a share of, or interest in, a foreign entity if he along with its associated enterprises, -

- neither holds the right of control or management,
- nor holds voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest,

in the foreign company or entity directly holding the Indian assets (direct holding company).

In case the transfer is of shares or interest in a foreign entity which does not hold the Indian assets directly then the exemption shall be available to the transferor if he along with its associated enterprises,-

- neither holds the right of management or control in relation to such company or the entity,
- nor holds any rights in such company which would entitle it to either exercise control or management of the direct holding company or entity or entitle it to voting power or share capital or total interest exceeding 5% in the direct holding company or entity.

Further, where all the assets owned, directly or indirectly, by a company or, as the case may be, an entity registered or incorporated outside India, are not located in India, the income of the non-resident transferor, from transfer outside India of a share of, or interest in the foreign company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets located in India and determined in the prescribed manner.

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"Associated enterprise", in relation to another enterprise, means an enterprise—

- which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- 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.

(2) Income from salaries earned in India [Section 9(1)(ii)]

Income, which falls under the head "Salaries", deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India would be treated as earned in India.

Further, any income under the head "Salaries" payable for rest period or leave period which is preceded and succeeded by services rendered in India, and forms part of the service contract of employment, shall be regarded as income earned in India.

(3) Income from salaries payable by the Government for services rendered outside India [Section 9(1)(iii)]

Income from 'Salaries' which is payable by the Government to a citizen of India for services rendered outside India would be deemed to accrue or arise in India.

However, allowances and perquisites paid or allowed outside India by the Government to an Indian citizen for services rendered outside India is exempt, by virtue of section 10(7).

Note - *Exemption under section 10(7) would be available to an assessee irrespective of the regime under which he pays tax.*

ILLUSTRATION 4

J, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India for the year ended 31.3.2026 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2026-27. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2026-27.

SOLUTION

As per section 9(1)(iii), salaries payable by the Government to a citizen of India for services rendered outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y. 2026-27.

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As per section 10(7), all allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India is exempt from tax. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

(4) Dividend paid by an Indian company outside India [Section 9(1)(iv)]

Dividend paid by an Indian company outside India is deemed to be accrue or arise in India and would be taxable in India in the hands of non-resident shareholders.

(5) Interest [Section 9(1)(v)]

Under section 9(1)(v), an interest is deemed to accrue or arise in India if it is payable by -

(i) the Government;

(ii) a person who is a resident;

Exception: Where it is payable in respect of any debt incurred or money borrowed and used, for the purposes of a business or profession carried on by him outside India or for the purposes of making or earning any income from any source outside India, it will not be deemed to accrue or arise in India.

(iii) a person who is a non-resident only when it is payable in respect of any debt incurred or moneys borrowed and used, for the purpose of a business or profession carried on by such person in India.

Example: *If a non-resident 'A' borrows money from a non-resident 'B' and invests the same in shares of an Indian company, interest payable by 'A' to 'B' will not be deemed to accrue or arise in India.*

Meaning of interest: Interest means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.

Taxability of interest payable by the Permanent Establishment of a non-resident engaged in banking business to the head office

In order to provide clarity and certainty, on the issue of taxability of interest payable by the PE of a non-resident engaged in banking business to the head office, an Explanation has been inserted in section 9(1)(v). Accordingly, in the case of a **non-resident, being a person engaged in the business of banking,** any interest payable by the **PE in India of**

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such non-resident to the head office or any PE or any other part of such non-resident outside India, shall be deemed to accrue or arise in India.

Such interest shall be chargeable to tax in addition to any income attributable to the PE in India.

Further, the PE in India shall be deemed to be a person separate and independent of the non-resident person of which it is a PE and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery would apply accordingly.

Also, the PE in India has to deduct tax at source on any interest payable to either the head office or any other branch or PE, etc. of the non-resident outside India. Non-deduction would result in disallowance of interest claimed as expenditure by the PE and may also attract levy of interest and penalty in accordance with relevant provisions of the Act.

Permanent establishment includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

(6) Royalty [Section 9(1)(vi)]

Royalty will be deemed to accrue or arise in India when it is payable by -

(i) the Government;

(ii) a person who is a resident in India

Exception: Where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, or

(iii) a non-resident only when the royalty is payable in respect of any right, property or information used or services utilised for purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

Important points:

(A) Lumpsum royalty not deemed to accrue arise in India: Lumpsum royalty payments made by a resident for the transfer of all or any rights (including the granting of a license) in respect of **computer software** supplied by a non-resident manufacturer along with computer hardware under any scheme approved by the government under the policy on computer software export, software development and training, 1986 shall not be deemed to accrue or arise in India.

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(B) Meaning of Computer software: "Computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customised electronic data.

(C) Meaning of Royalty: The term 'royalty' means consideration (including any lumpsum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'capital gains') for:

(i) the transfer of all or any rights (including the granting of license) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

(v) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(vi) the transfer of all or any rights (including the granting of license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting.

Note - Consideration for sale, distribution or exhibition of cinematographic films is covered within the scope of royalty.

(vii) the rendering of any service in connection with the activities listed above.

The definition of 'royalty' for this purpose is wide enough to cover both industrial royalties as well as copyright royalties. The definition specially excludes income which should be chargeable to tax under the head 'capital gains'.

(D) Consideration for use or right to use of computer software is royalty within the meaning of section 9(1)(vi)

The consideration for use or right to use of computer software is royalty by clarifying that, transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software

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(including granting of a license) irrespective of the medium through which such right is transferred *[Explanation 4].*

Consequently, the provisions of tax deduction at source under section 194J and section 195 would be attracted in respect of consideration for use or right to use computer software since the same falls within the definition of royalty as per the provisions of the Income-tax Act, 1961.

The Central Government has, vide *Notification No. 21/2012 dated 13.6.2012* to be effective from 1st July, 2012, exempted certain software payments from the applicability of tax deduction under section 194J. Accordingly, where payment is made by the transferee for acquisition of software from a resident-transferor, the provisions of section 194J would not be attracted if –

(1) the software is acquired in a subsequent transfer without any modification by the transferor;

(2) tax has been deducted either under section 194J or under section 195 on payment for any previous transfer of such software; and

(3) the transferee obtains a declaration from the transferor that tax has been so deducted along with the PAN of the transferor.

The issue of whether the amounts paid by resident Indian end-users/ distributors to non-resident computer software manufacturers/ suppliers, as consideration for the use/resale of the computer software through End-User Licence Agreement (EULAs) /distribution agreements, be considered as payment of royalty for the use of copyright in the computer software came up before the Supreme Court in Engineering Analysis Centre of Excellence P. Ltd v. CIT and Another (2021) ITR 471.

The Apex Court observed that as per the definition given in Explanation 2(v) to section 9(1)(vi) of the Income-tax Act, 1961, "royalty" means consideration for, inter alia, the transfer of all or any rights (including the granting of a licence), in respect of any copyright, literary, artistic or scientific work. As per Explanation 4 thereto, such transfer of all or any rights includes transfer of all or any right for use or right to use a computer software (including the granting of a licence). As per the meaning of royalties as assigned in the DTAA with Singapore, "royalty" means payment of any kind received as consideration for "the use of, or the right to use, any copyright" of a literary, artistic or scientific work. The meaning of royalty in India's DTAA with other countries like Australia, Canada, France, Italy, USA, Netherlands, Sweden, Taiwan, Japan, China etc. is also similar if not identical.

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The definition of the royalties under the DTAA does not include transfer of right for use or right to use a computer software.

The scope of definition of royalties under the Act is wider as compared to the definition of royalties under India's DTAA with these countries.

The Apex Court observed the following four categories of cases, in which the distribution agreements and end-user licence agreements did not create any interest or right to such distributors or end-users, which could amount to the use of or right to use any copyright:

(i) where computer software is purchased directly by an end-user, resident in India, from a foreign, non-resident supplier or manufacturer.

(ii) where resident Indian companies acting as distributors or resellers, purchase computer software from foreign, non-resident suppliers or manufacturers and then, resell the same to resident Indian end-users.

(iii) where the distributor happens to be a foreign, non-resident vendor, who, after purchasing software from a foreign, non-resident seller, resells the same to resident Indian distributors or end-users.

(iv) where computer software is affixed onto hardware and is sold as an integrated unit/equipment by foreign, non-resident suppliers to resident Indian distributors or end-users.

Therefore, in the specified cases mentioned above, the Apex Court held that the amount paid by resident Indian end-users or distributors to non-resident computer software manufacturers or suppliers, as consideration for the resale or use of the computer software through end-user licence agreements or distribution agreements, is not royalty. Consequently, the consideration paid to the non-resident computer software manufacturers or suppliers would not be chargeable to tax India. Hence, no tax is required to be deducted at source u/s 195.

(E) Consideration in respect of any right, property or information – Is it royalty?

Royalty includes and has always included consideration in respect of any right, property or information, whether or not,

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India *[Explanation 5].*

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(F) Meaning of Process

The term "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret *[Explanation 6].*

(7) Fees for technical services [Section 9(1)(vii)]

Any fees for technical services will be deemed to accrue or arise in India if they are payable by -

(i) the Government.

(ii) a person who is resident in India

Exception: Where the fees is payable in respect of technical services utilised in a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India.

(iii) a person who is a non-resident, only where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning any income from any source in India.

Fees for technical services mean any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including providing the services of technical or other personnel). However, it does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.

Income deemed to accrue or arise in India to a non-resident by way of interest, royalty and fee for technical services to be taxed irrespective of territorial nexus [*Explanation* to section 9]

Income by way of interest, royalty or fee for technical services which is deemed to accrue or arise in India by virtue of clauses (v), (vi) and (vii) of section 9(1), shall be included in the total income of the non-resident, whether or not –

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India.

In effect, the income by way of fee for technical services, interest or royalty, from services utilized in India would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

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ILLUSTRATION 5

Miss Vivitha, Resident, paid a sum of 5000 USD to Mr. Kulasekhara, a management consultant practising in Colombo, specializing in project financing. The payment was made in Colombo. Mr. Kulasekhara is a non-resident. The consultancy is related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara?

SOLUTION

A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India.

The income deemed to accrue or arise in India under section 9 comprises, *inter alia*, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of "fees for technical services".

The *Explanation* to section 9(2) clarifies that income by way of, *inter alia*, fees for technical services, would be deemed to accrue or arise in India in case of a non-resident and be included in his total income, whether or not such services were rendered in India or whether or not the non-resident has a residence or place of business or business connection in India.

In the instant case, since the services were utilized in India, the payment received by Mr. Kulasekhara, a non-resident, in Colombo is chargeable to tax in his hands in India, as it is deemed to accrue or arise in India.

(8) Any sum of money paid by a resident Indian to a non-corporate non-resident or foreign company or to a resident but not ordinarily resident in India [Section 9(1)(viii)]

Income arising outside India, being any sum of money paid without consideration, by a Indian resident person to a non-corporate non-resident or foreign company *or to a RNOR* would be deemed to accrue or arise in India if the same is chargeable to tax under section 56(2)(x) i.e., if the aggregate of such sum received by a non-corporate non-resident or foreign company exceeds ₹ 50,000.

It may be noted that this deeming provision applies to only sum of money paid outside India to a non-corporate non-resident or foreign company or to a RNOR, and not in respect of property, movable or immovable, transferred outside India without consideration or for inadequate consideration to a non-corporate non-resident or foreign company or to a RNOR.

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ILLUSTRATION 6

Compute the total income in the hands of an individual, aged 55 years, being a resident and ordinarily resident, resident but not ordinarily resident, and non-resident for the A.Y. 2026-27 if he has shifted out of the default tax regime and pays tax under normal provisions of the Act:

Particulars	Amount (₹)
Interest on UK Development Bonds, 50% of interest received in India	10,000
Income from a business in Chennai (50% is received in India)	20,000
Short term capital gains on sale of shares of an Indian company received in London	20,000
Dividend from British company received in London	5,000
Long term capital gains on sale of plant at Germany, 50% of profits are received in India	40,000
Income earned from business in Germany which is controlled from Delhi (₹ 40,000 is received in India)	70,000
Profits from a business in Delhi but managed entirely from London	15,000
Income from house property in London deposited in an Indian Bank at London, brought to India (Computed)	50,000
Interest on debentures in an Indian company received in London	12,000
Fees for technical services rendered in India but received in London	8,000
Profits from a business in Bombay managed from London	26,000
Pension for services rendered in India but received in London (Computed)	4,000
Income from property situated in Pakistan, received there (Computed)	16,000
Past foreign untaxed income brought to India during the previous year	5,000
Income from agricultural land in Nepal received there and then brought to India	18,000
Income from profession in Kenya which was set up in India, received there but spent in India	5,000
Gift received on the occasion of his wedding	20,000
Interest on savings bank deposit in State Bank of India	12,000
Income from a business in Russia, controlled from Russia	20,000
Dividend from Reliance Petroleum Limited, an Indian Company	5,000
Agricultural income from a land in Rajasthan	15,000

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SOLUTION

Computation of total income for the A.Y. 2026-27

Particulars	Resident and ordinarily resident ₹	Resident but not ordinarily resident ₹	Non-resident ₹
Interest on UK Development Bonds, 50% of interest received in India	10,000	5,000	5,000
Income from a business in Chennai (50% is received in India)	20,000	20,000	20,000
Short term capital gains on sale of shares of an Indian company received in London	20,000	20,000	20,000
Dividend from British company received in London	5,000	-	-
Long term capital gain on sale of plant at Germany, 50% of profits are received in India	40,000	20,000	20,000
Income earned from business in Germany which is controlled from Delhi, out of which ₹ 40,000 is received in India	70,000	70,000	40,000
Profits from a business in Delhi but managed entirely from London	15,000	15,000	15,000
Income from property in London deposited in a Bank at London, later on remitted to India	50,000	-	-
Interest on debentures in an Indian company received in London	12,000	12,000	12,000
Fees for technical services rendered in India but received in London	8,000	8,000	8,000
Profits from a business in Bombay managed from London	26,000	26,000	26,000
Pension for services rendered in India but received in London	4,000	4,000	4,000
Income from property situated in Pakistan, received there	16,000	-	-
Past foreign untaxed income brought to India during the previous year	-	-	-

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Income from agricultural land in Nepal received there and then brought to India	18,000	-	-
Income from profession in Kenya which was set up in India, received there but spent in India	5,000	5,000	-
Gift received on the occasion of his wedding **[not taxable]**	-	-	-
Interest on savings bank deposit in SBI	12,000	12,000	12,000
Income from a business in Russia, controlled from Russia	20,000	-	-
Dividend from Reliance Petroleum Limited, an Indian Company	5,000	5,000	5,000
Agricultural income from a land in Rajasthan **[Exempt under section 10(1)]**	-	-	-
Gross Total Income	**3,56,000**	**2,22,000**	**1,87,000**
Less: Deduction u/s 80TTA			
[Interest on savings bank account subject to a maximum of ₹ 10,000]	10,000	10,000	10,000
Total Income	**3,46,000**	**2,12,000**	**1,77,000**

(3) Presence of Eligible Fund Manager in India not to constitute Business Connection in India of such Eligible Investment Fund on behalf of which he undertakes Fund Management Activity [Section 9A]

(i) **Fund Management Activity through an eligible fund manager not to constitute business connection [Section 9A(1)]:** In the case of an eligible investment fund, the fund management activity carried out through an eligible fund manager acting on behalf of such fund shall not constitute business connection in India of the said fund, subject to fulfillment of certain conditions.

(ii) **Location of Fund Manager in India not to affect residential status of an eligible investment fund [Section 9A(2)]:** An eligible investment fund shall not be said to be resident in India merely because the eligible fund manager undertaking fund management activities on its behalf, is located in India.

(iii) **Conditions to be fulfilled by an Eligible Investment Fund [Section 9A(3)]:** The eligible investment fund means a fund established or incorporated or registered outside India,

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which collects funds from its members for investing it for their benefit. Further, it should fulfill the following conditions:

(a) the fund should not be a person resident in India;

(b) the fund should be a resident of a country or a specified territory with which an agreement referred to in section 90(1) or section 90A(1) has been entered into or should be established or incorporated or registered, outside India in a country or a specified territory notified by the Central Government in this behalf;

(c) the aggregate participation or investment in the fund, directly by persons being resident in India should not exceed 5% of the corpus of the fund ***as on 1st April and 1st October of the previous year***;

However, for the purposes of calculation of aggregate participation or investment in the fund, any contribution made by the eligible fund manager during the first 3 years of operation of the fund, not exceeding ₹ 25 crore, would not be taken into account.

Further, if the aggregate participation or investment in the fund exceeds 5% as on 1st April and 1st October of the previous year, the condition mentioned above will be deemed to be satisfied if the fund reduces its aggregate participation or investment to 5% or less within 4 months from 1st April or 1st October of such previous year, as the case may be.

(d) the fund and its activities should be subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident;

(e) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%;

(h) the investment by the fund in any entity shall not exceed 20% of the corpus of the fund;

(i) no investment shall be made by the fund in its associate entity;

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(j) the monthly average of the corpus of the fund shall not be less than ₹ 100 crore. If the fund has been established or incorporated in the previous year, the corpus of fund should not be less than ₹ 100 crore at the end of a period of twelve months from the last day of the month of its establishment or incorporation;

However, this condition shall not be applicable to a fund which has been wound up in the previous year.

(k) the fund shall not carry on or control and manage, directly or indirectly, any business in India;

(l) the fund should neither be engaged in any activity which constitutes a business connection in India nor should have any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf.

(m) the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken on its behalf should not be less than the amount calculated in the prescribed manner.

(iv) **Certain conditions not to apply to investment fund set up by the Government or the Central Bank of a foreign State or a Sovereign Fund or other notified fund [Proviso to Section 9A(3)]:** The following conditions would, however, not be applicable in case of an investment fund set up by the Government or the Central Bank of a foreign State or a sovereign fund or such other fund notified by the Central Government [i.e., an investment fund set up by a Category-I or Category-II Foreign Portfolio Investor registered under the SEBI (Foreign Portfolio Investors) Regulations, 2014, made under the SEBI Act, 1992 and an investment fund set up by a Category-I foreign portfolio investor registered under the SEBI (Foreign Portfolio Investors) Regulations, 2019, made under the SEBI Act, 1992]:

(e) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%.

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(v) **Eligible Fund Manager [Section 9A(4)]:** The eligible fund manager, in respect of an eligible investment fund, means any person who is engaged in the activity of fund management and fulfills the following conditions:

(a) the person should not be an employee of the eligible investment fund or a connected person of the fund;

(b) the person should be registered as a fund manager or investment advisor in accordance with the specified regulations;

> The CBDT has, vide **Circular No.8/2019 dated 10.5.2019**, clarified that a fund manager includes an Asset Management Company (AMC) approved by SEBI under the SEBI (Mutual Funds) Regulations, 1996. This is because AMCs are engaged in the activity of fund management of Mutual Funds and hence are, in substance, Fund Managers.

(c) the person should be acting in the ordinary course of his business as a fund manager;

(d) the person along with his connected persons shall not be entitled, directly or indirectly, to more than 20% of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through such fund manager.

(vi) **Furnishing of Statement in prescribed form [Section 9A(5)]:** Every eligible investment fund shall, in respect of its activities in a financial year, furnish within 90 days from the end of the financial year, a statement in the prescribed form to the prescribed income-tax authority. The statement should contain information relating to –

(a) the fulfillment of the above conditions; and

(b) such other relevant information or document which may be prescribed.

If any eligible investment fund fails to furnish such statement or information or document within 90 days from the end of the financial year, the income-tax authority prescribed under the said sub-section may direct that such fund shall pay, by way of penalty, a sum of ₹ 5,00,000 [Section 271FAB].

(vii) **Non-applicability of special taxation regime under section 9A [Section 9A(6)/(7)]:** This special taxation regime would not have any impact on taxability of any income of the eligible investment fund which would have been chargeable to tax irrespective of whether

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the activity of the eligible fund manager constituted business connection in India of such fund or not.

Further, the said regime shall not have any effect on the scope of total income or determination of total income in the case of the eligible fund manager.

(viii) CBDT to prescribe guidelines for the manner of application of the provisions of this section.

(ix) **Certain conditions not to apply or apply with modification to investment fund and its fund manager, if such fund manager is located in an IFSC and has commenced its operation on or before *31.3.2030* [Section 9A(8A)]:** The Central Government may, by notification, specify that any one or more of the conditions specified in point (iii) and (v) above would not be applicable or applicable with such modifications, as may be specified in such notification in case of an eligible investment fund and its eligible fund manager, if such fund manager is located in an IFSC as defined in section 80LA and has commenced its operation on or before ***31.3.2030***:

Accordingly, the Central Government has, vide Notification No. 59/2022 dated 6.6.2022, specified that in case of –

I. An eligible investment fund -

(i) the following conditions mentioned under section 9A(3) would not be applicable

(e) the fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;

(f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;

(g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%.

(ii) the condition mentioned above in clause (k) of section 9A(3) would apply after the following modification -

"the fund shall not carry on, or participate in, the day to day operations of any person in India and for this purpose the monitoring mechanism to

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protect the investment in such person including the right to appoint directors or executive director shall not be considered as participation in day to day operations of such person in India"

II. Eligible fund manager –

The condition specified in section 9A(4)(b) would apply after the following modification:

"the person is registered as a portfolio manager or an investment advisor in accordance with the IFSC Authority (Capital Market Intermediaries) Regulation 2021 as notified under the IFSC Authority Act, 2019 or such other regulations made under the IFSC Authority Act, 2019".

(x) **Meaning of certain terms:**

Term	Meaning
Associate	An entity in which a director or a trustee or a partner or a member or a fund manager of the investment fund or a director or a trustee or a partner or a member of the fund manager of such fund, holds, either individually or collectively, share or interest, being more than 15% of its share capital or interest, as the case may be.
Corpus	The total amount of funds raised for the purpose of investment by the eligible investment fund as on a particular date.
Connected person	Any person who is connected directly or indirectly to another person and includes,— (a) any relative of the person, if such person is an individual; (b) any director of the company or any relative of such director, if the person is a company; (c) any partner or member of a firm or association of persons or body of individuals or any relative of such partner or member, if the person is a firm or association of persons or body of individuals; (d) any member of the Hindu undivided family or any relative of such member, if the person is a Hindu undivided family; (e) any individual who has a substantial interest in the business of the person or any relative of such individual; (f) a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a

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	substantial interest in the business of the person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member; (g) a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member has a substantial interest in the business of the person, or family or any relative of such director, partner or member; (h) any other person who carries on a business, if - (i) the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or (ii) the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu undivided family, or any director, partner or member of such company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member, has a substantial interest in the business of that other person;

21.3 EXEMPTED INCOME OF NON RESIDENTS

Section 10 of the Income-tax Act, 1961 exempts from tax various incomes including the following in the hands of a non-resident:

(1) Interest on moneys standing to the credit of individual in his NRE A/c [Section 10(4)(ii)]

As per 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 (NRE A/c) in any bank in India in accordance with the Foreign Exchange Management Act, 1999 (FEMA, 1999), and the rules made thereunder, would be exempt, provided such individual;

- is a person resident outside India, as defined in FEMA, 1999, or
- is a person who has been permitted by the Reserve Bank of India to maintain such account.

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The benefit of exemption under section 10(4)(ii) will be available to joint account holders, subject to fulfilment of other conditions contained in that section by each of the individual joint account holders.

Example: Mrs. Neena Kansal, is resident of Singapore since year 2000. She holds an NRE account with Bank of Baroda, New Delhi Branch. Interest of ₹ 10,000 was credited to such account during financial year 2025-26. Such interest income earned by her shall be exempt from income-tax while she files her tax return for A.Y 2026-27.

(2) Interest income of a non-corporate non-resident or foreign company on specified off-shore Rupee Denominated Bonds issued by an Indian company or business trust [Section 10(4C)]

Interest payable by an Indian company or business trust to a non-corporate non-resident or a foreign company in respect of money borrowed from a source outside India by way of issue of rupee denominated bond during the period from 17.9.2018 to 31.3.2019 would be exempt.

(3) Income of a specified fund on transfer of certain asset [Section 10(4D)]

Following income accrued or arising to or received by specified fund would be exempt -

- any income from transfer of a capital asset, being a bond of an Indian Company or a public sector company (sold by the Government and purchased by the specified fund in foreign currency), GDR or rupee denominated bond of an Indian company or derivative or any other notified security, on a recognized stock exchange located in any IFSC and where the consideration is paid or payable in convertible foreign exchange or
- any income from transfer of securities (other than shares in a company resident in India) or
- any income from securities issued by a non-resident (not being a permanent establishment of a non-resident in India) and where such income otherwise does not accrue or arise in India or
- any income from a securitisation trust which is chargeable under the head "Profits and gains of business or profession",

to the extent such income accrued or arisen to, or is received is attributable to units held by non-resident (not being the permanent establishment of a non-resident in India) or is attributable to the investment division of offshore banking unit, as the case may be, computed in the prescribed manner.

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Condition for exemption - The income attributable to units held by non-resident (not being the permanent establishment of a non-resident in India) in a specified fund would not be exempt under section 10(4D) unless the specified fund furnish the annual statement of exempt income on or before the due date u/s 139(1).

The income of a specified fund attributable to an eligible investment division would not be exempt under section 10(4D) unless it furnishes the annual statement of exempt income and the report of audit on or before the said due date. *[Notification no. 64/2022 dated 16.6.2022].*

Meaning of certain terms:

S.No.	Term	Meaning
1	**Securities**	Securities includes (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or a pooled investment vehicle or other body corporate; (ii) derivative; (iii) units or any other instrument issued by any collective investment scheme to the investors in such schemes; (iv) security receipt; (v) units or any other such instrument issued to the investors under any mutual fund scheme; It does not include any unit linked insurance policy or scrips or any such instrument or unit which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer (vi) units or any other instrument issued by any pooled investment vehicle; (vii) any certificate or instrument, issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be; (viii) Government securities; (ix) such other instruments as may be declared by the Central Government to be securities; and (x) rights or interest in securities It shall also include such other securities or instruments as may be notified by the Central Government.

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2	**Investment division of offshore banking unit**	An investment division of a banking unit of a non-resident located in an IFSC, as referred to in section 80LA(1A) and which has commenced its operations on or before ***31.3.2030***.
3	**Specified fund**	(i) A fund established or incorporated in India in the form of a trust or a company or a LLP or a body corporate, – (I) (a) which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the SEBI (Alternative Investment Fund) Regulation, 2012, made under the SEBI Act, 1992 or regulated under the IFSC Authority (Fund Management) Regulations, 2022 made under the IFSC Authority Act, 2019; *(b) which has been granted a certificate as a retail scheme or an Exchange Traded Fund and satisfies the conditions laid down for such schemes or funds under the IFSC Authority (Fund Management) Regulations, 2022, made under the IFSC Authority Act, 2019;* (II) which is located in any IFSC; and (III) of which all the units are held by non-residents other than units held by a sponsor or manager However, this condition would not apply where any unit holder or holders, being non-resident during the previous year when such unit or units were issued, becomes resident under section 6(1) or (1A) in any previous year subsequent to that year, if the aggregate value and number of the units held by such resident unit holder or holders do not exceed 5% of the total units issued and fulfill such other conditions as may be prescribed. (ii) investment division of an offshore banking unit, which has been (I) granted a certificate of registration as a Category-I foreign portfolio investor under the SEBI (Foreign Portfolio Investors) Regulations, 2019 made under the SEBI Act, 1992 and which has commenced its operations on or before ***31.3.2030***; and (II) fulfils such conditions including maintenance of separate accounts for its investment division, as may be prescribed.

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4	**Trust**	A trust established under the Indian Trust Act, 1882 or under any other law for the time being in force.
5	**Unit**	Unit means beneficial interest of an investor in the fund and shall include shares or partnership interests.
6	**Manager**	Any person or entity who is appointed by the Alternative Investment Fund to manage its investment by whatever name called. Manager may also be same as the sponsor of the Fund.
7	**Sponsor**	Any person or persons who set up the Alternative Investment Fund and includes promoter in case of a company and designated partner in case of LLP.

(4) Income of a non-resident as a result of transfer of non-deliverable forward contracts/ offshore derivative instruments/ over the counter derivatives entered into with an offshore banking unit of an IFSC [Section 10(4E)]

Any income accrued or arisen to, or received by a non-resident as a result of

- transfer of non-deliverable forward contracts or offshore derivative instruments or over-the-counter derivatives, or
- distribution of income on offshore derivative instruments ***or over-the-counter derivatives***,

entered into with an offshore banking unit of an IFSC as referred to in section 80LA(1A) ***or any Foreign Portfolio Investor being a unit of an IFSC***, which fulfils prescribed conditions would be exempt.

Accordingly, Rule 21AK specifies the following conditions to be fulfilled for claiming such exemption -

- the non-deliverable forward contract or offshore derivative instruments or over-the-counter derivatives is entered into by the non-resident with an offshore banking unit of an IFSC which holds a valid certificate of registration granted under IFSC Authority (Banking) Regulations, 2020 by the IFSC Authority ***or any Foreign Portfolio Investor being a unit of an IFSC***; and
- such contract or instrument or derivative is not entered into by the non-resident through or on behalf of its permanent establishment in India [The offshore banking unit (i.e., a banking branch unit located in an IFSC) ***or the Foreign Portfolio Investor*** has to ensure that this condition is complied with].

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Meaning of Certain terms:

Term	Meaning
Non-deliverable forward contract	A contract for the difference between an exchange rate agreed before and the actual spot rate at maturity, with the spot rate being taken as the domestic rate or a market determined rate and such contract being settled with a single payment in a foreign currency.
Offshore banking unit	A banking branch Unit located in an IFSC, as referred to in section 80LA(1A).
Offshore derivative instrument	Any instrument, by whatever name called, which is issued overseas by a foreign portfolio investor against securities held by it in India, as its underlying [Regulation 2(1)(o) of the SEBI Foreign Portfolio Investor Regulations, 2019];
Over-the-counter derivatives	A derivative contract that is not traded on an exchange but instead is privately negotiated between a purchaser and a seller.
Foreign Portfolio Investor	***A person registered under the SEBI (Foreign Portfolio Investors) Regulations, 2019 made under the SEBI Act, 1992***

(5) Income of a non-resident by way of royalty or interest, on account of lease of an aircraft or a ship in a previous year, paid by a unit of an IFSC [Section 10(4F)]

Income of a non-resident by way of royalty or interest, on account of lease of an aircraft or a ship in a previous year, paid by a unit of an IFSC referred to in section 80LA(1A), if the unit has commenced its operations on or before ***31.3.2030*** would be exempt.

"Aircraft", here, means an aircraft or a helicopter, or an engine of an aircraft or a helicopter, or any part thereof.

“Ship” means a ship or an ocean vessel, engine of a ship or ocean vessel, or any part thereof.

(6) Income received by a non-resident in an account maintained with an offshore banking unit in any IFSC [Section 10(4G)]

Any income received by a non-resident from

- portfolio of securities or financial products or funds, managed or administered by any portfolio manager on behalf of such non-resident, or
- such activity carried out by such person as may be notified by the Central Government,

in an account maintained with an Offshore Banking Unit in any IFSC, as referred to in section 80LA(1A) would be exempt, to the extent such income accrues or arises outside India and is not deemed to accrue or arise in India.

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(7) Income received by a non-resident or a Unit of an IFSC [Section 10(4H)]

Any income of a non-resident or a Unit of IFSC, as referred to in section 80LA(1A) engaged primarily in the business of leasing of an aircraft ***or a ship***, by way of capital gains on transfer of equity shares of domestic company, being a Unit of an IFSC, as referred to in section 80LA(1A), engaged primarily in the business of lease of an aircraft ***or a ship*** which has commenced operations on or before ***31.3.2030*** would be exempt.

The exemption from capital gains on transfer of equity shares of such domestic company is available for a period of ten assessment years -

(i) from A.Y. relevant to the P.Y. in which the domestic company has commenced its operations or

(ii) from A.Y. 2024-25, where the period of 10 A.Ys. under (i) above ends before 1.4.2034.

"Aircraft" means an aircraft or a helicopter, or an engine of an aircraft or a helicopter, or any part thereof.

"Ship" means a ship or an ocean vessel, engine of a ship or ocean vessel, or any part thereof.

(8) Remuneration received by individuals, who are not citizens of India [Section 10(6)]

(i) **Remuneration received by officials of Embassies etc. of Foreign States [Section 10(6)(ii)]**: The remuneration received by an individual, who is **not** a citizen of India, for services as an official by whatever name called of an embassy, high commission, legation, commission, consulate or trade representation of foreign state, or a member of staff of any of these official, for service in such capacity is exempt.

Conditions

(a) The remuneration received by our corresponding Government officials resident in such foreign countries should be exempt.

(b) The above-mentioned member of the staff of such officials should be the subjects of the respective countries and should not be engaged in any other business or profession or employment in India.

Examples:

- *Mr. A, a citizen of India but resident of USA since year 2012, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2025-26.* ***Being an Individual who is a citizen of India, though***

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fulfilling other conditions of the section, such remuneration shall not be exempt in his hands for A.Y. 2026-27.

- *Mr. Vikram Kohli, an Indian born person but currently a resident and Citizen of USA, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2025-26.* ***Being an Individual who is not a citizen of India and also fulfilling other conditions of the section, such remuneration shall be exempt in his hands for A.Y. 2026-27, subject to fulfilment of conditions.***
- *Mr. Frank D'Souza, an Irish Citizen but currently the resident of USA, was appointed as a senior official of the US embassy in India. He earned a remuneration of ₹ 10 lakhs during F.Y. 2025-26.* ***Being an Individual who is not a citizen of India, such remuneration shall be exempt in his hands for A.Y. 2026-27, subject to fulfilment of the conditions.***

(ii) **Remuneration received for services rendered in India by a Foreign National employed by foreign enterprise [Section 10(6)(vi)]:** The remuneration received by a foreign national as an employee of a foreign enterprises, for services rendered by him during his stay in India is exempt from tax.

Conditions

(a) The foreign enterprise is not engaged in any business or trade in India:

(b) The employee's stay in India does not exceed in the aggregate a period of 90 days in such previous year, and

(c) The remuneration is not liable to be deducted from the income of the employer chargeable under the Income-tax Act, 1961.

Examples:

- *Mr. A, citizen of India but resident of USA since year 2012, was appointed in India in October, 2024 as an employee of a US enterprise. Such US enterprise is not engaged in any business in India. A's job requires him to visit his US office every twenty five (25) days for reporting purposes.*
  During F.Y. 2025-26, Mr. A earned a remuneration of ₹ 10 lakhs for his India related assignment and his stay in India in aggregate was 85 days. Further, such US enterprise has not claimed any deduction of such remuneration under the Income-tax Act, 1961.

  Being an Individual who is a citizen of India, such remuneration shall not be exempt in his hands for A.Y. 2026-27 under this section i.e., section 10(6)(vi), though he may get exemption under any other provision of the Income-tax Act, 1961, subject to fulfilment of conditions stipulated thereunder.

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- *In the above case, let's consider that Mr. A is a citizen of USA. All other facts remaining same, his* ***remuneration shall be exempt from tax in his hands for A.Y. 2026-27 under this section.***
- *Let's take another variation, Mr. A is a citizen of USA but the remuneration paid to him is borne by the permanent establishment of such US enterprise in India. ₹ 10 lakhs paid to A is cross charged by the US enterprise to its Indian permanent establishment (PE).*

  In this case, the remuneration shall not be exempt from taxation in the hands of Mr. A as the same is getting deducted from the income of the Indian PE of such foreign enterprise.

(iii) **Salary received by a non-citizen for services rendered in connection with employment on foreign ship [Section 10(6)(viii)]**: Any income chargeable under the head "Salaries" received by or due to, non-citizen of India who is also a non-resident as remuneration for services rendered in connection with his employment on a foreign ship is exempt provided his total stay in India does not exceed 90 days during the previous year.

(iv) **Remuneration received by Foreign Government employees during their stay in India for specified training [Section 10(6)(xi)]**: Any remuneration received by employee of the Government of a foreign state from their respective Government during his stay in India, is exempt from tax, if remuneration is received in connection with training in any establishment or office of or in any undertaking owned by,-

(a) the Government; or

(b) any company owned by the Central Government or any State Government or partly by the Central Government and partly by one or more State Government; or

(c) any company which is subsidiary of a company referred to in (b) above, or

(d) any statutory corporation; or

(e) any society registered under Societies Registration Act, 1860 or under any law and wholly financed by the Central Government or any State Government(s) or partly by the Central Government and partly by one or more State Governments.

It may be carefully noted that exemption is available under section 10(6) only to an individual who is not a citizen of India.

(9) Income of a foreign company from lease rentals of cruise ships received from a specified company [Section 10(15B)]

Any income of a foreign company from lease rentals, by whatever name called, of cruise ships received from specified company which operates such ship or ships in India, would be exempt.

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The income would be exempt, where such foreign company and the specified company are subsidiaries of the same holding company, and such income is received or accrues or arises in India for any assessment year on or before 1.4.2030.

Meaning of Certain terms:

Term	Meaning
Specified company	Any company, other than a domestic company which operates cruise ships in India and opts to pay tax in accordance with the provisions of section 44BBC
Holding company, in relation to a foreign company or a specified company	A company of which such companies are subsidiary companies
Subsidiary company or subsidiary, in relation to a holding company	A company in which the holding company exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies

(10) Income accruing or arising to or received by a unit holder from a specified fund or on transfer of units in a specified fund [Section 10(23FBC)]

(i) **Nature of income exempted:** Any income accruing or arising to or received by a unit holder from a specified fund or on transfer of units in a specified fund would be exempt.

(ii) **Meaning of specified Fund:**

(a) A fund established or incorporated in India in the form of a trust or a company or a LLP or a body corporate, –

- (a) which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the SEBI (Alternative Investment Fund) Regulation, 2012, made under the SEBI Act, 1992 or regulated under the IFSC Authority (Fund Management) Regulations, 2022 made under the IFSC Authority Act, 2019;

  (b) which has been granted a certificate as a retail scheme or an Exchange Traded Fund and satisfies the conditions laid down for such schemes or funds under the IFSC Authority (Fund Management) Regulations, 2022, made under the IFSC Authority Act, 2019;

- which is located in any IFSC and

- of which all the units are held by non-residents other than units held by a sponsor or manager

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However, this condition would not apply where any unit holder or holders, being non-resident during the previous year when such unit or units were issued, becomes resident under section 6(1) or (1A) in any previous year subsequent to that year, if the aggregate value and number of the units held by such resident unit holder or holders do not exceed 5% of the total units issued and fulfill such other conditions as may be prescribed

(b) Investment division of an offshore banking unit, which has been

- granted a certificate of registration as a Category-I foreign portfolio investor under the SEBI (Foreign Portfolio Investors) Regulations, 2019 made under the SEBI Act, 1992 and which has commenced its operations on or before ***31.3.2030***; and
- fulfils such conditions including maintenance of separate accounts for its investment division, as may be prescribed;

(iii) **Meaning of Unit:** It means beneficial interest of an investor in the fund and shall include shares or partnership interests.

(11) Certain incomes of wholly owned subsidiary of Abu Dhabi Investment Authority, Sovereign Wealth Fund and specified pension fund [Section 10(23FE)]

(i) **Nature of income exempted:** Any income of a specified person in the nature of

- dividend,
- interest
- any sum referred to in section 56(2)(xii) i.e. any specified sum received by a unit holder from a business trust during the previous year, with respect to a unit held by him at any time during the previous year or
- long-term capital gains ***(whether or not such capital gains are deemed as short-term capital gains under section 50AA)***

arising from an investment made by it in India, whether in the form of debt or share capital or unit would be exempt, if such investment –

(a) is made on or after 1st April, 2020 but on or before ***31st March, 2030***; and

(b) is held for at least three years.

(ii) **Eligible investment:** Such investment should be in

(a) a business trust; or

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(b) a company or enterprise or an entity carrying on the business of developing, or operating and maintaining, or developing, operating and maintaining any infrastructure facility as defined in *Explanation* to section 80-IA(4)(i) or such other business as notified by the Central Government in this behalf; or

(c) a Category-I or Category-II AIF regulated under the SEBI (Alternative Investment Fund) Regulations, 2012, made under the SEBI Act, 1992, having not less than 50% investment in one or more of the company or enterprise or entity referred to in (b) or (d) or (e) or in an Infrastructure Investment Trust; or

(d) a domestic company, set up and registered on or after 1.4.2021, having minimum 75% investments in one or more of the companies or enterprises or entities referred to in (b); or

(e) a non-banking financial company registered as an Infrastructure Finance Company as referred to in notification number RBI/2009-10/316 issued by the RBI or in an Infrastructure Debt Fund, a non-banking finance company, as referred to in the Infrastructure Debt Fund - NBFC (Reserve Bank) Directions, 2011, issued by the RBI, having minimum 90% lending to one or more of the companies or enterprises or entities referred to in (b).

The Central Government may prescribe the method of calculation of "50%" referred to in (c) or "75%" referred to in (d) or "90%" referred to in (e).

(iii) **Power of CBDT to issue guidelines:** In case any difficulty arises regarding interpretation or implementation of the provisions of this clause, the CBDT may issue guidelines for the purpose of removing the difficulty with the approval of the Central Government.

Every guideline issued by the CBDT has to be laid before each House of Parliament, and shall be binding on the income-tax authorities and specified person.

(iv) **Taxability on failure to satisfy the conditions:** Where any income has not been included in the total income of the specified person due to the aforesaid provisions, and subsequently during any previous year the specified person fails to satisfy any of the conditions mentioned so that the said income would not have been eligible for such non-inclusion, such income shall be chargeable to income-tax as the income of the specified person of that previous year.

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(v) **Proportionate exemption of income attributable to investment in Category-I or Category-II AIF, domestic companies or NBFC referred to in (c), (d) or (e) of (ii) above if they are not having 100% investment in specified companies or entities:**

(a) In case a Category-I or Category-II AIF referred to in (c) of (ii) above has investment of less than 100% in one or more of the companies or enterprises or entities referred to in (b) or (d) or (e) of (ii) above or in an Infrastructure Investment Trust referred to in (c) of (ii) above, income accrued or arisen or received or attributable to such investment, directly or indirectly, which is exempt under this section shall be calculated proportionately to that investment made in one or more of the companies or enterprises or entities referred to in (b) or (d) or (e) of (ii) above or in the Infrastructure Investment Trust referred to in (c) of (ii) above, in such manner as may be prescribed.

(b) In case a domestic company referred to in (d) of (ii) above has investment of less than 100% in one or more of the companies or enterprises or entities referred to in (b) of (ii) above, income accrued or arisen or received or attributable to such investment, directly or indirectly, which is exempt under this section shall be calculated proportionately to that investment made in one or more of the companies or enterprises or entities referred to in (b) of (ii) above, in such manner as may be prescribed.

(c) In case a non-banking finance company registered as an Infrastructure Finance Company or Infrastructure Debt Fund referred to in (e) of (ii) above has lending of less than 100% in one or more of the companies or enterprises or entities referred to in (b) of (ii) above, income accrued or arisen or received or attributable to such lending, directly or indirectly, which is exempt under this section shall be calculated proportionately to the lending made in one or more of the companies or enterprises or entities referred to in (b) of (ii) above, in such manner as may be prescribed.

(vi) **Non applicability of exemption under section:** In case a sovereign wealth fund or pension fund has loans or borrowings, directly or indirectly, for the purposes of making investment in India, such fund shall be deemed to be not eligible for exemption under this section.

In order to address the concern with regard to the term "indirect borrowings" which have not been defined in the section and the consequent eligibility or otherwise of the exemption to the specified fund, where the loan and borrowings have been taken by the specified fund or its holding or any other entity in the chain of holding or any associate thereof, the CBDT has, vide Circular No. 19/2021 dated 26.10.2021, issued the guidelines and clarified the following:

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- if the loans and borrowings have been taken by the specified fund or any of its group concern, specifically for the purposes of making investment by the specified fund in India, such fund shall not be eligible for exemption under section 10(23FE); and
- if the loans and borrowings have been taken by the specified fund or any of its group concern, not specifically for the purposes of making investment in India, it shall not be presumed that the investment in India has been made out of such loans and borrowings and such specified fund shall be eligible for exemption under section 10(23FE), subject to the fulfilment of all other stipulated conditions, provided that the source of the investment in India is not from such loans and borrowings.

(vii) **Meaning of certain terms:**

S. No.	Term	Meaning
(i)	Investee	A business trust, or a company, or an enterprise, or an entity, or a Category I or Category II AIF, or an Infrastructure Investment Trust or a domestic company, or an Infrastructure Finance Company or an Infrastructure Debt Fund referred to in (e) of (ii) above, in which the sovereign wealth fund or the pension fund, as the case may be, has made the investment, directly or indirectly, under the provisions of this section.
(ii)	Loan and borrowing	(a) Any loan taken or borrowing by a sovereign wealth fund from, or any deposit or investment made in a sovereign wealth fund by, any person other than the Government of the country in which the sovereign wealth fund is set up; (b) Any loan taken or borrowing by a pension fund from or any deposit or investment made in a pension fund by, any person. However, it shall not include the deposit or investment which represents statutory obligations and defined contributions of one or more funds or plans established for providing retirement, social security, employment, disability, death benefits or any similar compensation to the participants or beneficiaries of such funds or plans, as the case may be.

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(viii) ***Meaning of specified person:***

*** These two conditions would not apply to any payment made to creditors or depositors for loan taken or borrowing for the purpose other than for making investment in India**

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Exempted Income of Non-Residents

Section	Income	Available to
10(4)(ii)	Interest on money standing to the credit in a Non-resident (External) account of an Individual in any bank in India as per the FEMA Act, 1999.	Individual resident outside India (under FEMA Act) or an individual who has been permitted to maintain said account by RBI
10(4C)	Interest payable by an Indian company or business trust in respect of moneys borrowed from a source outside India by way of issue of rupee denominated bond during the period from 17.9.2018 to 31.3.2019	A non-corporate non-resident or foreign company
10(4D)	Income accrued or arising to or received by specified fund - (i) on transfer of a capital asset, being a bond of an Indian Company or a public sector company (sold by the Government and purchased by the specified fund in foreign currency), GDR or rupee denominated bond of an Indian company or derivative or any other notified security, on a recognized stock exchange located in any IFSC and where the consideration for such transfer is paid or payable in convertible foreign exchange; or (ii) on transfer of securities (other than shares in a company resident in India); or (iii) from securities issued by a non-resident (not being a permanent establishment of a non-resident in India) and where such income otherwise does not accrue or arise in India; or (iv) from a securitisation trust which is chargeable under the head "Profits and gains of business or profession", to the extent such income accrued or arisen to, or is received, is attributable to units held by non-resident (not being the permanent establishment of a non-resident in India) or is attributable to the investment division of	A specified fund

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	offshore banking unit, as the case may be, computed in the prescribed manner.	
10(4E)	Any income accrued or arisen to, or received by a non-resident as a result of - transfer of non-deliverable forward contracts or offshore derivative instruments or over-the-counter derivatives, or - distribution of income on offshore derivative instruments ***or over-the-counter derivatives***, entered into with an offshore banking unit of an IFSC as referred to in section 80LA(1A) or ***any Foreign Portfolio Investor being a unit of an IFSC***, which fulfils prescribed conditions.	Non-resident
10(4F)	Any income of a non-resident by way of royalty or interest, on account of lease of an aircraft or a ship in a previous year, paid by a unit of an IFSC referred to in section 80LA(1A), if the unit has commenced its operation on or before ***31.3.2030***. "Aircraft", here, means an aircraft or a helicopter, or an engine of an aircraft or a helicopter, or any part thereof. "Ship" means a ship or an ocean vessel, engine of a ship or ocean vessel, or any part thereof.	Non-resident
10(4G)	Any income received by a non-resident from - portfolio of securities or financial products or funds, managed or administered by any portfolio manager on behalf of such non-resident, or - such activity carried out by such person as may be notified by the Central Government, in an account maintained with an Offshore Banking Unit in any IFSC, as referred to in section 80LA(1A), to the extent such income accrues or arises outside India and is not deemed to accrue or arise in India.	Non-resident

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10(4H)	Any income by way of capital gains on transfer of equity shares of domestic company, being a Unit of an IFSC, as referred to in section 80LA(1A), engaged primarily in the business of lease of an aircraft ***or a ship*** which has commenced operations on or before ***31.3.2030***. The exemption from capital gains on transfer of equity shares of such domestic company is available for a period of ten assessment years - (i) from A.Y. relevant to the P.Y. in which the domestic company has commenced its operations or (ii) from A.Y. 2024-25, where the period of 10 A.Ys. under (i) above ends before 1.4.2034.	- Non-resident or - a Unit of IFSC, as referred to in section 80LA(1A) engaged primarily in the business of leasing of an aircraft ***or a ship***
10(6)(ii)	Remuneration received by Foreign Diplomats/Consulate and their staff (Subject to conditions)	Individual (not being a citizen of India)
10(6)(vi)	Remuneration received as an employee of a foreign enterprise for services rendered by him during his stay in India, if: a) Foreign enterprise is not engaged in any trade or business in India; b) His stay in India does not exceed in the aggregate a period of 90 days in such previous year; and c) Such remuneration is not liable to deducted from the income of employer chargeable under this Act	Individual Salaried Employee (not being a citizen of India) of a foreign enterprise
10(6)(viii)	Salary received by or due for services rendered in connection with his employment on a foreign ship if his total stay in India does not exceed 90 days in the previous year.	Individual Salaried Employee (Non-resident who is not a citizen of India) of a foreign ship
10(6)(xi)	Remuneration received as an employee of the Government of a foreign state during his stay in India in connection with his training in any Government Office/ Statutory Undertaking/ corporation/ registered society etc.	Individual Salaried Employee (not being a citizen of India) of Government of foreign state

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10(6BB)	Tax paid by Indian company, engaged in the business of operation of aircraft, which has acquired an aircraft or an aircraft engine on lease, under an approved (by Central Government) agreement entered into between 1-4-1997 and 31-3-1999, or after 31-3-2007, on lease rental/income derived (other than payment for providing spares or services in connection with the operation of leased aircraft) by the Government of a Foreign State or foreign enterprise.	Government of foreign State or foreign enterprise (i.e., a person who is a non-resident)
10(6C)	Royalty income or fees for technical services under an agreement with the Central Government for providing services in or outside India in projects connected with security of India	Foreign company (notified by the Central Government)
10(6D)	Royalty income from or fees from technical services rendered in or outside India to, the National Technical Research Organisation (NTRO)	Non-corporate non-resident or foreign company
10(15)(iiia)	Interest on deposits made by a foreign bank with a scheduled bank with approval of RBI.	Bank incorporated outside India and authorised to perform Central Banking functions in that country.
10(15)(iv)(fa)	Interest payable by scheduled bank on deposits in foreign currency where acceptance of such deposits is duly approved by RBI. [Scheduled bank does not include co-operative bank]	a) Non-resident b) Individual or HUF being a resident but not ordinary resident
10(15)(viii)	Interest on deposit on or after 01.04.2005 in an Offshore Banking Unit	
10(15)(ix)	Interest payable by a unit located in an IFSC in respect of monies borrowed by it on or after 1.9.2019	Non-resident
10(15A)	Lease rental paid by Indian company, engaged in the business of operation of aircraft, to acquire an aircraft or an aircraft engine on lease (other than payment for providing spares or services in connection with the operation of leased aircraft) under	Government of foreign State or foreign enterprise (i.e., a person who is a non-resident)

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	an approved (by Central Government) agreement not entered into between 1-4-1997 and 31-3-1999, or after 31-3-2007.	
10(15B)	Any income of a foreign company from lease rentals of cruise ships, received from a specified company which operates such ship/ ships in India provided such foreign company and the specified company are subsidiaries of the same holding company. Such exemption is available upto A.Y. 2030-31.	Foreign Company
10(23BBB)	Income of European Economic Community derived in India from interest, dividends or capital gains from investment out of its funds under notified scheme of Central Government.	European Economic Community
10(23BBC)	Income of SAARC Fund for Regional Projects set up by Colombo Declaration.	SAARC Fund for Regional Projects.
10(23FBC)	Any income accruing or arising to or received by a unit holder from a specified fund or on transfer of units in a specified fund	Unit holder of specified fund
10(23FE)	Dividend, interest, any sum referred to in section 56(2)(xii) or long-term capital gains ***(whether or not such capital gains are deemed as short-term capital gains under section 50AA)*** arising to specified person from an investment made by it in India, whether in the form of debt or share capital or unit, if such investment (i) is made between 1.4.2020 and ***31.3.2030***; (ii) is held for at least 3 years (iii) is in (a) a business trust, (b) a company/ enterprise/entity in developing/ operating/maintaining an infrastructure facility or (c) a SEBI Category I or II AIF having not less than 50%	Specified person, being (i) a wholly owned subsidiary of the Abu Dhabi Investment Authority (ii) a sovereign wealth fund (iii) Pension fund satisfying the prescribed conditions. ***(iv) Public Investment Fund of the Government of the Kingdom of Saudi Arabia and its wholly owned subsidiary***

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	investment in one or more of the company or enterprise or entity referred to in (b) or in (d) or in (e) or in an Infrastructure Investment Trust or (d) a domestic company, set up and registered on or after 1.4.2021, having minimum 75% investments in one or more of the companies or enterprises or entities referred to in (b) or (e) a NBFC registered as an Infrastructure Finance Company or in an Infrastructure Debt Fund, having minimum 90% lending to one or more of the companies or enterprises or entities referred to in (b)	
10(23FF)	Income of the nature of capital gains on account of transfer of share of a company resident in India, by the resultant fund or a specified fund to the extent attributable to units held by non-resident (not being a PE of a non-resident in India) in such manner as may be prescribed, and such shares were transferred from the original fund, or from its wholly owned special purpose vehicle, to the resultant fund in relocation, and where capital gains on such shares were not chargeable to tax if that relocation had not taken place. Income would be exempt only when the specified fund furnishes an annual statement of exempt income in the prescribed form electronically under digital signature on or before the due date specified u/s 139(1). Where such form is not filed by the specified fund, the exempt income would be NIL. Further, such annual statement in prescribed form has to be certified by an accountant before the specified date [one month prior to the due date u/s 139(1)] and such	Non-resident or specified fund

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	accountant has to furnish by that date, the certificate in the prescribed form electronically under digital signature.	
10(34B)	Any income by way of dividends from a company being a unit of any IFSC primarily engaged in the business of leasing of an aircraft ***or a ship***.	Unit of any IFSC engaged in the business of leasing of an aircraft ***or a ship.***
10(48)	Income received in India in Indian currency on account of sale of Crude oil or any other goods or rendering of services, as may be notified by the Central Government in this behalf, to any person in India. Foreign company and agreement should be notified by the Central Government in national interest.	Foreign company on account of sale of crude oil, any other goods or rendering of services. It should not be engaged in any other activity in India.
10(48A)	Income accruing or arsing on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India. Foreign company and agreement should be notified by the Central Government in national interest.	Foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom.
10(48B)	Income from sale of leftover stock of crude oil from facility in India after the expiry of agreement or arrangement referred to in section 10(48A) or on termination of the said agreement or arrangement, in accordance with the terms mentioned therein, as the case may be, subject to such conditions, as may be notified by the Central Government.	Foreign company from sale of leftover stock of crude oil from the facility in India.

21.4 PRESUMPTIVE TAXATION FOR NON RESIDENTS

Section 28 details the income chargeable to tax under the head "Profits and Gains of Business or Profession". Certain provisions have been incorporated in the Income-tax Act, 1961, whereby the "Profits and gains of business or profession" of certain non-resident assessee is computed on the basis of certain percentage of the amount accrued or arisen and received in India.

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(1) Special provision for computing the profits and gains of shipping business other than cruise shipping in the case of non-residents [Section 44B]

Section 44B is a non-obstante clause. Accordingly, sections 28 to 43A are not applicable in the case of a non-resident engaged in the business of operation of ships (other than cruise ships referred to in section 44BBC).

Profits and gains of a non-resident engaged in the business of operation of ships (other than cruise ships referred to in section 44BBC) would be@7.5% of the aggregate of the following amounts

- Amounts paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of carriage of passengers, livestock, mail or goods shipped at any port in India
- \+ Amounts 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

The amounts referred above would include demurrage charges or handling charges or any other amount of similar nature.

The amounts paid or payable or the amounts received or deemed to be received will also include the amount paid or payable or received or deemed to be received by way of demurrage charges or handling charges or any other amount of similar nature [*CIT v. Japan Lines Ltd. 260 ITR 656(Mad)*]**.** Thus 7.5% of the gross amounts mentioned above would be liable to tax and no deduction would be allowed for any expenditure, (i.e. the provisions of section 28 to 43A are not to be taken into account) however carried forward losses would be allowed to be set off from such income.

Analysis of section 44B and section 172:

Section 44B	Section 172
Presumptive tax provisions for non-residents engaged in shipping business (other than other than cruise ships referred to in section 44BBC). It does not, however, contain any procedure for assessment and collection of tax.	Complete code for taxation of occasional shipping business of non-residents, including assessment and collection of tax.
Manner of computation of presumptive Income:	
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 ships (other than cruise ships referred to in section 44BBC), a sum equal to 7.5% of the aggregate of the -	Where a ship carries passengers, livestock, mail, or goods shipped at a port in India, a sum equal to **7.5%** of - the amount paid or payable on account of such carriage to the owner

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- amount paid or payable (whether in or outside India) to the non-resident or to any other person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any Indian port and - the amount received or deemed to be received in India on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India. **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".	or the charterer or to any person on his behalf, whether that amount is paid or payable in or out of India, **shall be deemed to be income accruing in India** to the owner or charterer on account of such carriage.

Other provisions of section 172

(i) **Furnish a return of the amount paid to the owner:** Section 172(3) imposes an obligation on the master of the ship to prepare and furnish to the Assessing Officer a return of the full amount paid or payable to the owner or charterer or any person on this behalf, on account of the carriage of all passengers, livestock, mail or goods shipped at any port in India since the last arrival of the ship thereat. Such return is, ordinarily, to be furnished by the master of the ship before the departure, from that port in India, of the ship.

A return may, however, be filed by the person authorized by the master of the ship within 30 days of the departure of the ship from the port, if:

(a) the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return required by section 172(3) before the departure of the ship from the port; and

(b) the master of the ship has made satisfactory arrangement for the filing of the return and payment of tax by any other person on this behalf.

(ii) **Assessment [Section 172(4)]:** This section provides for a summary procedure of assessment. On receipt of the return filed by the master of the ship or by any person on this behalf, the Assessing Officer has to determine the tax payable on the taxable income. By virtue of the provisions of section 172(2), the taxable income is a sum equal to 7.5% of the amount paid or payable on account of carriage of passengers etc. to the owner or charterer or to any person on his behalf, whether that amount is paid or payable in or out of India. The tax payable on such taxable income is to be calculated at the **rate or rates in force applicable to the total income of a foreign company**. The master of the ship is liable for payment of such tax.

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(iii) **Time limit for passing the assessment order [Section 172(4A)/(5)]:** It is incumbent on the Assessing Officer to pass the order of assessment within 9 months from the end of the financial year in which the return of income under section 172(3) is filed.

For the purpose of determining the tax payable, Assessing Officer is empowered to call for such accounts and documents as he may require.

(iv) **Grant of port of clearance to the ship [Section 172(6)]:** A port clearance shall not be granted to the ship until the Collector of customs or other authorized officer, is satisfied that the tax assessable under section 172 has been duly paid or that satisfactory arrangements have been made for the payment thereof.

(v) **Option to pay tax as per normal provisions of the Income-tax Act, 1961 on the income chargeable to tax under section 172 [Section 172(7)]:** The owner or charterer has the option to claim before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from the Indian port falls, that an assessment in respect of his total income for the previous year and the tax payable on the basis thereof be determined in accordance with the other provisions of this Act. In such a case, any payment made under section 172 is to be treated as a payment in advance of the tax leviable for that assessment year and the difference between the sum so paid and the amount of tax found payable by him on such assessment is to be paid by him or refunded to him, as the case may be.

The sum chargeable to tax under this section shall include amounts payable by way of **demurrage charge or handling charge** or any other amount of similar nature [Section 172(8)].

Section 172 *vis-à-vis* section 44B

In case the assessee is covered under section 172, 7.5% of the amount paid or payable on account of the carriage of the passengers, livestock, mail or goods to the owner or the chartered or to any person on his behalf is deemed as his income and tax is levied on such income at a rate applicable to a foreign company i.e., 35% *plus* surcharge, if any, and *plus* health and education cess @4%.

Under the provisions of section 172(7), the non-resident owner or charterer is allowed an option to be assessed on his total income of the previous year in accordance with other provisions of the Act i.e., as per section 44B.

When such option is exercised, a regular assessment is made. In such a case, the tax already paid under the provisions of section 172(4) by the non-resident owner or charterer would be treated as tax paid in advance for that assessment year before determining the amount of tax

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finally due. The difference between the sum so paid and the amount of tax payable by him on such assessment shall be paid by the assessee or refunded to him (See Note below).

In that case, the non-resident assessee is liable to pay interest under sections 234B and 234C and also entitled to receive interest under section 244A of the Income-tax Act, 1961 as the case may be. **[Circular No. 9/2001, dated 9-7-2001]**

Note *–Refund may arise in case of non-corporate non-residents, since they are liable to pay tax at a rate lower than the rate of 35% (plus surcharge, if any, and cess@4%) applicable to a foreign company.*

The Supreme Court, in *A.S. Glittre v CIT (1997) 225 ITR 739 (SC)*, held that the assessment made under section 172(4) shall be an 'adhoc' assessment and it will be superseded if a regular assessment is opted as per the provisions of the Act.

ILLUSTRATION 7

Sea Port Shipping Line, a non-resident foreign company, is engaged in the business of carriage of goods shipped at Mumbai port. During the previous year ended on 31.3.2026, it had collected freight of ₹ 100 lakhs, demurrages of ₹ 20 lakhs and handling charges of ₹ 10 lakhs. The expenses of operating its fleet during the year for the Indian Ports were ₹ 110 lakhs. Compute its income applying the presumptive provisions under section 44B.

SOLUTION

Section 44B provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The above amounts will include demurrage charges and handling charges.

These provisions for computation of income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961.

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Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax on deemed profit of ₹ 9.75 lakhs (7.50% on the total receipts of ₹ 130 lakhs). The tax payable would be reduced by the amount of tax paid under section 172(4).

(2) Special provision for computing profits and gains in connection with the business of exploration etc. of mineral oils [Section 44BB]

Section 44BB is a non-obstante clause. Accordingly, sections 28 to 41 and section 43 and 43A are not applicable in the case of a non-resident engaged in the business of providing services of 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.

(i) **Eligible assessee:** Section 44BB provides for determination of income of taxpayer being a non-resident engaged in the business of providing services and facilities in connection with, or supplying plant and machinery on hire used or to be used in the prospecting for, or extraction or production of mineral oils.

(ii) **Presumptive rate:** In such case, the profits and gains shall be deemed to be equal to **10%** of the following amounts:

- paid or payable to the taxpayer or to any person on his behalf whether in or out of India, on account of the provision of such services or facilities or supply of plant & machinery for the aforesaid purposes in India; and
- received or deemed to be received in India by or on behalf of the assesse on account of such service or facilities or supply of plant and machinery used or to be used in prospecting for, or extraction or production of mineral oils outside India.

(iii) **Non-applicability of presumptive taxation under section 44BB:** The provisions of section 44BB shall not apply to any income to which the provisions of section 42 or section 44DA, 115A or 293A apply for the purpose of computing profit or gains or any other income referred to in these sections.

Section	Provision
42	Special provision for deductions in the case of business for prospecting, etc., for mineral oil
44DA	Special provisions for computing income by way of royalties, etc., in case of non-residents.

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115A	Tax on royalty and fees for technical services
293A	Power to make exemption, etc., in relation to participation in the business of prospecting for, extraction, etc., of mineral oils.

(iv) **Option to claim lower profits:** An assessee may claim lower income than the presumptive rate of 10%, if he keeps and maintains books of account under section 44AA(2) and get them audited and furnish a report of such audit under section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

(v) **No set-off of unabsorbed depreciation and brought forward loss:** Where an assessee declares profits and gains of business @10% for any previous year in accordance with the presumptive provisions under this section, no set off of unabsorbed depreciation and brought forward loss would be allowed to the assessee for such previous year.

(vi) **Meaning of certain terms:** For the purposes of this section,-

(a) "Plant" includes ships, aircraft, vehicles, drilling units, scientific apparatus and equipment, used for the purposes of the said business;

(b) "Mineral oil" includes petroleum and natural gas.

Note *- If the income of a non-resident is in the nature of fees for technical services, it shall be taxable under the provisions of either section 44DA or section 115A irrespective of the business to which it relates. Section 44BB would apply only in a case where consideration is for services and other facilities relating to exploration activity which are not in the nature of technical services..*

(3) Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents [Section 44BBA]

Section 44BBA is a non-obstante clause. Accordingly, sections 28 to 43A are not applicable in the case of a non-resident engaged in the business of operation of aircraft.

(i) **Eligible assessee:** Section 44BBA provides presumptive rate in case of a non-resident engaged in the business of operation of aircraft.

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(ii) **Presumptive rate:** Income from such business is calculated at a flat rate of **5%** of the following:

(a) amount paid or payable, in or out of India, to the tax payer or to any person on his behalf on account or carriage of passenger, livestock, mail or goods from any place in India and

(b) amount received or deemed to be received in India by or on behalf of the taxpayer on account of carriage of passenger, livestock, mail or goods from any place outside India.

ILLUSTRATION 8

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2026:

(i) ₹ 2 crores in India on account of carriage of passengers from Chennai.

(ii) ₹ 1 crore in India on account of carriage of goods from Chennai.

(iii) ₹ 3 crores in India on account of carriage of passengers from Singapore.

(iv) ₹ 1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2026 was ₹ 6.75 crores.

Compute the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2026-27.

What would be your answer in case the business was carried on by a foreign company, Q Airlines (P) Ltd?

SOLUTION

Section 44BBA says for computing profits and gains of the business of operation of aircraft in the case of non-residents a sum equal to 5% of the aggregate of the following amounts -

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

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Keeping in view the provisions of section 44BBA, the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder -

Particulars	₹
Amount received in India on account of carriage of passengers from Chennai	2,00,00,000
Amount received in India on account of carriage of goods from Chennai	1,00,00,000
Amount received in India on account of carriage of passengers from Singapore	3,00,00,000
Amount received in Singapore on account of carriage of passengers from Chennai	1,00,00,000
	7,00,00,000

Income from business under section 44BBA at 5% of ₹ 7,00,00,000 is ₹ 35,00,000, which is the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2026-27.

In case the assessee is a foreign company, say, Q Airlines (P) Ltd, the answer would be the same since section 44BBA does not distinguish corporate and non-corporate taxpayers who operate aircraft provided their residential status is that of non-resident.

(4) Special provision for computing profits and gains of foreign companies engaged in the business of civil construction etc. in certain turnkey power projects [Section 44BBB]

(i) Eligible assessee: A foreign company 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 in this behalf.

(ii) Presumptive rate: A sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head 'profits and gains of business or profession'.

(iii) Option to claim lower profits: An assessee may claim lower income than the presumptive rate of 10%, if he keeps and maintains books of account under section 44AA(2) and get them audited and furnish a report of such audit under section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

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(iv) **No set-off of unabsorbed depreciation and brought forward loss:** Where an assessee declares profits and gains of business @10% for any previous year in accordance with the presumptive provisions under this section, no set off of unabsorbed depreciation and brought forward loss would be allowed to the assessee for such previous year.

(5) Special provision for computing profits and gains of business of operation of cruise ships in case of non-residents [Section 44BBC]

(i) **Eligible Assessee:** A non-resident engaged in the business of operation of cruise ships subject to prescribed conditions.

(ii) **Presumptive rate:** The profits and gains shall be deemed to be equal to **20%** of the following amounts:

- paid or payable to the eligible assessee or to any person on his behalf on account of the carriage of passengers; and
- received or deemed to be received by or on behalf of the assesse on account of the carriage of passengers.

The lease rentals paid by a foreign company which opts for presumptive regime under section 44BBC, would be exempt in the hands of the recipient company under section 10(15B), if such company is a foreign company and both these foreign companies are subsidiaries of the same holding company. This exemption would be available upto A.Y. 2030-31.

The CBDT has, vide Notification No. 9/2025 dated 21.01.2025 inserted Rule 6GB. Rule 6GB specified the conditions for non-resident, engaged in the business of operation of cruise ships for section 44BBC.

For the purposes of section 44BBC, an assessee, being a non-resident, engaged in the business of operation of cruise ships has to –

(i) operate a passenger ship having a carrying capacity of more than 200 passengers or length of 75 meters or more, for leisure and recreational purposes and having appropriate dining and cabin facilities for passengers;

(ii) operate such ship on scheduled voyage or shore excursion touching at least two sea ports of India or same sea ports of India twice;

(iii) operate such ship primarily for carrying passengers and not for carrying cargo; and

(iv) operate such ship as per the procedure and guidelines if any, issued by the Ministry of Tourism or Ministry of Shipping."

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(6) Special provision for computing profits and gains of non-residents engaged in business of providing services or technology for setting up an electronics manufacturing facility or in connection with manufacturing or producing electronic goods, article or thing in India [Section 44BBD]

(i) ***Eligible assessee:*** *A non-resident engaged in the business of providing services or technology in India, for setting up an electronics manufacturing facility or in connection with manufacturing or producing electronic goods, article or thing in India -*

a. *to a resident company which is establishing or operating electronics manufacturing facility or a connected facility for manufacturing or producing electronics goods, article or thing in India, under a scheme notified by the Central Government in the Ministry of Electronics and Information Technology; and*

b. *the resident company satisfies the conditions prescribed in this behalf.*

(ii) ***Presumptive rate:*** *The profits and gains shall be deemed to be equal to* **25%** *of the following amounts:*

- *paid or payable to the non-resident assessee or to any person on his behalf on account of providing services or technology; and*
- *received or deemed to be received by non-resident assessee or on behalf of the non-resident assessee on account of providing services or technology.*

(iii) ***Non-applicability of section 44DA or section 115A:*** *The provisions of section 44DA or section 115A do not apply in respect of income covered by this section.*

(iv) ***No set-off of unabsorbed depreciation and brought forward loss:*** *Where an assessee declares profits and gains of business @25% for any previous year in accordance with the presumptive provisions under this section, no set off of unabsorbed depreciation and brought forward loss would be allowed to the assessee for such previous year.*

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SUMMARY OF PRESUMPTIVE PROVISIONS APPLICABLE TO NON RESIDENTS

Particulars	44B	44BBA	44BB	44BBB	44BBC	44BBD
Nature of business	Shipping business other than cruise ship business u/s 44BBC	Operation of aircraft	Business of providing services or facilities in connection with, or supplying P & M on hire used, or to be used, in the prospecting for, or extraction or production of mineral oils	Business of civil construction or the business of erection of P&M or testing or commissioning thereof, in connection with turnkey power projects approved by the Central Government.	Business of operation of cruise ships	*Business of providing services or technology in India, for setting up an electronics manufacturing facility or in connection with manufacturing or producing electronic goods, article or thing in India*
Eligible assessee	Non-resident	Non-resident	Non-resident	Only Foreign Co.	Non-resident	*Non-resident*
Presumptive income	7.5% of specified sum	5% of specified sum	10% of specified sum	10% of specified sum	20% of specified sum	*25% of specified sum*
Specified sum	(i) Amount paid or payable on account of carriage of passengers, livestock, mail or goods shipped at/ from any port/place in India; and (ii) Amount received or deemed to be received in India on account of		(i) Amount paid or payable on account of the provision of such services or facilities for the aforesaid purposes in India; and (ii) Amount received or deemed to be	Amount paid or payable on a/c of such civil construction, erection, testing or commissioning	(i) Amount paid or payable on account of carriage of passengers; and (ii) Amount received or	*(i) Amount paid or payable to the non-resident assessee or to any person on his behalf on account of providing services or technology; and*

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	the carriage of passengers, livestock mail or goods shipped at/ from any port/place outside India	received in India on account of the provisions of services or facilities for the aforesaid purpose outside India.		deemed to be received on account of carriage of passengers	*(ii) Amount received or deemed to be received by non-resident assessee or on behalf of the non-resident assessee on account of providing services or technology*
Option to declare lower profits	Not available	Lower profits may be claimed u/s 44BB and u/s 44BBB provided the assessee maintains books of account u/s 44AA and gets them audited u/s 44AB. No set off of unabsorbed depreciation and brought forward loss would be allowed to the assessee in the previous year in which he/it declares profits and gains @10% in accordance with the presumptive provisions of section 44BB/ 44BBB.		Not available	*Not available.* *No set off of unabsorbed depreciation and brought forward loss would be allowed to the assessee in the previous year in which he/it declares profits and gains @25% in accordance with the presumptive provisions of section 44BBD.*

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(6) Deduction in respect of head office expenses in case of non-residents [Section 44C]

In case of a non-resident, head office expenditure is allowed in accordance with the provisions of section 44C. This section is a non-obstante provision, and anything contrary contained in sections 28 to 43A is not applicable.

Deduction in respect of head office expenditure is restricted to the least of the following:

(a) an amount equal to 5% of **"adjusted total income"** or in case adjusted total income is a loss, 5% of the **"average 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.

Meaning of certain terms:

Term	Meaning
Adjusted total income	Total income computed in accordance with the provisions of the Act without giving effect to the following :- ▪ Allowance under this section ▪ Unabsorbed depreciation allowance under section 32(2). ▪ Expenditure incurred by a company for the purpose of promoting family planning amongst its employees under first proviso to section 36(1)(ix). ▪ Business loss brought forward under section 72(1). ▪ Speculation loss brought forward under section 73(2). ▪ Loss under the head Capital Gain under section 74(1). ▪ Loss from certain specified source brought forward under Section 74A(3). ▪ Deduction under Chapter VI-A.
Average adjusted total income	(a) The total income of the assessee, assessable for each of the **three assessment years** immediately preceding the relevant assessment year, one third of the aggregate amount of the adjusted total income in respect of previous years relevant to the aforesaid three assessment years is average adjusted total income. (b) When the total income of the assessee is assessable only for **two of the aforesaid three assessment years**, one half of the aggregate amount of the adjusted total income in respect of the previous year's relevant to the aforesaid two assessment years is taken on average adjusted total income. (c) Where the total income of the assessee is assessable only for **one of the aforesaid three assessment years,** the amount of the adjusted total income in respect of the previous year relevant to that assessment year is average adjusted total income.

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Head office expenditure	Executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of: a. rent, rates, taxes, repairs or insurance of any premises outside India used for the purpose of the business or profession. b. salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India; c. traveling 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 administrative as may be prescribed.

Deduction of Head Office expenditure in case of Non-residents while computing Profit and gains from business or profession

Lower of

- 5% of adjusted Total Income
- Amount of Head Office expenditure incurred by the Non-resident attributable to the business or profession in India

Meaning of Adjusted Total Income

Total Income, without giving effect to:

(i) Head Office expenditure

(ii) Unabsorbed depreciation

(iii) Capital expenditure on family planning

(iv) Losses carry forward:

- Business loss u/s 72(1)
- Speculative business Loss u/s 73(2)
- LTCL/STCL u/s 74(1)
- Loss from owning and maintaining race horses u/s 74A(3)

(v) Deductions under Chapter VI-A from GTI

Meaning of Head Office expenditure

Executive and general administration expenditure incurred by the NR outside India, including:

(a) Rent, rates, taxes, repairs or insurance of any premises outside India used for business or profession

(b) Salary, wages, perquisites etc. to any employee or other person managing the affairs of any office outside India

(c) Travelling expenditure by any employee or other person managing the affairs of any office outside India

(d) Such other executive and general administration expenditure prescribed

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ILLUSTRATION 9

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2026 was a loss of ₹ 100 lakhs after charge of head office expenses of ₹ 200 lakhs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2026-27.

SOLUTION

Section 44C restricts the allowability of the head office expenses to the extent of lower of an amount equal to 5% of the adjusted total income or the amount actually incurred as is attributable to the business of the assessee in India.

For the purpose of computing the adjusted total income, the head office expenses of ₹ 200 Lakhs charged to the profit and loss account have to be added back.

The amount of income to be declared by the assessee for A.Y. 2026-27 will be as under:

Particulars	₹
Net loss for the year ended on 31.03.2026	(100 lakhs)
Add: Amount of head office expenses to be considered separately as per section 44C	200 lakhs
Adjusted total income	100 lakhs
Less: Head Office expenses allowable under section 44C is the lower of - (i) ₹ 5 lakhs, being 5% of ₹ 100 lakhs, or (ii) ₹ 200 lakhs.	5 lakhs
Income to be declared in return	**95 lakhs**

(7) Special provision for computing income by way of royalties etc. in case of non-residents [Section 44DA]

(i) **Eligible Assessee:** Section 44DA provides the method of computation of income by way of royalty or fees for technical services arising from the agreement made by the non-resident with the Indian company or Government of India after 31.03.2003 where:

(a) such non-resident carries business/profession in India through permanent establishment or fixed place of profession; and

(b) the right, property, or contract in respect of which the royalty or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of service.

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(ii) **Expenses not allowed as deduction**: While computing the income chargeable to tax under this section, the following expenses are not allowed as deduction:

- expenditure or allowance incurred which is not wholly and exclusively for such permanent establishment or fixed place of service in India
- amount paid (otherwise than reimbursement of actual expenses) by the permanent establishment to head office or to any of its other offices.

(iii) **Non-applicability of section 44BB:** The provisions of section 44BB do not apply in respect of income covered by this section.

(iv) **Mandatory requirement to maintain books of account and get them audited:** Under this section, the non-resident is mandatorily required to keep and maintain the books of account under section 44AA and get them audited before the date one month prior to the due date for furnishing the return of income under section 139(1) and furnish by that date a report of such audit.

	Assessee	Due date of filing return of income u/s 139(1)	Specified date of tax audit u/s 44AB
(i)	In case of an assessee who is required to furnish report referred to in section 92E	30th November of the A.Y.	31st October of the A.Y.
(ii)	In case of other assessees computing income u/s 44DA	31st October of the A.Y.	30th September of the A.Y.

21.5 CAPITAL GAINS TAXATION FOR NON RESIDENTS

Any person including a foreign company or non-corporate non-resident is liable to capital gains tax in India, if there is a transfer of a property (capital asset) in India which results in profit or gain. The provisions relating to non-residents in respect of capital gains taxation are discussed in detail in Chapter 4: Capital Gains in Module 1.

First Proviso to Section 48 read with Rule 115A:-

In case of non-residents who invest foreign exchange to acquire capital assets, exchange rate fluctuation benefit is allowed while computing the capital gains arising from the transfer of shares or debentures of an Indian company as per first proviso to section 48.

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The same is to be computed in the following manner:

- The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares or debentures were acquired.
- The resulting capital gains shall be reconverted into Indian currency.

The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures in an Indian company.

Rule 115A of the Income-tax Rules, 1962 provides that the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilized in purchase of the capital asset as on the date specified in column (3) in the table below, shall be considered to convert rupees into foreign currency for the purpose of computation of capital gains.

(1) S. No.	(2) Item	(3) Date
(a)	Cost of acquisition of capital asset	Date of acquisition of capital asset
(b)	Expenditure incurred wholly and exclusively in connection with transfer of capital asset	Date of transfer of capital asset
(c)	Full value of consideration received or accruing as a result of transfer of a capital asset	Date of transfer of capital asset

For reconverting capital gains computed in the foreign currency initially utilized in the purchase of the capital asset into rupees, the telegraphic transfer buying rate of such currency, as on the date of transfer of the capital asset, is to be considered.

Meaning of certain terms

Term	Meaning
Telegraphic transfer buying rate	The rate or rates of exchange adopted by the State Bank of India for buying foreign currency having regard to the guidelines specified from time to time by the RBI for buying foreign currency where such currency, made available to that bank through a telegraphic transfer.
Telegraphic transfer selling rate	The rate of exchange adopted by the State Bank of India for selling foreign currency where such currency is made available by that bank through telegraphic transfer.

However, the benefit of currency fluctuation would not be available in respect of capital gains arising from the transfer of the following long term capital assets referred to in section 112A –

(i) equity share in a company on which STT is paid both at the time of acquisition and transfer

(ii) unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.

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Other Important Points:

a. It is also provided that the aforesaid 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.

b. The shares and debentures (whether listed or non-listed) of Indian companies only are covered under first proviso to section 48. Indian company shall include Government company. However, bonds of Central Government/State Government and RBI are not covered for this purpose.

c. If the total income of an assessee includes any income chargeable under the head 'Capital Gains' arising from transfer of a capital asset being an equity share in a company or unit of an equity oriented fund or unit of a business trust, then, tax on short term capital gains shall be payable at the rates specified in section 111A if transaction of sale of such security has been entered on or after October 1, 2004 on which STT is chargeable; and tax on long-term capital gains shall be payable on such securities as per section 112A, if STT has been paid both at the time of acquisition and transfer of equity share or at the time of transfer of unit of equity oriented fund or unit of business trust.

d. Tax rates on long term capital gains arising to non-residents

S. No.	Long-term capital asset (LTCA)	Rate of tax
(i)	Unlisted securities or shares of a closely held company	12.5% without foreign currency fluctuation
(ii)	Other Assets (other than taxable u/s 112A)	12.5%

e. Section 50CA provides that where the consideration received or accruing as a result of transfer of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, such fair market value shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

This provision would, however, not be applicable to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.

f. Section 50D provides that, in case where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains,

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the fair market value of the said asset on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

ILLUSTRATION 10

Mr. A, a non-resident Indian, remits US $ 40,000 to India on 16.09.2006. The amount is partly utilised on 3.10.2006 for purchasing 10,000 equity shares in A Ltd, an Indian Company, at the rate of ₹ 12 per share. These shares are sold for ₹ 48 per share on 30.03.2026. Fair market value of these shares on 31.01.2018 was ₹ 35 per share.

The telegraphic transfer buying and selling rate of US dollars adopted by the State Bank of India is as follows:-

Date	Buying Rate (1 US$)	Selling Rate (1 US $)
16.09.2006	18	20
3.10.2006	19	21
30.3.2026	59	61

Compute the capital gain chargeable to tax for the A.Y. 2026-27 on the assumption that –

(a) These shares have not been sold through a recognised stock exchange

(b) These shares have been purchased and sold through a recognised stock exchange.

Ignore the provisions of Chapter XII-A

SOLUTION

(a) Where the shares are not sold through recognised stock exchange

Particulars	US $
Sale consideration (₹ 4,80,000/60)	8000
Less: Cost of Acquisition (1,20,000/20)	6000
Long term capital gain	**2000**

Long-term capital gain converted into $ 2000 x ₹ 59 = ₹ 1,18,000

(b) Where the shares are purchased and sold through a recognised stock exchange

Particulars		₹
Sale consideration		4,80,000
Less: Cost of Acquisition		
Higher of the following		
Cost of acquisition	1,20,000	

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Lower of Fair market value as on 31.1.2018 and Full value of consideration (i.e., lower of ₹ 3,50,000 and ₹ 4,80,000)	3,50,000	3,50,000
Long term capital gain		**1,30,000**

Long term capital gains upto ₹ 1,25,000 would be exempt. Long term capital gains exceeding ₹ 1,25,000, i.e., ₹ 5,000 is taxable @12.5% under section 112A.

Rupee Denominated Bonds of an Indian company

As a measure to enable Indian companies to raise funds from outside India, the RBI has permitted them to issue rupee denominated bonds outside India. Accordingly, in case of non-resident assesses, any gains arising on account of appreciation of rupee between the date of purchase and the date of redemption of rupee denominated bond of an Indian company held by him against foreign currency in which investment is made shall not be included in computation of full value of consideration. This would provide relief to the non-resident investor who bears the risk of currency fluctuation **[Fifth Proviso to Section 48].**

21.6 SPECIAL PROVISIONS PRESCRIBED UNDER CHAPTER XII-A

Chapter XII-A, introduced in the Income-tax Act 1961 with effect from June 01, 1983, contains seven sections viz. 115C, 115D, 115E ,115F,115G,115H and115-I. The provisions of this Chapter are applicable to a non-resident Indian who derives investment income from a foreign exchange asset and/ or long term capital gains in respect thereof.

(1) Definitions [Section 115C]

	Terms	Meaning
(a)	Convertible foreign exchange	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	Any specified asset which the assessee has acquired or purchased with, or subscribed to in, convertible foreign exchange.
(c)	Investment income	Any income derived from a foreign exchange asset.
(d)	Long-term capital gains	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.

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(e)	Non-resident Indian	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	Any of the following assets, namely: (i) Shares in an Indian company; (ii) Debentures issued by an Indian company which is not a private company (iii) Deposits in an Indian Company which is not a private company (iv) Any security of the Central Government (v) Any other asset which the Central Government may notify

(2) Special provisions relating to taxation of investment income and long-term capital gains of a non-resident [Sections 115D to 115F]

(i) **Taxation on gross basis [Section 115D(1)]:** Section 115D deals with the computation of total income of non-residents. In computing the investment income of non-resident Indian, no deduction is to be allowed under any provision of the Act in respect of any expenditure or allowance thereabout.

(ii) **No deduction allowed [Section 115D(2)]:** No deduction under Chapter VI-A shall be allowed and indexation benefit will **not** be available, where the gross total income of a non-resident Indian consists only of investment income or/and long term capital gain.

However, where the gross total income includes investment incomes or/and long term capital gain, the deduction under Chapter VI-A shall be allowed only on that portion of gross total income which does not include the investment income and long term capital gain.

(iii) **Tax rate on investment income and long term capital gains [Section 115E]:** Under section 115E, tax payable by non-resident Indian shall be aggregate of –

(a) income-tax on Investment income at 20%;

(b) income-tax on long term capital gains from transfer of specified assets (i.e., purchased in foreign currency) at 12.5%

(c) income-tax on his other total income

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Investment Income
↓
20% + Surcharge (if applicable) + Health and Education Cess@4%
Long-term Capital Gain on Foreign Exchange Assets
↓
12.5% + Surcharge (if applicable) + Health and Education Cess@4%

(iv) **Exemption for long-term capital gains [Section 115F]**

Where a non-resident Indian has long term capital gain from transfer of a foreign exchange asset and has within a period of six months after the date of such transfer, invested the whole or part of the net consideration in any specified asset then

(a) If the cost of the new asset is not less than the net consideration in respect of the original asset, the whole of the capital gains shall not be charged to tax under section 45

(b) If the cost of the new asset is less than the net consideration in respect of the original asset, the amount as calculated below shall not be charged to tax under section 45

$$\text{Capital Gains} \times \frac{\text{Cost of acquisition of new asset}}{\text{Net Consideration}}$$

Important points:

1. Net consideration means the full value of consideration from transfer less expenditure incurred wholly and exclusively in connection with transfer.

2. Where the new asset is transferred or converted into money within a period of 3 years from the date of its acquisition, the amount of capital gains arising from the transfer of original asset not charged to tax earlier shall be deemed to be the income under the head "Capital Gains '' relating to long term capital assets. The same shall be charged to tax in the previous year in which new asset is transferred or converted into money.

ILLUSTRATION 11

A non-resident Indian acquired shares in an Indian company, A Ltd., on 1.1.2009 for ₹ 1,00,000 in foreign currency. These shares are sold by him on 1.1.2026 for ₹ 3,00,000. He invests ₹ 3,00,000 in shares on 31.03.2026 and these shares are sold by him on 30.06.2026 for ₹ 3,50,000. Discuss the tax implications. Ignore the effect of first proviso to section 48.

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SOLUTION

Computation of Long term Capital Gain for Assessment Year 2026-27

Particulars	Amount (₹)
Sale consideration	3,00,000
Less: Cost of Acquisition	1,00,000
Long term capital gain	2,00,000
Less: Exemption under section 115F	2,00,000
Exempt long-term capital gain	**NIL**

Capital Gain for Assessment year 2027-28:

1. LTCG of ₹ 2,00,000 which was exempt in A.Y.2026-27 becomes taxable this year.
2. STCG of ₹ 50,000 is also taxable this year.

ILLUSTRATION 12

Mr. John, a non-resident Indian, purchased unlisted shares of an Indian Company at a cost of ₹ 70,000 on 01.07.2010 in foreign currency. Mr. John sold the said shares for a consideration of ₹ 2,50,000 on 01.08.2025 and the expenditure incurred wholly or exclusively in connection with the transfer is ₹ 10,000. Compute the taxable capital gain if he deposited in specified assets ₹ 1,50,000 out of sale consideration. Ignore the effect of first proviso to section 48.

SOLUTION

Particulars	Amount (₹)
Sale Consideration	2,50,000
Less: Transfer Expenses	10,000
Net Consideration	2,40,000
Less: Cost of Acquisition	70,000
Long-term capital gain	1,70,000
Less: Exemption u/s 115F	1,06,250*
Taxable long-term capital gain	**63,750**

$$* \frac{1,70,000 \times 1,50,000}{2,40,000} = ₹\ 1,06,250$$

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(v) **Option not to file income-tax return [Section 115G]**

A non-resident Indian need not furnish a return of income under section 139(1) if he satisfies the following two conditions:-

(a) His total income consists only of investment income or income by way of long-term capital gains or both; and

(b) Tax deductible at source has been deducted from such income.

(vi) **Continuance of benefits after the non-resident becomes a resident [Section 115H]**

(a) Where a person who is an NRI in any previous year becomes assessable as a resident in any subsequent year, then he may furnish a declaration in writing along with the return of income under section 139 for the year in which he is so assessable.

(b) The declaration shall be to the effect that the provisions of this chapter shall continue to apply to him in respect of the investment income derived from foreign exchange assets being debentures, deposits, securities of Central Government and such other notified assets as specified under section 115C.

(c) If he does so, the provisions of this chapter shall continue to apply to him in relation to such income for that assessment year and every subsequent year until the transfer or conversion into money of such assets.

(vii) **Option to opt out of Chapter XII-A [Section 115-I]**

This section gives an option to a non-resident Indian to elect that he should not be governed by the special provisions of Chapter XII-A for any particular assessment year by furnishing his return of income for that assessment year under section 139 declaring therein that the provisions of Chapter XII-A shall not apply to him for that assessment year. In case where such an option is exercised by a non-resident Indian, his total income for that assessment year would be charged to tax under the general provisions of the Act.

A Quick Recap

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21.7 DETERMINATION OF TAX IN CERTAIN SPECIAL CASES [CHAPTER XII]

Sections 111A, 112 and 112A have already been discussed in detail in Chapter 4: Capital Gains in Module 1. The special provisions contained in other sections under Chapter XII are discussed hereunder -

(1) Special provisions for computing tax on income by way of royalty, fees for technical service, interest etc. [Section 115A]

(i) **Tax on dividend and interest in case of non-corporate non-residents and foreign companies:**

Where the total income of a foreign company or a non-corporate non- resident includes any income by way of	Rate of Tax
(1) - Dividends received from a unit in an IFSC, referred to in section 80LA(1A) - Dividend other than mentioned above	10% 20%
(2) Interest received from the Government or an Indian concern on monies borrowed or debt incurred by the Government /Indian concern in foreign currency, other than 3 and 4 mentioned below	20%
(3) Interest received from an infrastructure debt fund referred to in section 10(47)	5%
(4) Interest referred to in section 194LC received from an Indian company or business trust – - in respect of monies borrowed by an Indian company or business trust in foreign currency from sources outside India • Under a loan agreement between 1.7.2012 and 30.6.2023 or • by way of issue of long-term infrastructure bonds between 1.7.2012 and 30.9.2014 or • by way of issue of long-term bonds including long term infrastructure bond between 1.10.2014 and 30.6.2023 as approved by the Central Government - in respect of monies borrowed from sources outside India by way of rupee denominated bond on or before 30.6.2023	5%
- in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or rupee denominated bond between 1.4.2020 and 30.6.2023, which is listed only on a recognised stock exchange located in any IFSC	4%
- in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or rupee denominated bond on or after 1.7.2023, which is listed only on a recognised stock exchange located in any IFSC	9%

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	to the extent to which such interest does not exceed the interest calculated at the rate approved by the Central Government	
(5)	Distributed income referred to in section 194LBA(2), being interest income of a business trust from a SPV, distributed by business trust to its non-resident unit holders	5%
(6)	Income received in respect of units purchased in foreign currency of a mutual fund specified under section 10(23D) or of the Unit Trust of India	20%

(ii) **Tax on royalty or fees for technical services in case of non-residents**

Where the total income of a foreign company or a non-corporate non-resident includes any income by way of royalty or fees for technical services (FTS) other than the income referred to in section 44DA	Applicable Rate of Tax
(1) Received from the Government in pursuance of an agreement made by the non-resident/foreign company with the Government	20% of such royalty or FTS. However, if DTAA provides for a rate lower than 20%, then, the provisions of DTAA would apply.
(2) Received from the Indian concern in pursuance of an agreement made by the non-resident/foreign company with the Indian concern and the agreement is approved by the Central Government or where it relates to industrial policy of Government of India, the agreement in accordance with that policy.	

Important Points:

1. Special rate of tax is applicable on the above mentioned incomes. The remaining income of the assessee will be chargeable to tax at normal rates applicable to assessee.

2. No deduction in respect of any expenditure or allowance shall be allowed to the assessee under sections 28 to 44C and section 57 in computing the above income.

3. Deduction under Chapter VI-A is not available in respect of dividend and interest referred to in (i) above. However, this condition would not be applicable to deduction allowed to a unit of an International Financial Services Centre (IFSC) under section 80LA i.e. a unit of an IFSC can claim deduction under section 80LA against dividend and interest referred to in (i) above.

4. It shall not be necessary for the assessee to furnish a return of income if the following conditions are satisfied:

   (a) The total income consists of only the interest or dividend income referred to in (i) above or royalty or fees for technical services referred to in (ii) above; and

   (b) Tax deductible at source has been deducted from such income and the rate of such deduction is not less than the rate specified in (i) or the rate of 20% specified in (ii).

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A Quick Recap

Tax treatment of Royalty & Fees for technical service received from Government/Indian concern in pursuance of approved agreement

If tax has been deducted at a rate lower than 20% by availing the beneficial provisions of DTAA, then, no exemption would be available from filing return of income.

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(2) Special provision for computing tax on income from units purchased in foreign currency or capital gains arising from their transfer in case of offshore fund [Section 115AB]

Where the total income of an overseas financial organisation (Offshore Fund) includes the following incomes namely-

(i) Income received in respect of units purchased in foreign currency or

(ii) by way of long-term capital gains arising from the **transfer of units** of a mutual fund specified under section 10(23D) or units of UTI purchased in **foreign currency**,

then, the income tax payable shall be the aggregate of the following:

(a) At the rate of **10%** on income in respect of units purchased in foreign currency

(b) At the rate of **12.5%** of income by way of long-term capital gain

(c) the amount of income-tax with which the Offshore Fund would have been chargeable had its total income been reduced by the amount of long-term capital gains and income received referred to above.

Important Points:

(i) The benefit of indexation shall **not** be available in the computation of long- term capital gains.

(ii) No deduction shall be allowed to the assessee under sections 28 to 44C or section 57(i)/(iii) or under Chapter VI-A in computing the above income.

(iii) Where the gross total income of the Overseas Financial Organisation consists of other incomes, then, the deduction under Chapter VI- A will be available in respect of other incomes. The normal provisions of the Income-tax Act, 1961 will apply for computation of other income.

(iv) **"Overseas Financial Organisation"** means any fund, institution, association or body, whether incorporated or not, established under the laws of a country outside India, which has entered into an arrangement for investment in India with any public sector bank or public financial institution or a mutual fund specified under section 10(23D). Such arrangement should be approved by the Securities and Exchange Board of India.

(v) It may be noted that short term capital gains on units of equity oriented fund are taxable @20% under section 111A provided securities transaction tax has been paid on the sale of such units.

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(vi) It may be noted that capital gain on transfer of unit of specified mutual fund (mutual fund where not more than 35% of its total proceeds is invested in the equity shares of domestic companies) is a short term capital gain [Section 50AA].

(3) Special provision for computing tax on income from bonds or Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer [Section 115AC]

(i) **Eligible assessee and special rate of tax:** According to section 115AC(1), where the total income of an assessee, being a non-resident includes:

(a) income by way of interest on bonds of an Indian company issued in accordance with such scheme as the Central Government may notify or on bonds of a public sector company sold by the Government, and purchased by him in foreign currency; or

(b) income by way of dividends on Global Depository Receipts –

(1) issued in accordance with such scheme as the Central Government may specify against the initial issue of shares of an Indian company and purchased by him in foreign currency through an approved intermediary; or

(2) issued against the shares of a public sector company sold by the Government and purchased by him in foreign currency through an approved intermediary; or

(3) issue or re-issued in accordance with such scheme as the Central Government may specify against the existing shares of an Indian company purchased by him in foreign currency through an approved intermediary; or

(c) income by way of long-term capital gains arising from the transfer of above bonds or GDRs,

then, the income tax payable shall be the aggregate of the following:

(I) At the rate of **10%** in respect of interest or dividend referred to in (a) and (b) above

(II) At the rate of **12.5%** in respect of long-term capital gain from the transfer of above bonds or GDRs

(III) the amount of income-tax with which the non -resident would have been chargeable had its total income been reduced by the amount of long-term capital gains and income received referred to above.

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(ii) **Deductions not allowable [Section 115AC(2)]:** Where the gross total income of the non-resident consists only the aforesaid interest or dividend income referred to in (a) and (b) of (i) above, no deduction shall be allowed to him under section 28 to 44C or section 57(i) or 57(iii) or under Chapter VIA.

Deduction under Chapter VI-A is also **not** allowable against long term capital gains arising from transfer of bonds or GDRs.

Where the gross total income of the non-resident consists of incomes other than interest, dividend and long term capital gains referred to in (a), (b) and (c) of (i) above, then, the deduction under Chapter VI-A will be available in respect of other incomes.

(iii) **Non-availability of indexation benefit and computation of capital gains in foreign currency [Section 115AC(3)]:** The indexation benefit and benefit of computation of capital gains in foreign currency, shall not be available for the computation of long-term capital gains arising out of the transfer of long term asset, being bonds or GDRs.

(iv) **Filing of Return of Income not required [Section 115AC(4)]:** It shall not be necessary for a non-resident to furnish under section 139(1), a return of income if his total income in respect of which he is assessable under the Act during the previous year consisted only of aforesaid interest or dividend income, and the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

(v) **Concessional tax treatment for GDR/Bonds acquired in course of Amalgamation [Section 115AC(5)]:** Where the assessee acquired GDR or bonds in an amalgamated or resulting company by virtue of his holding GDR or bonds in the amalgamating or demerged company, in accordance with the provisions of 115AC(1), the concessional tax treatment would apply to such GDR or bonds.

(vi) **Meaning of Global Depository Receipts:** "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 or in an IFSC and issued to investors against the issue of —

(a) ordinary shares of issuing company, being a company listed on a recognized stock exchange in India;

(b) foreign currency convertible bonds of issuing company; or

(c) ordinary shares of issuing company, being a company incorporated outside India, if such depository receipt or certificate is listed and traded on any IFSC.

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(4) Special provisions for computing tax on income of Specified Fund or Foreign Institutional Investors from securities or capital gains arising from their transfer [Section 115AD]

(i) **Special rate of tax:** Where the total income of a Specified Fund or Foreign Institutional Investor includes the income referred to in column (2), the same would be subject to tax at the rate mentioned in column (3):

(1)	(2)	(3)
S. No.	Income	Rate of Tax
(a)	Income received in respect of securities **other than** income on units referred to in section 115AB i.e., units of Mutual Fund specified u/s 10(23D) or UTI	20% in case of FII, 10% in case of specified fund
(b)	Income by way of Short term capital gains arising from the transfer of securities (other than Short term capital gains u/s 111A)	30%
(c)	Income by way of Short term capital gains u/s 111A	20%
(d)	*Income by way of Long term capital gains arising from the transfer of securities (other than Long term capital gains u/s 112A)*	*12.5%*
(e)	Income by way of long term capital gains u/s 112A exceeding ₹ 1.25 lakh	12.5%
(f)	Other income of Specified Fund or FII	At normal rates of tax

In case of specified fund, the provision of this section would apply only to the extent of income that is attributable to units held by non-resident (not being a permanent establishment of a non-resident in India) calculated in the prescribed manner.

The specified fund has to furnish an annual statement of income eligible for concessional taxation electronically under digital signature on or before the due date u/s 139(1), which is duly verified in the manner indicated therein.

The income of a specified fund attributable to the units held by a non-resident (not being the permanent establishment of a non-resident in India), would not be eligible for tax rates specified under section 115AD unless it furnishes the annual statement of income eligible for concessional taxation on or before the said due date. [Notification no. 64/2022 dated 16.6.2022]

Where the specified fund is investment division of an offshore banking unit, the provisions of this section would apply to the extent of income that is attributable to the investment division

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of offshore banking units [granted certificate of registration as a Category-I foreign portfolio investor under the SEBI (Foreign Portfolio Investors) Regulations, 2019 made under the SEBI Act, 1992, and fulfills the prescribed conditions, including maintenance of separate accounts for its investment division] calculated in the prescribed manner.

The eligible investment division has to furnish an annual statement of income, eligible for taxation under section 115AD(1B) in the prescribed form electronically under digital signature on or before the due date specified u/s 139(1).

The income of an eligible investment division would not be eligible for tax rates specified under section 115AD unless the eligible investment division furnishes an annual statement of income eligible for taxation under section 115AD(1B) on or before the said due date [Notification no. 64/2022 dated 16.6.2022].

(ii) Surcharge:

Under normal provisions of the Act

Surcharge applicable on tax on total income of individuals/AoPs[3]/BoIs/ Artificial Juridical Persons (having any income under section 115AD and such person has shifted out of the default tax regime and opted to pay tax under the normal provisions of the Act) for payment of advance tax for A.Y.2026-27 –

	Particulars	Rate of surcharge on income-tax	Example	
			Components of total income	Applicable rate of surcharge
(i)	Where the total income > ₹ 50 lakhs but ≤ ₹ 1 crore	10%	**Example:**	
			• Capital gains on securities referred to in section 115AD(1)(b) ₹ 60 lakhs; **and** • Other income ₹ 35 lakhs;	Surcharge would be levied@10% on income-tax computed on total income of ₹ 95 lakhs.
(ii)	Where total income > ₹ 1 crore but ≤ ₹ 2 crore	15%	**Example:**	
			• Capital gains on securities referred to in section 115AD(1)(b) ₹ 1.20 crore; **and**	Surcharge would be levied@15% on income-tax computed on total income of

[3] AoPs(other than AoP consisting of only companies as its members)

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			• Other income ₹ 60 lakhs;	₹ 1.80 crore.
(iii)	Where total income [excluding dividend and STCG/LTCG on securities referred to in section 115AD(1)(b)] > ₹ 2 crore but ≤ ₹ 5 crore	25%	**Example:** • Dividend ₹ 1.05 crore • Capital gains on securities referred to in section 115AD(1)(b) ₹ 1.05 crore; **and** • Other income ₹ 2.1 crores;	Surcharge would be levied: @15% on income-tax leviable on dividend of ₹ 1.05 crore and capital gains of ₹ 1.05 crore refered to in section 115AD; **and** @25% on income-tax computed on other income of ₹ 2.1 crores included in total income
	Rate of surcharge on the income-tax payable on dividend and the portion of income chargeable to tax u/s 115AD(1)(b)	Not exceeding 15%		
(iv)	Where total income [excluding dividend and STCG/ LTCG on securities referred to in section 115AD(1)(b)] > ₹ 5 crore	37%	**Example:** • Dividend ₹ 1.05 crore • Capital gains on securities referred to in section 115AD(1)(b) ₹ 1.70 crore; and • Other income ₹ 6 crore	Surcharge would be levied - @15% on income-tax leviable on dividend of ₹ 1.05 crore and capital gains of ₹ 1.70 crore referred to in section 115AD; **and** @37% on income-tax computed on other income of ₹ 6 crore included in total income.
	Rate of surcharge on the income-tax payable on dividend and the portion of income chargeable to tax u/s 115AD(1)(b)	Not exceeding 15%		

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(v)	Where total income [including dividend and STCG/ LTCG on securities referred to in 115AD(1)(b)] > ₹ 2 crore in cases not covered under (iii) and (iv) above	15%	**Example:**	
			• Dividend ₹ 1.05 crore • Capital gains on securities referred to in section 115AD(1)(b) ₹ 1.10 crore; **and** • Other income ₹ 1.60 crore;	Surcharge would be levied@15% on tax on total income of ₹ 3.75 crore.

Surcharge and health and education cess would not be applicable to specified fund in respect of income received from securities referred to in section 115AD(1)(a).

Note – *In case of default tax regime, the maximum rate of surcharge would be 25% (instead of 37%).*

In case of an AoP consisting of only companies as its members, the rate of surcharge would be 10%, where the total income > ₹ 50 lakhs but ≤ ₹ 1 crore and 15%, where the total income > ₹ 1 crore.

(iii) **No deduction is allowed [Section 115AD(2)]:** Where the gross total income of the specified fund or Foreign Institutional Investor comprises only of the aforesaid interest or dividend income from securities, no deduction shall be allowed to it under sections 28 to 44C or section 57(i) or 57(iii) or under Chapter VI-A.

Deduction under Chapter VI-A is also not allowable in case of short term capital gain or long term capital gain arising from transfer of securities.

Where the gross total income of the specified fund or Foreign Institutional Investor consists of incomes other than income referred to in (a) to (e) of table in (i) above, then, the deduction under Chapter VI-A will be available in respect of other incomes. However, the provisions of AMT under section 115JEE would not apply to specified fund.

(iv) **First and second provisos to section 48 shall not apply [Section 115AD(3)]:**The benefit of computation of capital gains in foreign currency and the benefit of indexation would not be available for the computation of capital gains arising on transfer of securities.

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(v) Meaning of certain terms

S. No.	Term	Meaning
1	Investment division of offshore banking unit	An investment division of a banking unit of a non-resident located in an IFSC, as referred to in section 80LA(1A) and which has commenced its operations on or before ***31.3.2030***
2	Specified fund	(i) A fund established or incorporated in India in the form of a trust or a company or a LLP or a body corporate,– (I) (a) which has been granted a certificate of registration as a Category III Alternative Investment Fund and is regulated under the SEBI (Alternative Investment Fund) Regulations, 2012, made under the SEBI Act, 1992 or IFSC Authority Act, 2019; *(b) which has been granted a certificate as a retail scheme or an Exchange Traded Fund and satisfies the conditions laid down for such schemes or funds under the IFSC Authority (Fund Management) Regulations, 2022, made under the IFSC Authority Act, 2019;* (II) which is located in any IFSC and (III) of which all the units are held by non-residents other than units held by a sponsor or manager; However, this condition would not apply where any unit holder or holders, being non-resident during the previous year when such unit or units were issued, becomes resident under section 6(1) or (1A) in any previous year subsequent to that year, if the aggregate value and number of the units held by such resident unit holder or holders do not exceed 5% of the total units issued and fulfill such other conditions as may be prescribed. (ii) investment division of an offshore banking unit, which has been (a) granted a certificate of registration as a Category-I foreign portfolio investor under the SEBI (Foreign Portfolio Investors) Regulations, 2019 made under the SEBI Act, 1992 and which has commenced its operations on or before 31.3.2030; and (b) fulfils such conditions including maintenance of separate accounts for its investment division, as may be prescribed.

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(5) Special provision for computing tax on non-resident sportsmen or sports associations [Section 115BBA]

(i) **Eligible assessee and special rate of tax:** Where the total income of an assessee, referred to in column (2) includes income referred to in column (3) of the table below, such income would be chargeable to tax@20%.

	Assessee	Income
(1)	(2)	(3)
(a)	A sportsman (including an athlete), who is not a citizen of India and is a non-resident	Any income received or receivable by way of— (i) participation in India in any game (other than a game the winnings wherefrom are taxable under section 115BB, being winning from crossword puzzles, races including horse races, card games and other games of any sort of gambling or betting) or sport; or (ii) advertisement; or (iii) contribution of articles relating to any game or sport in India in newspapers, magazines or journals;
(b)	A non-resident sports association or institution	Any amount guaranteed to be paid or payable to such association or institution in relation to any game (other than a game the winnings wherefrom are taxable under section 115BB) or sport played in India
(c)	An entertainer who is not a citizen of India and is a non-resident	Any income received or receivable from his performance in India

(ii) **Deduction of expenditure not permissible:** No deduction in respect of any expenditure or allowance shall be allowed under any provision of this Act in computing the income referred to in (*a*) or (b) or (c) in the table given above.

(iii) **Filing of return of income not required:** The assessee is **not** required to furnish under section 139(1) a return of his income if—

(a) his total income in respect of which he is assessable under this Act during the previous year consisted **only** of income referred to in (a) or (b) or (c) above; and

(b) the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

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ILLUSTRATION 13

During the financial year 2025-26, Nadal, a tennis professional and a Spanish citizen participated in India in a Tennis Tournament and won prize money of ₹ 15 lakhs. He contributed articles on the tournament in a local newspaper for which amount of ₹ 1 lakh is payable to him. He also earned ₹ 5 lakhs from a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur ₹ 3 lakhs towards his travel costs to India. He was a non-resident for tax purposes in India.

What would be his tax liability in India for A.Y. 2026-27? Is he required to file his return of income?

SOLUTION

Under section 115BBA, all the three items of receipts in India viz. prize money of ₹ 15 lakhs, amount received from newspaper of ₹ 1 lakh and amount received towards TV advertisement of ₹ 5 lakhs - are chargeable to tax. No expenditure is allowable as deduction against such receipts. The rate of tax chargeable under section 115BBA is 20%, *plus* health and education cess @4%. The total tax liability works out to ₹ 4,36,800 being 20.8% of ₹ 21 lakhs. Thus, Nadal will be liable to tax on the income earned in India

He is not required to file his return of income if -

(a) his total income during the previous year consists only of income arising under section 115BBA; **and**

(b) the tax deductible at source under the provisions of Chapter XVII-B have been deducted from such incomes.

21.8 SPECIAL PROVISIONS RELATING TO CONVERSION OF INDIAN BRANCH OF A FOREIGN BANK INTO A SUBSIDIARY COMPANY [CHAPTER XII-BB]

(1) Conversion of an Indian branch of foreign company into subsidiary Indian company [Section 115JG(1)]

(i) The provisions of this section apply to a foreign company engaged in banking business in India through its branch situated in India, which is converted into an Indian subsidiary company in accordance with the scheme framed by RBI.

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(ii) If the conditions notified by the Central Government in this behalf are satisfied, then capital gains arising from such conversion would not be chargeable to tax in the assessment year relevant to the previous year in which such conversion takes place.

(iii) Also, the provisions of the Act relating to computation of income of foreign company and Indian subsidiary company would apply with such exceptions, modifications and adaptations as specified in the notification.

(iv) Further, the benefit of set-off of unabsorbed depreciation, set-off or carry forward and set-off of losses, tax credit in respect of tax paid on deemed income relating to certain companies available under the Act shall apply with such exceptions, modifications and adaptations as specified in the notification.

Accordingly, the Central Government has, vide Notification no. 85/2018, specified the conditions to be fulfilled –

(1) For Capital Gains exemption:

Where a foreign company is engaged in the business of banking through its Indian branch and converts such Indian branch into its Indian subsidiary company in accordance with the scheme framed by RBI, the capital gains arising from such conversion would not be chargeable to tax, if -

(a) the Indian branch amalgamates with the Indian subsidiary company in accordance with the scheme of amalgamation approved by the shareholders of the foreign company and the Indian subsidiary company and sanctioned by the RBI[4]

(b) all the assets and liabilities of the Indian branch immediately before conversion would become the assets and liabilities of the Indian subsidiary company;

(c) the asset and liabilities of the Indian branch are transferred to the Indian subsidiary company at values appearing in the books of account of the Indian branch immediately before its conversion.

Note - Any change in the value of assets consequent to their revaluation would not be considered while determining the value of the assets.

(d) the foreign bank or its nominee shall hold the whole of the share capital of the Indian subsidiary company during the period beginning from the date of conversion and ending on the last day of the previous year in which the conversion took place and continue to

[4]under paragraph 20(h) of the Framework for setting up of wholly owned subsidiaries by foreign banks in India issued by the Reserve Bank of India *vide* Press release number 2013-2014/936 dated 6th November, 2013

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hold the shares of Indian subsidiary company carrying not less than 51% of the voting power for a period of five years immediately succeeding the said previous year;

(e) the foreign company 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 Indian subsidiary company.

(2) Application of the provisions of the Income-tax Act, 1961 with modifications/ exceptions

The provisions of the Income-tax Act, 1961 relating to unabsorbed depreciation, set off or carry forward and set off of losses, tax credit in respect of tax paid on deemed income relating to certain companies and the computation of income in case of foreign company and Indian subsidiary company shall apply with following modifications, exceptions and adaptation –

	Purpose	Modification/exception/adaptation
(a)	**Allowance of depreciation under section 32**	The aggregate deduction, in respect of depreciation on buildings, machinery, plant or furniture, being tangible assets, or know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets, allowable to the Indian branch and the Indian subsidiary company shall not exceed in any previous year the deduction calculated at the prescribed rates as if the conversion had not taken place. Such deduction would be apportioned between the Indian branch and the Indian subsidiary company in the ratio of the number of days for which the assets were used by them;
(b)	**Set-off and c/f of loss and depreciation**	The accumulated loss and the unabsorbed depreciation of the Indian branch would be deemed to be the loss or allowance for depreciation of the Indian subsidiary company for the previous year in which conversion was effected; and provisions of the Income-tax Act, 1961, relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.
(c)	**Determination of actual cost u/s 43(1)**	The actual cost of the block of assets in the case of the Indian subsidiary company shall be the written down value of the block of assets as in the case of the Indian branch on the date of its conversion into the Indian subsidiary company The actual cost of any capital asset on which deduction has been allowed or is allowable under section 35AD, shall be treated as 'nil' in the case of the Indian subsidiary company if the capital asset became the property of the Indian subsidiary company as a result of conversion of the Indian branch.

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(d)	**Cost of acquisition of other capital assets**	Where the capital asset other than those referred to in (c) above became the property of the Indian subsidiary company as a result of conversion of the Indian branch, the cost of acquisition of the asset for the purposes of computation of capital gains shall be deemed to be the cost for which the Indian branch acquired it or, as the case may be, the cost for which previous owner has acquired it.
(e)	**Tax credit**	The tax credit of the Indian branch shall be deemed to be the tax credit of the Indian subsidiary company for the purpose of the previous year in which conversion was effected; and the provisions of section 115JAA of the Income-tax Act, 1961 shall apply accordingly.
(f)	**Amortisation of VRS Expenditure**	The provisions of 35DDA of the Act shall be, as far as may be, apply to the Indian subsidiary company, as they would have applied to the Indian branch, if the conversion had not taken place
(g)	**Deemed credit balance in provision for bad and doubtful debts**	The credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) of the Indian branch on the date of conversion shall be deemed to be the credit balance of the Indian subsidiary company and the provisions of section 36 of the Income-tax Act, 1961, shall apply accordingly
(h)	**Non-applicability of section 56(2)(x)**	The provisions of section 56(2)(x) shall not apply to the transaction of receipt of shares in the Indian subsidiary company by the foreign company or its nominee in consequence of the conversion of the Indian branch into the Indian subsidiary company.

Meaning of certain terms:

Term	Meaning
Accumulated loss	So much of the loss of the Indian branch before its conversion into Indian subsidiary company under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such Indian branch would have been entitled to carry forward and set off under the provisions of section 72, if the conversion had not taken place.
Unabsorbed depreciation	So much of the allowance for depreciation of the Indian branch before its conversion into Indian subsidiary company, which remains to be allowed and which would have been allowed to the Indian branch under the provisions of the Act, if the conversion had not taken place.
Previous owner	In relation to any capital asset owned by the Indian subsidiary company means the last previous owner of the capital asset who

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	acquired it by a mode of acquisition other than those referred in section 49(1)(i)/(ii)/(iii)/(iv) or section 115JG(1).
Tax credit	So much of the tax credit of the Indian branch before conversion into Indian subsidiary company which such Indian branch would have been entitled to carry forward and set off under the provisions of section 115JAA of the Act, if the conversion had not taken place.
Date of conversion	The date, which the Reserve Bank of India appoints for the vesting of undertaking of the Indian branch in Indian subsidiary company[5]

(2) Consequences of failure to comply with the specified conditions [Section 115JG(2)]

If the conditions specified in the scheme of RBI or notification issued by the Central Government are not complied with, then, all the provisions of the Act would apply to the foreign company and Indian subsidiary company without any benefit, exemption or relief under this section.

(3) Consequences of subsequent failure to comply with the conditions [Section 115JG(3)]

(i) If the benefit, exemption or relief has been granted to the foreign company or Indian subsidiary company in any previous year and thereafter, there is a failure to comply with any of the conditions specified in the scheme or notification, then, such benefit, exemption or relief shall be deemed to have been wrongly allowed.

(ii) In such a case, the Assessing Officer is empowered to re-compute the total income of the assessee for the said previous year and make the necessary amendment. This power is notwithstanding anything contained in the Income-tax Act, 1961.

(iii) The provisions of rectification under section 154, would, accordingly, apply and the four year period within which such rectification should be made has to be reckoned from the end of the previous year in which the failure to comply with such conditions has taken place.

(iv) Every notification under issued under this section shall be laid before each House of Parliament.

[5]under paragraph 20(i) of the Framework for setting up of wholly owned subsidiaries by foreign banks in India issued by the Reserve Bank of India vide press release number 2013-2014/936 dated 6th day of November, 2013.

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21.9 WITHHOLDING TAX PROVISIONS FOR NON-RESIDENTS

(1) Salary payable in foreign currency [Section 192]

By virtue of section 9(1)(ii), salary is deemed to accrue or arise in India, if services are rendered in India. Therefore, if a non-resident renders services in India, the salary income would be chargeable to tax in India and the person responsible for paying the salary income i.e., the employer, has to deduct withholding tax in accordance with the provisions of section 192, at the rates in force for the financial year in which the payment is made where the employee exercises option to opt out of new tax regime under section 115BAC.

(i) Tax on non-monetary perquisites paid by employer [Section 192(1A)] – In case of non-monetary perquisite, employer can opt to pay tax on whole or part of such income without making any deduction therefrom at the time tax was otherwise deductible.

Such tax will have to be calculated at the average rate applicable to aggregate salary income of the employee and payment of tax will have to be made every month along with tax deducted at source on monetary payment of salary, allowances etc. [Section 192(1)].

(ii) Meaning of Average rate of income-tax – Average rate of income-tax means the rate arrived at by dividing the amount of income-tax calculated on the total income, by such total income.

(iii) Deferment of TDS on perquisite of specified security or sweat equity shares provided by an eligible start-up [Section 192(1C)] - An employer, being an eligible start up referred to in section 80-IAC, responsible for paying any income to the assessee by way of perquisite being any specified security or sweat equity shares allotted or transferred free of cost or at concessional rate to the assessee, has to deduct or pay, as the case may be, tax on the value of such perquisite provided to its employee within 14 days from the earliest of the following dates –

- after the expiry of 48 months from the end of the relevant assessment year; or
- from the date of the sale of such specified security or sweat equity share by the assessee; or
- from the date of the assessee ceasing to be the employee of the employer who allotted such shares

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Such tax has to deducted or paid for the financial year in which said specified security or sweat equity share is allotted or transferred.

(iv) Calculation of TDS where salary is payable in foreign currency [Section 192(6)] - Section 192(6) deals with the provisions of withholding tax in case of salary payable in foreign currency. In case, where salary is payable in foreign currency, the amount of tax deducted is to be calculated after converting the salary payable into Indian currency at the telegraphic transfer buying rate as adopted by State Bank of India on the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears [Rule 26 read with Rule 115].

Students may note that the Rule 26 and Rule 115 have been given as Annexure – 1 at the end of this module.

(2) Payments to non-resident sportsmen or sports association [Section 194E]

(i) Applicability

This section provides for deduction of tax at source in respect of any income referred to in section 115BBA payable to a non-resident sportsman (including an athlete) or an entertainer who is not a citizen of India or a non-resident sports association or institution.

(ii) Rate of TDS

Deduction of tax at source **@20%** (*plus* surcharge, if applicable, and health and education cess@4%) should be made by the person responsible for making the payment. Health and education cess @4% on TDS rate of 20% would be leviable, since payment is made to a non-resident.

(iii) Time of deduction of tax

Such tax deduction should be at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(iv) Income referred to in section 115BBA

(i) income received or receivable by a non-resident sportsman (including an athlete), who is not a citizen of India, by way of-

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(a) participation in any game or sport in India (However, games like crossword puzzles, horse races etc. taxable under section 115BB are not included herein); or

(b) advertisement; or

(c) contribution of articles relating to any game or sport in India in newspapers, magazines or journals.

(ii) Guarantee amount paid or payable to a non-resident sports association or institution in relation to any game or sport played in India. However, games like crossword puzzles, horse races etc. taxable under section 115BB are not included herein.

(iii) income received or receivable by a non-resident entertainer (who is not a citizen of India) from his performance in India.

Note: The issue as to whether the non-resident match referees and umpires in the games played in India fall within the meaning of "sportsmen" to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer was taken up by the Calcutta High Court in *Indcomv. CIT (TDS) (2011) 335 ITR 485*.

In order to attract the provisions of the section 194E, the person should be a non-resident sportsperson or non-resident sports association or institution whose income is taxable as per the provisions of section 115BBA.

Umpires and match referees can be described as professionals or technical persons who render professional or technical services, but they cannot be said to be either non-resident sportsmen (including an athlete) or non-resident sports association or institution so as to attract the provisions of section 115BBA and consequently, the provisions of tax deduction at source under section 194E are can not be attracted.

The Calcutta High Court held that although the payments made to non-resident umpires and the match referees are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.

It may be noted that since income has accrued and arisen in India to the non-resident umpires and match referees, the TDS provisions under section 195 would be attracted and tax would be deductible at the rates in force.

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Board of Control for Cricket in Sri Lanka v. DIT (International Taxation) & Pilcom v. CIT (2020) 425 ITR 312 (SC)

The International Cricket Council (ICC), having its headquarters in London, is the organisation which makes and alters the rules of the game of cricket, sets the different levels and minimum standards at which the game is to be played in each country to get its recognition, the different formats of the game, e. g. test cricket, first class cricket, limited overs competition and so on. It has affiliates from similar organisations in countries, all over the world. It controls, supervises and regulates the game of cricket in every respect.

At a special meeting of the ICC held in London in the year 1993, India, Pakistan and Sri Lanka were chosen to co-host the world cup. A joint management committee of these three countries, [(Pak-Indo-Lanka) joint management committee (PILCOM)] was formed to conduct this world cup cricket tournament. Bank accounts were opened by PILCOM in London to be operated jointly by the India and Pakistan Cricket Boards. In this account were deposited moneys from sponsorships, TV rights, etc. The Board of Control for Cricket in India (BCCI) appointed its own committee, INDCOM, for discharge of its functions. INDCOM had its bank account at Calcutta. From the bank account of PILCOM at London certain amounts were transferred to the bank accounts of the host countries for the purpose of payment of fees to umpires and referees, defraying administrative expenses and payment of prize money. PILCOM paid £ 43,50,000 which included £ 19,55,000 as guarantee money to eleven cricket associations.

The payments of £ 8,85,000 representing guarantee money paid to the Boards of Australia, England, New Zealand, Sri Lanka and Kenya with whom Double Taxation Avoidance Agreements exist, and of £ 7,10,000 representing guarantee money paid to the Boards of Pakistan, West Indies, Zimbabwe and Holland were in the nature of guarantee money paid to non-resident sports associations. The payments were not made by the assessee in India but through its bank accounts at London or elsewhere. The non-resident sports associations had participated in the event, where cricket teams of these associations had played various matches in the country. Though the payments were described as guarantee money, they were intricately connected with the event where various cricket teams were scheduled to play and did participate in the event. The source of income was in the playing of the matches in India.

The mandate under section 115BBA(1)(b) is that if the total income of a non-resident sports association includes the amount guaranteed to be paid or payable to it in relation to any game or sports played in India, the amount of Income-tax calculated in terms of the section shall become payable. The expression “in relation to” emphasises the connection between the game or sport played in India on the one hand and the guarantee money paid or payable to the non-resident

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sports association on the other. Once the connection is established, the liability under the provision must arise. To the extent the payments represented amounts which could not be subject matter of charge under the provisions of the Act, appropriate benefit had already been extended to the assessee.

The payments made to the non-resident sports associations represented their income which accrued or arose or was deemed to have accrued or arisen in India. Consequently, the assessee was liable to deduct tax at source in terms of section 194E.

ILLUSTRATION 14

Smith, a foreign national and a cricketer came to India as a member of Australian cricket team in the year ended 31st March, 2026. He earned ₹ 5 lakhs for participation in matches in India. He also earned ₹ 1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he earned ₹ 10,000. When he stayed in India, he also won a prize of ₹ 20,000 from horse racing in Mumbai. He has no other income in India during the year.

(i) Compute tax liability of Smith for Assessment Year 2026-27.

(ii) Are the income specified above subject to deduction of tax at source?

(iii) Is he liable to file his return of income for Assessment Year 2026-27?

(iv) What would have been his tax liability, had he been a match referee instead of a cricketer and pays tax under the default tax regime under section 115BAC?

SOLUTION

(i) Computation of tax liability of Smith for the A.Y.2026-27

Particulars	₹	₹
Income taxable under section 115BBA		
Income from participation in matches in India	5,00,000	
Advertisement of product on TV	1,00,000	
Contribution of articles in newspaper	10,000	
Income taxable under section 115BB		
Income from horse races	20,000	
Total income	**6,30,000**	
Tax@ 20% under section 115BBA on ₹ 6,10,000		1,22,000

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Tax@ 30% under section 115BB on income of ₹ 20,000 from horse races		6,000
		1,28,000
Add: Health and Education cess@4%		5,120
Total tax liability of Smith for the A.Y.2026-27		**1,33,120**

(ii) Yes, the above income is subject to tax deduction at source.

Income referred to in section 115BBA (i.e., ₹ 6,10,000, in this case) is subject to tax deduction at source@ 20% under section 194E.

Income referred to in section 115BB (i.e.,₹ 20,000, in this case) is subject to tax deduction at source@30% under section 194BB.

Since Smith is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by health and education cess@4%.

(iii) Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. However, in this case, Mr. Smith has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for A.Y.2026-27.

(iv) The Calcutta High Court in *Indcom v. CIT (TDS)(2011) 335 ITR 485* has held that 'match referee' would not fall within the meaning of "sportsmen" to attract the provisions of section 115BBA.Therefore, although the payments made to non-resident 'match referee' are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA. They are subject to the normal rates of tax under section 115BAC.

Particulars		₹
Tax@30% under section 115BB on winnings of ₹ 20,000 from horse races		6,000
Tax on ₹ 6,10,000 at normal rate of tax		
Upto ₹ 4,00,000	Nil	
4,00,000 – 6,10,000 @5%	10,500	10,500
		16,500
Add: Health and Education cess@4%		660
Total tax liability		**17,160**

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(3) Income by way of interest from Infrastructure Debt Fund [Section 194LB]

(i) Special rate of tax on interest received by non-residents from notified infrastructure debt funds

Interest income received by a non-corporate non-resident or a foreign company from notified infrastructure debt funds set up in accordance with the prescribed guidelines would be subject to tax at a concessional rate of ***5%*** under section 115A on the gross amount of such interest income as compared to tax @20% on other interest income of non-resident. The concessional rate of tax is expected to give a fillip to infrastructure and encourage inflow of long-term foreign funds to the infrastructure sector.

(ii) Rate of TDS

Accordingly, tax would be deductible @***5%*** *plus* surcharge, if applicable, *plus* health and education cess @4% on interest paid/credited by such fund to a non-resident/foreign company.

(iii) Time of deduction

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.

(4) Income by way of interest from an Indian company or business trust [Section 194LC]

(i) Concessional rate of tax on interest on foreign currency borrowings by an Indian company or business trust

Interest paid by an Indian company or business trust to a foreign company or a non-corporate non-resident would be subject to tax at a concessional rate on gross interest (as against the rate of 20% of gross interest applicable in respect of other interest received by a non-corporate non-resident or foreign company from Government or an Indian concern on money borrowed or debt incurred by it in foreign currency)

Tax is deductible at concessional rate of 5% on the following interest paid by an Indian company or business trust to a foreign company or a non-corporate non-resident -

(a) in respect of borrowing made in foreign currency from sources outside India

- under a loan agreement at any time between 1.7.2012 and 30.6.2023 or

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- by way of issue of long-term infrastructure bonds during the period between 1.7.2012 and 30.9.2014 or
- by way of issue of any long-term bond, including long-term infrastructure bond during the period between 1.10.2014 and 30.6.2023

as approved by the Central Government in this behalf.

(b) in respect of monies borrowed by it from a source outside India by way of issue of rupee denominated bond on or before 30.6.2023.

Tax is deductible at concessional rate of **4%** in respect of monies borrowed by an Indian company or business trust from a source outside India by way of issue of any long-term bond or rupee denominated bond between 1.4.2020 and 30.6.2023, which is listed only on a recognised stock exchange located in any IFSC.

Tax is deductible at concessional rate of **9%** in respect of monies borrowed by an Indian company or business trust from a source outside India by way of issuance of any long-term bond or rupee denominated bond on or after 1.7.2023, which is listed only on a recognised stock exchange located in any IFSC.

The interest to the extent the same does not exceed the interest calculated at the rate approved by the Central Government, taking into consideration the terms of the loan or the bond and its repayment, will be subject to tax at a concessional rate of **5%, 4% or 9%, as the case may be,** *plus* surcharge, wherever applicable, *plus* health and education cess @4%.

Note *- Interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the period from 17.9.2018 to 31.3.2019 shall be exempt from tax, and consequently, no tax shall be deducted on the payment of interest in respect of the said bond under section 194LC.*

(ii) Non-applicability of higher rate of TDS under section 206AA for non-furnishing of PAN

Section 206AA provides that any person whose receipts are subject to deduction of tax at source i.e., the deductee, shall mandatorily furnish his PAN to the deductor failing which the deductor has to deduct tax at source at higher of the following rates –

(i) the rate prescribed in the Act;

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(ii) at the rate in force i.e., the rate mentioned in the Finance Act; or

(iii) at the rate of 20%

Levy of higher rate of TDS under **section 206AA in the absence of PAN would not be attracted** in respect of payment of interest on long-term bonds, as referred to in section 194LC, to a non-corporate non-resident or to a foreign company and other payment subject to prescribed conditions.

For the purpose of reducing the compliance burden, Rule 37BC provides for relaxation to a non-corporate non-resident or a foreign company not having PAN in respect of payment in the nature of interest, royalty, fees for technical services, dividends and payments on transfer of any capital asset, subject to the deductee furnishing the following details and documents to the deductor, namely:-

a. name, e-mail id, contact number;

b. address in the country or specified territory outside India of which the deductee is a resident;

c. a certificate of his being resident in any country or specified territory outside India from the Government of that country or specified territory if the law of that country or specified territory provides for issuance of such certificate;

d. Tax Identification Number of the deductee in the country or specified territory of his residence and in case no such number is available, then a unique number on the basis of which the deductee is identified by the Government of that country or the specified territory of which he claims to be a resident.

(5) Other sums (payable to non-residents) [Section 195]

(i) Applicability

Any person responsible for paying interest (other than interest referred to in section 194LB or section 194LC) or any other sum chargeable to tax (other than salaries) to a non-corporate non-resident or to a foreign company is liable to deduct tax at source at the rates prescribed by the relevant Finance Act. Such persons are also required to furnish the information relating to payment of any sum in such form and manner as may be prescribed by the CBDT.

Payee to be a non-resident - In order to subject an item of income to deduction of tax under this section the payee must be a non-corporate non-resident or a foreign company.

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Payer may be a resident or non-resident - Under section 195(1), the obligation to deduct tax at source from interest and other payments to a non-resident, which are chargeable to tax in India, is on "any person responsible for paying to a non-resident or to a foreign company".

The words "any person" used in section 195(1) is intended to include both residents and non-residents. Therefore, a non-resident person is also required to deduct tax at source before making payment to another non-resident, if the payment represents income of the payee non-resident, chargeable to tax in India. Therefore, if the income of the payee non-resident is chargeable to tax, then tax has to be deducted at source, whether the payment is made by a resident or a non-resident.

Explanation 2 clarifies that the obligation to comply with section 195(1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident has:-

(a) a residence or place of business or business connection in India; or

(b) any other presence in any manner whatsoever in India.

(ii) Time of deduction

The tax is to be deducted at source at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

Where any interest or other sum as aforesaid is credited to any account, whether called "Interest payable account" or "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee.

However, in the case of interest payable by the Government or a public sector bank within the meaning of section 10(23D) or a public financial institution within the meaning of section 10(23D), deduction of tax shall be made only at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode.

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(iii) Payments subject to tax deduction

The statutory obligation imposed under this section would apply for the purpose of deduction of tax at source from any sum being income assessable to tax (other than salary income) in the hands of the non-resident non-corporate/foreign company.

Payment to a non-resident by way of royalties and payments for technical services rendered in India are common examples of sums chargeable under the said provisions of the Act to which the liability for deduction of tax at source would apply.

(iv) Certificate of non-deduction of tax at source

(a) Under section 195(3), any person entitled to receive any interest or other sum on which income-tax has to be deducted under section 195(1) may make an application in the prescribed form to the Assessing Officer for grant of certificate authorizing him to receive such interest or other sum without deduction of tax thereunder.

(b) Where any such certificate is granted, every person responsible for paying such interest or other sum to the person to whom certificate is granted make payment of such interest or other sum without deduction of tax at source under section 195(1), so long as the certificate in force.

(c) Such certificate shall remain in force till the expiry of the period specified therein. However, if it is cancelled by the Assessing Officer before the expiry of such period, the certificate shall remain in force till such cancellation.

(d) The CBDT is empowered to make rules specifying the cases in which, and the circumstances under which, an application may be made for the grant of certificate. While doing so, it should take into account the convenience of the assessees and the interests of the revenue.

(e) Such Rules would provide for the conditions subject to which such certificate may be granted and any other matter connected therewith.

(v) Person responsible for paying any sum to non-resident to furnish prescribed information

Section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax under the provisions of the Act, to a non-corporate non-resident or to a

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foreign company, shall be required to furnish the information relating to payment of such sum in the prescribed form and prescribed manner.

(vi) Specified class or classes of persons, making payment to the non-resident, to mandatorily make application to Assessing Officer to determine the appropriate proportion of sum chargeable to tax

(a) Under section 195(1), any person responsible for paying to a non-corporate non-resident or to a foreign company, any interest or any other sum chargeable under the provisions of the Act (other than salary), has to deduct tax at source at the rates in force.

(b) Under section 195(2), where the person responsible for paying any such sum chargeable to tax under the Act (other than salary) to a non-resident, considers that the whole of such sum would not be income chargeable in the hands of the recipient, he may make an application in such form and manner to the Assessing Officer, to determine in such manner, as may be prescribed, the appropriate proportion of such sum so chargeable. When the Assessing Officer so determines, the appropriate proportion, tax shall be deducted under section 195(1) only on that proportion of the sum which is so chargeable.

(c) Section 195(7) provides that, notwithstanding anything contained in sections 195(1) and 195(2), the CBDT may, by notification in the Official Gazette, specify a class of persons or cases, where the person responsible for paying to a non-corporate non-resident or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall make an application in the prescribed form and manner to the Assessing Officer, to determine in the prescribed manner, the appropriate proportion of sum chargeable to tax. Where the Assessing Officer determines the appropriate proportion of the sum chargeable, tax shall be deducted under sub-section (1) on that proportion of the sum which is so chargeable.

(d) Consequently, where the CBDT specifies a class of persons or cases, the person responsible for making payment to a non-corporate non-resident or a foreign company in such cases has to mandatorily make an application in the prescribed form and manner to the Assessing Officer, whether or not such payment is chargeable under the provisions of the Act.

Accordingly, the CBDT has inserted Rule 29BA to specify the following form and manner of making application to the Assessing Officer and manner for determining the appropriate fraction on which tax is deductible at source:

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Sub-rule	Provision
(1)	**Form and manner of making application:** An application by a person for determination of appropriate proportion of sum chargeable in the case of non-resident recipient under section 195(2)/(7) has to be made in **Form 15E** electronically – (i) under digital signature; or (ii) through electronic verification code.
(2)	**Determination of appropriate proportion of sum chargeable to tax after examining the taxability of the amount as per the Act and the relevant DTAA:** The Assessing Officer has to examine whether the sum being paid or credited is chargeable to tax under the provisions of the Act read with the relevant DTAA, if any. If the sum is chargeable to tax, he has to determine the appropriate proportion of such sum chargeable to tax.
(3)	**Issuance of certificate determining appropriate proportion of sum chargeable to tax:** The Assessing Officer has to examine the application and on being satisfied that the whole of such sum would not be the income chargeable in case of the recipient, he may issue a certificate determining appropriate proportion of such sum chargeable under the provision of the Act, for the purposes of tax deduction under section 195(1).
(4)	**Information to be considered while examining the application:** While examining the application, the Assessing Officer has to take into consideration, following information in relation to the recipient:- (i) tax payable on estimated income of the previous year relevant to the assessment year (ii) tax payable on the assessed or returned or estimated income, as the case may be, of preceding four previous years (iii) existing liability under the Income-tax Act, 1961 (iv) advance tax payment, tax deducted at source and tax collected at source for the assessment year relevant to the previous year till the date of making application in Form 15E.
(5)	**Validity of the certificate:** The certificate would be valid only for the payment to non-resident named therein and for such period of the previous year as may be specified in the certificate, unless it is cancelled by the Assessing Officer at any time before the expiry of the specified period.
(6)	**Application for fresh certificate:** An application for a fresh certificate may be made, if the assessee so desires, -

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	- after the expiry of the period of validity of the earlier certificate or - within three months before the expiry thereof.
(7)	**Procedures, formats and standards to be laid down for ensuring secure capture and transmission of data and uploading of documents:** The PDGIT (Systems) or the DGIT (Systems), as the case may be, has to lay down procedures, formats and standards for ensuring secure capture and transmission of data and uploading of documents. They would also be responsible for evolving and implementing appropriate security, archival and retrieval policies in relation to the furnishing of Form No 15E and issuance of Certificate.

(vii) Refund for denying liability to deduct tax under section 195 [Section 239A]:

(a) Application for refund of tax - This section provides that where under an agreement or other arrangement, in writing, the tax deductible on any income, other than interest, under section 195 is to be borne by the person by whom the income is payable, and such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income, he may file an application before the Assessing Officer for refund of such tax in prescribed form 29D. The claim for refund of tax shall be accompanied by a copy of an agreement or arrangement as applicable.

(b) Time limit for filing application - Such application may be filed within 30 days from the date of payment of such tax.

(c) Passing of order by Assessing Officer - The Assessing Officer has to, by an order in writing, allow or reject the application. However, no application would be rejected unless an opportunity of being heard has been given to the applicant. The Assessing Officer, may, before passing an order make such inquiry as he considers necessary.

(d) Time limit for passing order - The order has to be passed within 6 months from the end of the month in which application for refund is received.

(viii) Procedure for refund of TDS under section 195 to the person deducting tax in cases where tax is deducted at a higher rate prescribed in the DTAA

(I) The CBDT has, through *Circular No.7/2011 dated 27.9.2011*, modified Circular No.07/2007, dated 23.10.2007 which laid down the procedure for refund of tax deducted at source under section 195 of the Income-tax Act, 1961 to the person deducting tax at source from the payment to a non-resident. The said Circular

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allowed refund to the person making payment under section 195 in the circumstances indicated below where, after the deposit into Government account of the tax deducted at source under section 195,

(a) the contract is cancelled, and no remittance is made to the non-resident;

(b) the remittance is duly made to the non-resident, but the contract is cancelled. In such cases, the remitted amount has been returned to the person responsible for deducting tax at source;

(c) the contract is cancelled after partial execution and no remittance is made to the non-resident for the non-executed part;

(d) the contract is cancelled after partial execution and remittance related to non-executed part is made to the non-resident. In such cases, the remitted amount has been returned to the person responsible for deducting the tax at source or no remittance is made but tax was deducted and deposited when the amount was credited to the account of the non-resident;

(e) there occurs exemption of the remitted amount from tax either by amendment in law or by notification under the provisions of Income-tax Act, 1961;

(f) an order is passed under section 154 or 248 or 264 of the Income-tax Act, 1961 reducing the tax deduction liability of a deductor under section 195;

(g) there occurs deduction of tax twice from the same income by mistake;

(h) there occurs payment of tax on account of grossing up which was not required under the provisions of the Income-tax Act, 1961;

(i) there occurs payment of tax at a higher rate under the domestic law while a lower rate is prescribed in the relevant double taxation avoidance treaty entered into by India.

In the cases mentioned above, income does not either accrue to the non-resident or it accrues but the excess amount in respect of which refund is claimed, is borne by the deductor. The amount deducted as tax under section 195 and paid to the credit of the Government therefore belongs to the deductor.

In the type of cases referred to in (a), the non-resident not having received any payment would not apply for a refund. For cases covered in (b) to (i), no claim may be made by the non-resident where he has no further dealings with the resident deductor of tax or the tax is to be borne by the resident deductor. The resident

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deductor was therefore put to genuine hardship as he would not be able to recover the amount deducted and deposited as tax.

In the type of cases referred to above, where no income has accrued to the non-resident due to cancellation of contract or where income has accrued but no tax is due on that income or tax is due at a lesser rate, the amount deposited to the credit of Government to that extent under section 195, cannot be said to be "tax".

Therefore, the CBDT decided that this amount can be refunded to the person who deducted it from the payment to the non-resident, under section 195.

Refund to the person making payment under section 195 is being allowed as income does not accrue to the non-resident or if the income is accruing no tax is due or tax is due at a lesser rate. The amount paid into the Government account in such cases to that extent, is no longer "tax".

If a resident deductor is entitled for the refund of tax deposited under section 195, then, it has to be refunded with interest under section 244A from the date of payment of such tax [Circular No. 11/2016 dated 26.4.2016].

In case of refund being made to the person who made the payment under section 195, the Assessing Officer may, after giving intimation to the deductor, adjust it against any existing tax liability of the deductor under the Income-tax Act, 1961, or any other direct tax law. The balance amount, if any, should be refunded to the person who made such payment under section 195.

A refund in terms of this circular should be granted only after obtaining an undertaking that no certificate under section 203 of the Income-tax Act has been issued to the non-resident. In cases where such a certificate has been issued, the person making the refund claim under this circular should either obtain it or should indemnify the Income-tax Department from any possible loss on account of any separate claim of refund for the same amount by the non-resident. A refund in terms of this circular should be granted only if the deductee has not filed return of income and the time for filing of return of income has expired.

The refund as per this circular is, *inter alia*, permitted in respect of transactions with non-residents, which have either not materialized or have been cancelled subsequently. It, therefore, needs to be ensured by the Assessing Officer that they disallow corresponding transaction amount, if claimed, as an expense in the case of the person, being the deductor making refund claim. Besides, in all cases, the Assessing Officer should also ensure that in the case of a deductor making the

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claim of refund, the corresponding disallowance of expense amount representing TDS refunded is made.

(II) The said Circular, however, did not cover a situation where tax is deducted at a rate prescribed in the relevant DTAA which is higher than the rate prescribed in the Income-tax Act, 1961. Since the law requires deduction of tax at a rate prescribed in the relevant DTAA or under the Income-tax Act, 1961, whichever is lower, there is a possibility that in such cases excess tax is deducted relying on the provisions of relevant DTAA.

(III) Accordingly, in order to remove the genuine hardship faced by the resident deductor, the CBDT has modified *Circular No. 07/2007, dated 23-10-2007* to the effect that the beneficial provisions under the said Circular allowing refund of tax deducted at source under section 195 to the person deducting tax at source shall also apply to those cases where deduction of tax at a higher rate under the relevant DTAA has been made while a lower rate is prescribed under the domestic law.

(6) Income from units of mutual fund or specified company [Section 196A]

(i) **Applicability and rate of TDS:** The person responsible for paying to non-corporate non-resident or a foreign company any income in respect of units of a mutual fund specified under section 10(23D) or from the specified company referred to in section 10(35) shall deduct tax **@20%** plus surcharge, wherever applicable, plus health and education cess@4%.

However, where an agreement referred to in section 90(1) or section 90A(1) applies to the payee and if the payee has furnished a tax residency certificate referred to in section 90(4) or section 90A(4), as the case may be, then, tax thereon shall be deducted @20% or at the rate or rates of income-tax provided in such agreement for such income, whichever is lower.

(ii) **Time of deduction:** Tax shall be deducted at the time of credit of such income to the account of the payee or at the time of payment thereof by any mode, whichever is earlier.

Where any such income is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section will apply accordingly.

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(iii) **Non-applicability in certain cases:** No deduction of tax is to 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 (42 of 1999), and the rules made thereunder.

(iv) **Meaning of non-resident:** An individual, being a citizen of India or a person of Indian origin who is not a "resident. A person would be deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in undivided India.

(7) Income from units [Section 196B]

The person responsible for making the following payment to an Offshore Fund shall deduct tax at the time of credit of such income to the account of the payee or at the time of payment thereof by any mode, whichever is earlier at the following rates:

- **@10%** plus surcharge, wherever applicable, plus health and education cess@4% in respect of income in respect of units referred to in section 115AB(1)((i) i.e., income received in respect of **units** of a mutual fund specified under section 10(23D) or units of UTI purchased in foreign currency; or
- **@12.5%** plus surcharge, wherever applicable, plus health and education cess @4% in respect of long-term capital gains arising from the transfer of such units referred to in section 115AB.

(8) Income from foreign currency bonds or shares of Indian company [Section 196C]

The person responsible for making the following payments to a non-resident has to deduct tax at the time of credit of such income to the account of the payee or at the time of payment thereof by any mode, whichever is earlier at the following rates:

- **@10%** plus surcharge, wherever applicable, plus health and education cess@4% in respect of income by way of interest or dividend from bonds or Global Depository Receipts referred to in section 115AC or
- **@12.5%** plus surcharge, wherever applicable, plus health and education cess@4% in respect of long-term capital gains arising from the transfer of such bonds or Global Depository Receipts.

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(9) Income of foreign institutional investors and specified funds from securities [Section 196D]

(i) Applicability and rate of TDS: The person responsible for making the payment in respect of securities referred to in section 115AD(1)(a)

- to a Foreign Institutional Investor has to deduct tax **@20%** or
- to a specified fund referred to in section 10(4D) has to be deduct tax **@10%**

plus surcharge, wherever applicable, *plus* health and education cess@4% at the time of credit of such income to the account of the payee or at the time of payment thereof by any mode, whichever is earlier.

However, where an agreement referred to in section 90(1) or section 90A(1) applies to the Foreign Institutional Investor and if the FII has furnished a tax residency certificate referred to in section 90(4) or section 90A(4), as the case may be, then, tax thereon shall be deducted @20% or at the rate or rates of income-tax provided in such agreement for such income, whichever is lower.

Note – The enhanced rate of surcharge@25% and 37% of tax payable are **not** applicable in case of tax deductible u/s 196D on dividend income.

Surcharge and health and education cess would not be applicable to specified fund in respect of income received from securities referred to in section 115AD(1)(a)

(ii) Non-applicability of TDS: No deduction shall be made in respect of

- income exempt under section 10(4D) in the hands of specified fund; or
- income, by way of capital gains arising from the transfer of securities referred to in section 115AD, payable to a Foreign Institutional Investor.

The summary of withholding tax provisions relating to non-residents is given below. These provisions are discussed in detail in the following chapters mentioned in Column (4):

Section	Nature of payment	Rate of TDS	Chapter
(1)	(2)	(3)	(4)
192	Salary	Concessional rate u/s 115BAC/ normal slab rates if the individual has exercised the option to shift out of the default tax regime	13: Deduction, Collection and Recovery of Tax (Module 3)

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192A	Premature withdrawal from EPF, aggregating to ₹ 50,000 or more	10%	
194B	Income by way of winnings from lotteries, crossword puzzles, card games and other games of any sort or from gambling or betting of any form or nature whatsoever, where amt in respect of single transaction > ₹ 10,000.	30%	
194BA	Income by way of winnings from any online game	30%	
194BB	Income by way of winnings from horse races, where amt in respect of single transaction > ₹ 10,000.	30%	
194G	Commission etc. on the sale of lottery tickets, where amount payable to a person > ₹ 20,000	2%	
194N	On withdrawal of cash in excess of ₹ 1 crore Where the recipient is a co-operative society, the higher threshold limit of ₹ 3 crores is applicable for withdrawals	2% on amount exceeding ₹ 1 crore	
	In case the recipient has not filed ROI for all the 3 immediately preceding P.Y.s, for which time limit u/s 139(1) has expired, the sum shall be the amt or agg. of amts, in cash > ₹ 20 lakh during the P.Y.	- @2% of the sum, where cash withdrawal > ₹ 20 lakhs ≤ ₹ 1 crore (₹ 3 crores, where the recipient is a co-operative society) - @5% of the sum, where cash withdrawal exceeds ₹ 1 crore (₹ 3 crores, where the recipient is a co-operative society)	

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194T	Distribution of any sum by a firm in the nature of salary, remuneration, commission, bonus or interest to a partner of the firm, where amt or aggregate of amts paid to a partner of firm > ₹ 20,000.	10%	
194LBA(2)	Distribution of any interest income, received or receivable by a business trust from a SPV, to its unit holders.	5%	10: Assessment of Trusts, Political Parties and other Special Entities (Module 2)
	Distribution of any dividend income, received or receivable by business trust from a SPV exercising option to pay tax at concessional rate under section 115BAA, to its unit holders However, if the SPV is not exercising the option to pay tax at concessional rate under section 115BAA, dividend income would be exempt in the hands of unit holders and tax would not be deductible at source.	10%	
194LBA(3)	Distribution of any income received from renting or leasing or letting out any real estate asset directly owned by the business trust, to its unit holders.	At the rates in force	
194LBB	Investment fund paying income to a unit holder [other than income which is exempt under section 10(23FBB)].		
194LBC(2)	Income in respect of investment made in a securitisation trust (specified in *Explanation* to section 115TCA)		
194E	Income referred to under section 115BBA payable to non-resident sportsmen/sports association or an entertainer	20%	21: Non Resident Taxation (Module 4)

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194LB	Interest payable by infrastructure debt fund to a non-corporate non-resident or foreign company	5%	
194LC	Interest payable by an Indian Company or a business trust to a non-corporate non-resident or foreign company - in respect of money borrowed in foreign currency from a source outside India • under a loan agreement between 1.7.2012 and 30.6.2023 or • by way of issue of long-term infrastructure bonds during the period between 1.7.2012 and 30.9.2014 • by way of issue of long term bonds (including long term infrastructure bond) between 1.10.2014 and 30.6.2023 as approved by Central Government or - in respect of money borrowed from source outside India by way of rupee denominated bond on or before 30.6.2023	5%	
	Interest payable by an Indian company or a business trust to a non-corporate non-resident or foreign company, in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or rupee denominated bond between 1.4.2020 and 30.6.2023, which is listed only on a recognised stock exchange located in any International Financial Services Centre	4%	

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	Interest payable by an Indian company or a business trust to a non-corporate non-resident or foreign company, in respect of monies borrowed by it from a source outside India by way of issue of any long-term bond or rupee denominated bond on or after 1.7.2023, which is listed only on a recognised stock exchange located in any International Financial Services Centre	9%	
	Interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the period from 17.9.2018 to 31.3.2019	Nil (Since such interest is exempt u/s 10(4C), no tax is deductible u/s 194LC)	
195	Any other sum payable to a non-resident	At the rates in force	
196A	Income on units of a mutual fund specified under section 10(23D) or from the specified company referred to in section 10(35) payable to non-corporate non-resident or foreign company. Where a DTAA applies to the payee and if the payee has furnished a TRC then, tax thereon shall be deducted @20% or at the rate or rates of income-tax provided in such agreement for such income, whichever is lower.	20%	
196B	Income from units of a mutual fund or UTI purchased in foreign currency (including long term capital gain on transfer of such units) payable to an Offshore Fund	10% in respect of income from units 12.5% in respect of long term capital gain on transfer of such units	

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196C	Income by way of interest or dividend on bonds of an Indian company or public sector company sold by the Government and purchased by a non-resident in foreign currency or GDRs referred to in section 115AC (including long term capital gain on transfer of such bonds or GDRs) payable to a non-resident	10% in respect of interest or dividend from bonds or GDRs 12.5% in respect of long-term capital gains on transfer of such bonds or GDRs	
196D	Income of foreign Institutional Investors from securities (not being capital gain arising from such securities). Where a DTAA applies to the payee and if the payee has furnished a TRC then, tax thereon shall be deducted @20% or at the rate or rates of income-tax provided in such agreement for such income, whichever is lower.	20%	
	Income of specified fund from securities [not being income exempt u/s 10(4D)]	10%	

Note: *In all the above cases, the rate of tax would be increased by surcharge, wherever applicable, and health and education cess @4% except in case of deduction u/s 196D on income of a specified fund.*

21.10 MISCELLANEOUS PROVISIONS

(1) Recovery of tax in respect of non-resident from his assets [Section 173]

In a case where the person entitled to the income arising from any business connection in India or from any property in India or through or from any asset or source of income in India or through the transfer of a capital asset situated in India is a non-resident, the tax chargeable thereon, whether in his name or in the name of his agent who is liable as a representative assessee, may be recovered by deduction under any of the provisions of Chapter XVII-B. Further, any arrears of tax may be recovered also in accordance with the provisions of the Income-tax Act from any assets of

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the non- resident which are, or may at any time come, within India. These provisions are without prejudice to the provisions of section 161(1) or of section 167.

(2) Recovery against the assessee's property in foreign countries [Section 228A]

Where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may, if the assessee is a resident of a country (being a country with which the Central Government has entered into an agreement for the recovery of income tax under this Act and the corresponding law in force in that country) or has any property in that country, forward to the CBDT a certificate drawn up by him under section 222. Thereafter, the CBDT may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

Similarly, the Government of the other country or any authority under that Government may send to the CBDT a certificate of recovery of any tax due under such corresponding law from a person having property in India and the CBDT may forward such certificate to Tax Recovery Officer having jurisdiction over the resident or within whose jurisdiction such property is situated, for recovery of such tax. Tax Recovery Officer can proceed to recover the amount specified in the Certificate by –

(a) attachment and sale of assesses movable or immovable property

(b) arrest of the assessee and his detention in prison.

(c) appointing a receiver for the management of assesses movable and immovable property.

He shall thereafter remit the sum so recovered to the CBDT.

(3) Submission of statement by a non-resident having liaison office [Section 285]

(i) A non-resident can operate in India through a branch or a liaison office set up after getting the approval of the Reserve Bank of India. Since the branch constitutes a permanent establishment of the non-resident, it has to file its return of income.

(ii) Such a non-resident is required to file a statement in the prescribed form [Form No.49C] to the Assessing Officer having jurisdiction, within ***eight months from the end of such financial year***, a statement providing the details in respect of activities carried out by the liaison office in India during the financial year.

(iii) This requirement has to be complied with by every person, being a non-resident having a liaison office in India set up in accordance with the guidelines issued by the RBI under the Foreign Exchange Management Act, 1999.

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(iv) The statement is to be verified by a Chartered Accountant or by the Authorized Signatory i.e., the person authorized by the non-resident in this behalf.

(4) Furnishing of information or documents by an Indian Concern [Section 285A]

(i) There shall be a reporting obligation on the Indian concern through or in which the Indian assets are held by a foreign company or entity.

(ii) For the purposes of determination of any income accruing or arising in India under section 9(1)(i), an Indian concern has to furnish, within the prescribed period to the prescribed income-tax authority, the information or documents, in prescribed manner, if -

- any share of, or interest in, a company or an entity registered or incorporated outside India derives, directly or indirectly, its value substantially from the assets located in India, as referred to in *Explanation 5* to section 9(1)(i), and
- such company or, entity, holds, directly or indirectly, such assets in India through, or in, the Indian concern.

(iii) The information has to be furnished in Form No.49D electronically within a period of 90 days from the end of the financial year in which the transfer of such share or interest referred to above takes place. However, if the share or the interest has the effect of directly or indirectly transferring the rights of management or control in relation to the Indian concern, the information has to be furnished in Form No.49D within a period of 90 days of the transaction.

(iv) If any Indian concern fails to furnish the information or documents, the income-tax authority, as may be prescribed under the said section, may direct that such Indian concern shall pay, by way of penalty under section 271GA,—

(a) @2% of the value of the transaction in respect of which such failure has taken place, if such transaction had the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern;

(b) ₹ 5,00,000 in any other case.

Note – *Rule 114DB prescribes the time limit and information or documents to be furnished under section 285A*[6].

[6] For detailed reading of Rule 114DB of the Income-tax Rules, 1962, students may visit https://incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx

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(5) Statutory agent of non-residents [Section 163]

According to section 163, an agent, in relation to a non-resident person, includes any person in India:

(i) who is employed by or on behalf of the non-resident;

(ii) who is having any business connection with the non-resident;

(iii) from or through whom the non-resident is in receipt of any income, whether directly or indirectly;

(iv) who is trustee of the non-resident; and

any other person who (whether resident or non-resident) has acquired a capital asset in India by means of a transfer from the non-resident.

In the first four cases stated above, the person sought to be assessed as the agent of a non-resident must necessarily be in India whereas it need not be so in the fifth case. Thus, a non-resident may be treated as the agent of another non-resident. The appointment of the agent may be made any time before or after the expiry of the relevant previous year. An agent of a non-resident may be appointed under this section even if at the date of such appointment, the non-resident is not alive.

According to the proviso to this section, where transactions are carried on in the ordinary course of business through a broker in India and the broker does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker and such non-resident broker also carries on such transactions in the ordinary course of his business and not as a principal, the broker in India cannot be treated as statutory agent in respect of the income arising to the non-resident from such transactions. Thus, where *bona fide* hedging transactions take place through a broker in India and a foreign broker acting for an undisclosed principal, the Indian broker cannot be deemed to be agent of the foreign principal.

For the purposes of section 163(1), the expression "business connection" shall have the meaning assigned to it in *Explanation 2* to clause (i) of section 9(1) of the Income-tax Act, 1961. [*Explanation* to section 163(1)]

Before a person can be treated as an agent of a non-resident he must be given a reasonable opportunity of being heard by the Assessing Officer as to his liability to be so treated.

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In certain cases, the income received by one person can be assessed in the hands of another. Persons who are liable to be assessed on behalf of other because of their association with the real recipient of the income are known as representative assessees.

In respect of Income of a non-resident which is deemed to accrue or arise to him in India under section 9(1), agent of a non-resident including a person who is treated as an agent under section 163 would be considered a representative assessee under section 160. As per the provisions of section 161, every representative assessee, shall be subject to the same duties, responsibilities and liabilities as the assessee and the taxes shall be levied upon 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.

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TEST YOUR KNOWLEDGE

Questions

1. *Peeyush, who returned to India on 12th June, 2025 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various incomes and seeks your opinion to know about his liability to income tax thereon in India in A.Y. 2026-27 assuming that he has exercised the option to shift out of the default tax regime under section 115BAC:*

   (i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2025.

   (ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

   (iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of ₹ 75,000 in U.K. in foreign currency (not received in India) and of ₹ 20,000 in India.

   (iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at ₹ 37,500 while in terms of Indian Rupee it was ₹ 50,000.

2. *Mr. David, a citizen of India, serving in the Ministry of External Affairs in India, was transferred to Indian Embassy in Canada on 31.03.2025. He did not visit India any time during the previous year 2025-26. He has received the following income for the Financial Year 2025-26:*

S.No.	Particulars	₹
(i)	Salary (Computed)	5,00,000
(ii)	Foreign Allowance	4,00,000
(iii)	Interest on fixed deposit from bank in India	1,00,000
(iv)	Income from agriculture in Country X	2,00,000
(v)	Income from house property in Country X	2,50,000

Compute his gross total income for Assessment Year 2026-27.

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3. *Mr. A, a citizen of India, left for USA for the purposes of employment on 1.5.2025. He has not visited India thereafter. Mr. A borrows money from his friend Mr. B, who also left India for employment purpose one week before Mr. A's departure, to the extent of ₹ 10 lakhs and buys shares in X Ltd., an Indian company. Discuss the taxability of the interest charged @10% in B's hands, if the said interest has been received in New York.*

4. *JJ Limited, a company incorporated in Australia has entered into an agreement with KK Limited, an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, JJ Limited rendered both off-shore services and on-shore services to KK Limited at fee of ₹ 1 crore and ₹ 1.5 crore, respectively. JJ Limited is of the view that it is not liable to tax in India in respect of fee of ₹ 1 crore as it is for rendering services outside India. Discuss the correctness of the view of JJ Limited.*

5. *Examine with reasons whether the following transactions attract income-tax in India, in the hands of recipients under section 9 of Income-tax Act, 1961:*

   (i) *A non-resident German company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made towards drawings & designs, which were described as "Engineering Fee". The assessee contended that such business profits should be taxable in Germany as there is no business connection within the meaning of section 9(1)(i) of the Income-tax Act, 1961.*

   (ii) *A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement.*

   (iii) *Amount paid by Government of India for use of a patent developed by Mr. A, who is a non-resident.*

   (iv) *Sai Engineering, a non-resident foreign company entered into a collaboration agreement on 25/6/2025, with an Indian Company and was in receipt of interest on 8% debentures for ₹ 20 lakhs, issued by Indian Company, in consideration of providing technical know-how utilised in its business in Mumbai during previous year 2025-26.*

6. *Z, an American tourist, comes to India for the first time on June 17, 2025. He leaves India on September 29, 2025. Determine his residential status for the assessment year 2026-27.*

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Would your answer change if he is a person of Indian origin and his total income from Indian sources for A.Y.2026-27 is ₹ 16 lakhs?

7. *M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2025-26 (April, 2025 to March, 2026) and collected charges of ₹ 125 lakhs for carriage of passengers and cargo out of which ₹ 65 lakhs were received in New York in U.S Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were ₹ 95 lakhs. Compute the income chargeable to tax of the foreign airlines.*

8. *Atlant Italy, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers, and also made available to its customers, who used it to carry out their business activities. The Assessing Officer contended that the consideration for supply of software embedded in hardware is 'royalty' under section 9(1)(vi).*

   Examine the correctness of the action of the Assessing Officer assuming that the software that was loaded on the hardware and embedded in the system does not have any independent existence.

9. *Singtel Ltd. is a company incorporated in Singapore and 55% of its shares are held by Godavari (P) Ltd., an Indian company. Singtel Ltd. has its presence in India also. The details relating to Singtel Ltd. for the P.Y.2025-26, are as under:*

Particulars	India	Singapore
Fixed assets at depreciated values for tax purposes (₹ in crores)	120	80
Intangible assets (₹ in crores)	50	200
Other assets (value as per books of account) (₹ in crores)	40	120
Income from trading operations (₹ in crores)	25	50
The above figure includes:		
(i) Income from transactions where purchases are from associated enterprises and sales are to unrelated parties	2	4
(ii) Income from transactions where sales are to associated enterprises and purchases are from unrelated parties	3	5

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(iii) Income from transactions where both purchases and sales are from/to associated enterprises	*5*	*10*
Interest and dividend from investments (₹ in crores)	*20*	*15*
Number of employees (Residents in respective countries)	*70*	*90*
Payroll expenses on employees (₹ in crores)	*8*	*12*

Determine the residential status of Singtel Ltd. for A.Y.2026-27, if during the F.Y.2025-26, eight board meetings were held – 3 in India and 5 in Singapore.

10. *STYLE Inc., a notified Foreign Institutional Investor (FII), derived the following incomes for the financial year 2025-26:-*

(1) Dividend from listed shares of Indian companies – ₹ 6,20,000

(2) Interest on securities – ₹ 17,32,000 (Expenses of ₹ 26,000 has been incurred to earn such income)

(3) Income from sale of securities and shares:

(i) Bonds of J Ltd.
[Date of purchase 5 May, 2018; Date of sale 7 March, 2026]

Sale proceeds : ₹ 47,00,000

Cost of purchase : ₹ 32,00,000

Cost Inflation Index: F.Y.2018-19:280; F.Y.2025-26:376

(ii) Listed Shares of E Ltd.
[Date of purchase – 2 May, 2025; Date of sale – 9 February, 2026]

Sale Consideration ₹ 12,40,000

Purchase cost ₹ 7,80,000

[STT paid both at the time of purchase and sale]

(iii) Unlisted equity shares of M Ltd.
[Date of purchase – 1 July, 2025; Date of sale – 7 March, 2026]

Sale Consideration ₹ 8,40,000

Purchase cost ₹ 3,72,000

Compute the total income and tax liability of the FII, STYLE Inc., for the A.Y. 2026-27 as per section 115AD, assuming that no other income is derived by STYLE Inc. during the F.Y.2025-26.

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Answers

1. Peeyush returned to India on 12th June 2025 for permanently residing in India after staying in UK for 20 years. During the P.Y.2025-26, he stays in India for 293 days. Since he has stayed in India for a period of 182 days or more during the previous year 2025-26, he would be a resident in India for the A.Y.2026-27. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2025-26 his stay in India during the seven previous years is less than 730 days. The residential status of Peeyush for A.Y.2026-27 is, therefore, **Resident but Not Ordinarily Resident.**

As per section 5(1), only income which is received/ deemed to be received/ accrued or arisen/ deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of ₹ 1,500 per child under section 10(32).

Accordingly, income of ₹ 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of ₹ 1,500. Therefore, ₹ 18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is **not** includible in the income of Peeyush.

Since the other son is major, his income is not includible in the income of Peeyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Peeyush was a non-resident, is not taxable in the A.Y.2026-27 since it is not the income of the P.Y.2025-26.

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Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2026-27. Since his total income (i.e., ₹ 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2026-27.

2. As per section 6(1), Mr. David is a non-resident for the A.Y. 2026-27, since he was not present in India at any time during the previous year 2025-26.

As per section 5(2), a non-resident is chargeable to tax in India only in respect of following incomes:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

In view of the above provisions, income from agriculture in Country X and income from house property in Country X would not be chargeable to tax in the hands of David, assuming that the same were received in Country X.

Income from 'Salaries' payable by the Government to a citizen of India for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii). Hence, such income is taxable in the hands of Mr. David, even though he is a non-resident. However, allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India is exempt under section 10(7). Hence, foreign allowance of ₹ 4,00,000 is exempt under section 10(7).

Gross Total Income of Mr. David for A.Y. 2026-27

Particulars	₹
Salaries	5,00,000
Income from other sources (Interest on fixed deposit in India)	1,00,000
Gross Total Income	**6,00,000**

3. An individual is said to be resident in India in any previous year, if he -

(i) has been in India during that year for a total period of 182 days or more, or

(ii) has been in India during the four years immediately preceding that year for a total period of 365 days or more and has been in India for at least 60 days in that year.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

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In this case, Mr. A is an Indian citizen who left India for employment outside India on 01.05.2025. Mr. A has been in India only from 1.4.2025 to 01.05.2025 i.e. for 31 days. Since his stay in India during the previous year 2025-26 is only 31 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y. 2026-27 is non-resident. Mr. B, who left India one week before A's departure, is also a non-resident for the same reasons.

Section 9(1)(v) provides that income by way of interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India shall be deemed to accrue or arise in India.

Therefore, interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purpose of making or earning any income from any source other than a business or profession carried on by him in India, shall **not** be deemed to accrue or arise in India. Therefore, interest payable by Mr. A on money borrowed from Mr. B to invest in shares of an Indian company shall **not** be deemed to accrue or arise in India and hence, is not taxable in India in the hands of Mr. B.

4. The *Explanation* below section 9(2) clarifies that income by way of, *inter alia*, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per the *Explanation* below section 9(2), the fee of ₹ 2.5 crore for technical services rendered by JJ Ltd. (both off-shore and on-shore services) to KK Ltd. is deemed to accrue or arise in India and includible in the total income of JJ Ltd.

Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of ₹ 1 crore (as it is for rendering services outside India) is **not** correct.

5. **(i)** Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as "engineering fee") are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii), since the services are utilized for execution of electrical work in India *[Aeg Aktiengesllschaft v. CIT (2004) 267 ITR 209 (Kar.)].*

As per *Explanation* below section 9(2), where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of

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the non-resident German company, regardless of whether it has a residence or place of business or business connection in India.

(ii) As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India.

In this case, there was a professional connection between the firm of solicitors in Mumbai and the barrister in UK. The expression "business" includes not only trade and manufacture; it includes, within its scope, "profession" as well. Therefore, the existence of professional connection amounts to existence of "business connection" under section 9(1)(i). It was so held by the Supreme Court in *Barendra Prasad Roy v. ITO (1981) 129 ITR 295.*

Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

(iii) As per section 9(1)(vi), income by way of royalty payable by the Government of India is deemed to accrue or arise in India. "Royalty" means consideration for, *inter alia*, use of patent. Therefore, the amount paid by Government of India for use of patent developed by Mr. A, a non-resident, is deemed to accrue or arise in India. Hence, it is taxable in India in the hands of Mr. A.

(iv) ₹ 20 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how for use in its business in India, is in the nature of fee for technical services, deemed to accrue or arise in India to Sai Engineering, a non-resident foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Sai Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

Note *– Since the question specifically requires the candidates to examine the taxability of the above transactions under section 9, the provisions of double taxation avoidance agreement, if any, applicable in the above cases, have not been taken into consideration.*

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6. Previous year 2025-26: 105 [14+31+31+29]

Previous year 2024-25: Nil

Previous year 2023-24: Nil

Previous year 2022-23: Nil

Previous year 2021-22: Nil

He is non-resident for the assessment year 2026-27 as he does not satisfy either of the basic conditions.

Even if he is a person of Indian origin whose total income from Indian sources exceeds ₹ 15 lakhs, he would still be a non-resident for A.Y.2026-27. For becoming a resident but not ordinarily resident, he should have stayed in India for atleast 120 days in the previous year 2025-26 and 365 days in four immediately preceding previous years. Since his stay in India in the P.Y.2025-26 is less than 120 days, he would be **non-resident** in India for A.Y.2026-27.

7. As per section 44BBA, in case of a non-resident engaged in the business of operation of aircraft, 5% of the following amounts would be deemed to be the profits and gains from such business:

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

In the present case, the income chargeable to tax of M/s Global Airlines applying the provisions of section 44BBA are as follows:

Particulars	Fare booked from India to outside India whether received in India or not (₹)	Fare booked from New York to Mumbai and received outside India (₹)
Fare	60,00,000 (1,25,00,000 – 65,00,000)	65,00,000
Deemed income @5% u/s 44BBA	3,00,000 (60,00,000 × 5%)	Nil (since the amount not received in India)

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8. The issue under consideration in this case is whether consideration for supply of software embedded in hardware would tantamount to 'royalty' for attracting deemed accrual of income under section 9(1)(vi).

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident in India would be deemed to accrue or arise in India. However, where it is payable for the transfer of any right or the use of any property or information or for the utilization of services for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India, the amount payable by way royalty would not be deemed to accrue or arise in India, in the hands of non-resident.

For this purpose, 'royalty' includes transfer of all or any right for use or right to use a computer software irrespective of the medium through which such right is transferred.

The facts of the case are similar to the facts in *CIT v. Alcatel Lucent Canada (2015) 372 ITR 476*, wherein the above issue came up before the Delhi High Court. The Court observed that the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers. Where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as 'royalty' for software in terms of section 9(1)(vi).

In this case, since the software that was loaded on the hardware and embedded in the system does not have any independent existence, there could not be any independent use of such software. Therefore, the rationale of the Delhi High Court ruling can be applied to the case on hand. Accordingly, the action of the Assessing Officer in treating the consideration for supply of software embedded in hardware as royalty under section 9(1)(vi) is **not** correct.

9. The residential status of a foreign company is determined on the basis of place of effective management (POEM) of the company.

For determining the POEM of a foreign company, the important criteria is whether the company is engaged in active business outside India or not.

A company shall be said to be engaged in "**Active Business Outside India"** (ABOI) for POEM, if

- the passive income is not more than 50% of its total income; **and**
- less than 50% of its total assets are situated in India; **and**

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- less than 50% of total number of employees are situated in India or are resident in India; **and**
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Singtel Ltd. shall be regarded as a company engaged in active business outside India for P.Y.2025-26 for POEM purpose only if it satisfies all the four conditions cumulatively.

Condition 1: The passive income of Singtel Ltd. should not be more than 50% of its total income

Total income of Singtel Ltd. during the P.Y. 2025-26 is ₹ 110 crores [(₹ 25 crores + ₹ 50 crores) + (₹ 20 crores + ₹ 15 crores)]

Passive income is the aggregate of, -

(i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and

(ii) income by way of royalty, dividend, capital gains, interest or rental income;

Passive Income of Singtel Ltd. is ₹ 50 crores, being sum total of :

(i) ₹ 15 crores, income from transactions where both purchases and sales are from/to associated enterprises (₹ 5 crores in India and ₹ 10 crores in Singapore)

(ii) ₹ 35 crores, being interest and dividend from investment (₹ 20 crores in India and ₹ 15 crores in Singapore)

Percentage of passive income to total income = ₹ 50 crore/ ₹ 110 crore x 100 = 45.45%

Since passive income of Singtel Ltd. **is 45.45%, which is not more than 50%** of its total income, the first condition is satisfied.

Condition 2: Singtel Ltd. should have less than 50% of its total assets situated in India

Value of total assets of Singtel Ltd. during the P.Y. 2025-26 is ₹ 610 crores [₹ 210 crores, in India + ₹ 400 crores, in Singapore]

Value of total assets of Singtel Ltd. in India during the P.Y. 2025-26 is ₹ 210 crores

Percentage of assets situated in India to total assets = ₹ 210 crores/₹ 610 crores x 100 = 34.43%

Since the value of assets of Singtel Ltd. **situated in India is less than 50%** of its total assets, the second condition for ABOI test is satisfied.

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Condition 3: Less than 50% of the total number of employees of Singtel Ltd. should be situated in India or should be resident in India

Number of employees situated in India or are resident in India is 70

Total number of employees of Singtel Ltd. is 160 [70 + 90]

Percentage of employees situated in India or are resident in India to total number of employees is 70/160 x 100 **= 43.75%**

Since employees situated in India or are residents in India of Singtel Ltd. **are less than 50%** of its total employees, the third condition for ABOI test is satisfied.

Condition 4: The payroll expenses incurred on employees situated in India or resident in India should be less than 50% of its total payroll expenditure

Payroll expenses on employees employed in and resident of India = ₹ 8 crores.

Total payroll expenses = ₹ 20 crores (₹ 8 crores + ₹ 12 crores)

Percentage of payroll expenses of employees situated in India or are resident in India to the total payroll expenses = 8 x 100/20 = 40%

Since the payroll expenses incurred on employees situated in India or resident in India **is less than 50% of its total payroll expenditure**, the fourth condition for ABOI test is also satisfied.

Thus, since Singtel Ltd. has satisfied all the four conditions, the company would be said to be engaged in "active business outside India" during the P.Y. 2025-26.

POEM of a company engaged in active business outside India shall be presumed to be outside India, if the majority of the board meetings are held outside India.

Since Singtel Ltd. is engaged in active business outside India in the P.Y. 2025-26 and majority of its board meetings i.e., 5 out of 8, were held outside India, POEM of Singtel Ltd. would be outside India.

Therefore, Singtel Ltd. would be non-resident in India for the P.Y. 2025-26.

10. Computation of total income of STYLE Inc., a notified FII, for A.Y.2026-27

Particulars	₹	₹
Dividend income	6,20,000	
Interest on securities [No deduction is allowable in respect of expenses incurred in respect thereof]	17,32,000	23,52,000

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Long-term capital gains on sale of bonds of J Ltd.		
Sale consideration	47,00,000	
Less: Cost of acquisition	32,00,000	15,00,000
[Benefit of indexation is not allowable]		
Short-term capital gains on sale of STT paid equity shares of E Ltd.		
Sale consideration	12,40,000	
Less: Cost of acquisition	7,80,000	4,60,000
Short-term capital gains on sale on unlisted equity shares of M Ltd.		
Sale consideration	8,40,000	
Less: Cost of acquisition	3,72,000	4,68,000
Total Income		**47,80,000**

Computation of tax liability of STYLE Inc. for A.Y.2026-27

Particulars	₹
Tax@20% on interest on securities and dividend =20% x ₹ 23,52,000	4,70,400
Tax@12.5% on long-term capital gains on sale of bonds of J Ltd. = 12.5% x ₹ 15,00,000	1,87,500
Tax @ 20% on short-term capital gains on sale of listed equity shares of E Ltd., in respect of which STT has been paid = 20% of ₹ 4,60,000	92,000
Tax @ 30% on short-term capital gains on sale of unlisted equity shares of M Ltd. = 30% of ₹ 4,68,000	1,40,400
	8,90,300
Add: HEC@4%	35,612
Tax liability	**9,25,912**
Tax liability (rounded off)	**9,25,910**

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CHAPTER 22

DOUBLE TAXATION RELIEF

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** the need for double taxation relief;
- **appreciate** the types of double taxation relief available;
- **comprehend and apply** the provisions relating to double taxation relief contained in the Income-tax Act, 1961 and Income-tax Rules, 1962 in problem solving and addressing related issues;
- **comprehend** the procedure for claiming deduction where there is no double taxation avoidance agreement between India and the other country where the income has been taxed and **compute** the amount of deduction;
- **appreciate** the concept of Permanent Establishment under double taxation avoidance agreements and its relevance.

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22.1 CONCEPT OF DOUBLE TAXATION RELIEF

In the present era of cross-border transactions across the globe, the effect of taxation is one of the important considerations for any trade and investment decision in other countries. One of the most significant results of globalisation is the visible impact of one country's domestic tax policies on the economy of another country. This has led to the need for continuously assessing the tax regimes of various countries and bringing about necessary reforms.

Where a taxpayer is resident in one country but has a source of income situated in another country it gives rise to possible double taxation. This arises from the two basic rules that enables the country of residence as well as the country where the source of income exists to impose tax namely, (i) the source rule and (ii) the residence rule.

Source rule of taxation

The source rule holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a non-resident.

Residence rule of taxation

The residence rule stipulates that the power to tax should rest with the country in which the taxpayer resides.

If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating on an international scale would become prohibitive and would deter the process of globalisation. It is from this point of view that Double Taxation Avoidance Agreements (DTAA) become very significant.

DTAAs lay down the allocation rules for taxation of the income by the source country and the residence country. Such rules are laid for various categories of income, for example, interest, dividend, royalties, capital gains, business income etc. Each such category is dealt with by separate article in the DTAA.

Double taxation means taxing the same income twice in the hands of an assessee. A particular income may be taxed in India in the hands of a person based on his/its residence. However, the same income may be taxed in his/its hands in the Source Country also, as per the domestic laws of that country. This gives rise to double taxation. It is a universally accepted principle that the same income should not be subjected to tax twice. In order to take care of such situations, the Income-tax Act, 1961 has provided for double taxation relief.

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22.2 TYPES OF RELIEF

Relief from double taxation can be provided in mainly two ways:

(1) **Bilateral Relief**

Under this method, the Governments of two countries can enter into an agreement to provide relief against double taxation by mutually working out the basis on which the relief is to be granted. India has entered into agreements for relief against or avoidance of double taxation with almost 100 countries which include Sri Lanka, Switzerland, Sweden, Denmark, Japan, Federal Republic of Germany, Greece, etc.

Bilateral Relief may be granted in either one of the following methods:

Exemption Method
- A particular income is taxed in only one of the two countries.

Tax Credit Method
- Income is taxable in both countries in accordance with their respective tax laws read with double taxation avoidance agreement.
- The country of residence of the tax payer, however, allows him credit for the tax charged thereon in the country of source.

India follows credit method in majority of its DTAAs.

(2) **Unilateral Relief**

This method provides for double taxation relief unilaterally by a country to its resident for the taxes paid in the other country, even where no DTAA has been entered into with that country. India grants unilateral relief through credit

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method under section 91 to its residents for taxes paid in the country, with which India has not signed DTAA.

India has introduced foreign tax credit rules under Rule 128 which allows for granting credit to resident Indians for taxes paid in the other country.

22.3 DOUBLE TAXATION RELIEF PROVISIONS UNDER THE INCOME TAX ACT, 1961

Sections 90, 90A and 91 of the Income-tax Act, 1961 provide for double taxation relief in India.

(1) Agreement with foreign countries or specified territories outside India/ Adoption and implementation of agreement of specified association in India with specified association in specified territories outside India - Bilateral relief [Section 90/ 90A]

Both sections 90 and 90A provide for bilateral relief of double taxation. Section 90 empowers the Central Government to enter into an agreement with foreign country or specified territory outside India while section 90A empower the Central Government to make provisions for adopting and implementing of any agreement entered by any specified association in India with any specified association in the specified territory outside India.

(i) The objective of agreement under section 90 and 90A is

(a) for the granting of relief in respect of—

- income on which income-tax has been paid both in India and in that country or specified territory; or
- income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory to promote mutual economic relations, trade and investment; or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory); or

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(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory or investigation of cases of such evasion or avoidance; or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory.

(ii) Where the agreement has been entered under section 90 or 90A for granting of relief of tax or avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

(iii) However, the provisions of Chapter X-A, General Anti-Avoidance Rule, shall apply to the assessee even if such provisions are not beneficial to him.

(iv) The charge of tax in respect of a foreign company or a company incorporated in the specified territory outside India at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such company.

(v) Any term used in any agreement but not defined in the Act or in the agreement shall have the same meaning as assigned to in the notification issued by the Central Government in this behalf, unless the context otherwise requires and is not inconsistent with the provisions of the Act or the agreement.

Accordingly, the Central Government has, vide *Notification No.90/2008 dated 28.8.2008 and Notification No.91/2008 dated 28.8.2008*, notified that where an agreement under section 90A and 90 for granting of relief of tax or avoidance of double taxation provides that any income of a resident of India may be taxed in the other country, then such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

(vi) **Meaning of terms used in agreement**

	Particulars	Meaning of the term
(1)	Term used in any agreement under section 90(1) or 90A(1) and not defined in the agreement or the Act but assigned a meaning in the notification issued by	The term shall have the meaning assigned in the said notification and the meaning shall be deemed to have effect from the date on which

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	the Central Government in the Official Gazette, which is still in force.	the agreement came into force.
(2)	Term used in any agreement which is defined in the agreement itself.	The term shall have the same meaning assigned to it in the agreement.
(3)	Term used in any agreement, which is not defined in the said agreement, but defined in the Income-tax Act, 1961.	The term shall have the meaning assigned to it in the Income-tax Act, 1961 and explanation, if any, given to it by the Central Government.

(vii) The agreement under section 90 and 90A are intended to provide relief to the taxpayer, who is resident of one of the Contracting States to the agreement. Such taxpayer can claim relief by applying the beneficial provisions of either the treaty or the domestic law. However, in many cases, taxpayers who were not residents of a Contracting State also resorted to claiming the benefits under the agreement. In effect, third party residents claimed the unintended treaty benefits.

Therefore, section 90(4) and 90A(4) provides that the non-resident to whom the agreement referred to in section 90(1) or 90A(1) applies, shall be allowed to claim the relief under such agreements if a Tax Residence Certificate (TRC) obtained by him from the Government of that country or specified territory, is furnished declaring his residence of the country outside India or the specified territory outside India, as the case may be.

(viii) A certificate issued by the Government of a foreign country or specified territory outside India would constitute proof of tax residency, without any further conditions regarding furnishing of "prescribed particulars" therein. In addition to such certificate, section 90(5)/90A(5) requires the assessee to provide such other documents and information, as may be prescribed, for claiming the treaty benefits.

Documents and information, to be furnished by the assessee for claiming treaty benefits, prescribed by CBDT vide *Notification No. 57/2013 dated 01.08.2013*:

(i) Status (individual, company, firm etc.) of the assessee;

(ii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iii) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which

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the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;

(iv) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(v) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (iv) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The assessee shall keep and maintain such documents as are necessary to substantiate the information provided. An income-tax authority may require the assessee to provide the said documents in relation to a claim by the said assessee of any relief under an agreement referred to in section 90(1) or section 90A(1), as the case may be.

(ix) *Circular No. 333 dated 2.4.1982*, issued by CBDT provides that a specific provision of the DTAA will prevail over the general provisions of the Income-tax Act, 1961. However, where there is no specific provision in the treaty, then the Income-tax Act will apply. Generally, DTAA only provides for distribution of taxing rights between the residence and the source state. The computation mechanism is usually not provided under DTAA and the same is governed by the domestic tax law of each country.

(x) 'Specified association' under section 90A means any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory outside India and which may be notified as such by the Central Government.

Tax treaties are generally based on certain models. The most common ones are:

These model tax conventions will be discussed in detail in Chapter 27 "Overview of Model Tax Conventions".

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ILLUSTRATION 1

Examine the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 1961.

The double taxation avoidance treaties entered into by the Government of India override the domestic law.

SOLUTION

The statement is correct.

Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee [*CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)].*

(2) Countries with which no agreement exists – Unilateral Agreements [Section 91]

In the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under section 91 provided all the following conditions are fulfilled:

(a) The assessee is a resident in India during the previous year in respect of which the income is taxable.

(b) The income accrues or arises to him outside India.

(c) The income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.

(e) The assessee has paid tax on the income in the foreign country.

(f) There is no agreement for relief from double taxation between India and the other country where the income has accrued or arisen.

In such a case, the assessee shall be entitled to a deduction from the Indian income-tax payable by him. The deduction would be a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax in the said country, whichever is lower, or at the Indian rate of tax if both the rates are equal.

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Meaning of important terms:

Term	Meaning
Indian rate of tax	The rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provisions of the Act but before deduction of any double taxation relief due to the assessee
Rate of tax of the said country	Income-tax and super-tax actually paid in that country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before deduction on account of double taxation relief due in the said country, divided by the whole amount of income assessed in the said country
Income-tax in relation to any country	It includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country

ILLUSTRATION 2

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of ₹ 1,10,000 from theatrical works played abroad. Tax of ₹ 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to ₹ 6,10,000. In view of tax planning, she has deposited ₹ 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC ₹ 32,000. She also contributed ₹ 28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of ₹ 26,000 to insure the health of her mother, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2026-27, assuming that she opted out of the default tax regime under section 115BAC.

SOLUTION

Computation of tax liability of Nandita for the A.Y. 2026-27 under normal provisions of the Act

Particulars	₹	₹
Indian Income		6,10,000
Foreign Income		1,10,000
Gross Total Income		**7,20,000**
Less: **Deduction under section 80C**		
Deposit in PPF	1,50,000	

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Under section 80CCC		
Contribution to approved Pension Fund of LIC	32,000	
	1,82,000	
Under section 80CCE		
The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to ₹ 1,50,000	1,50,000	
Under section 80D		
Contribution to Central Government Health Scheme ₹ 28,000 is also allowable as deduction under section 80D. Since she is a resident senior citizen, the deduction is allowable to a maximum of ₹ 50,000 **(See Note 1)**	28,000	
Medical insurance premium of ₹ 26,000 paid for mother aged 84 years. Since the mother is a non-resident in India, she will not be entitled for the higher deduction of ₹ 50,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of ₹ 25,000.	25,000	2,03,000
Total Income		**5,17,000**
Tax on Total Income		
Income-tax (See Note below)		13,400
Add: Health and Education Cess @4%		536
		13,936
Average rate of tax in India	2.696%	
(i.e. ₹ 13,936/ ₹ 5,17,000 × 100)		
Average rate of tax in foreign country	10%	
(i.e. ₹ 11,000/ ₹ 1,10,000 × 100)		
Deduction under section 91 on ₹ 1,10,000 @ 2.696% (lower of average Indian-tax rate or average foreign tax rate)		2,966
Tax payable in India (₹ 13,936 – ₹ 2,966)		**10,970**

Notes:

1. Section 80D allows a higher deduction of up to ₹ 50,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, Nandita will be allowed deduction of ₹ 28,000 under section 80D, since she is a resident Indian of the age of 60 years.

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2. The basic exemption limit for senior citizens under the normal provisions of the Act is ₹ 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Nandita is eligible for the higher basic exemption limit of ₹ 3,00,000, since she is 60 years old.

3. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

   (a) The assessee is a resident in India during the relevant previous year.

   (b) The income accrues or arises to him outside India during that previous year.

   (c) Such income is not deemed to accrue or arise in India during the previous year.

   (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

   (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

   In this case, since all the above conditions are satisfied, Nandita is eligible for deduction u/s 91.

(3) Foreign Tax Credit [Rule 128 of Income-tax Rules, 1962]

(i) Year of availability of credit for foreign tax paid

An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this rule.

However, in a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.

(ii) Meaning of "Foreign tax":

	Country/Specified Territory	Foreign Tax
(i)	in respect of a country or specified territory outside India with which India has	the tax covered under the said agreement

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	entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A	
(ii)	in respect of any other country or specified territory outside India	the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in section 91. For this purpose, income-tax in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

(iii) Components of income-tax in respect of which FTC is available

Foreign Tax Credit (FTC) is available against the amount of tax, surcharge and cess payable under the Income-tax Act, 1961. However, it is not available in respect of any sum payable by way of interest, fee or penalty.

(iv) Manner of computing FTC

The credit of foreign tax would be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory outside India and shall be given effect to in the following manner:-

(a) the credit would be the lower of the tax payable under the Income-tax Act, 1961 on such income and the foreign tax paid on such income.

However, where the foreign tax paid exceeds the amount of tax payable in accordance with the provisions of the agreement for relief or avoidance of double taxation, such excess has to be ignored.

(b) the credit would be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.

Note *– Students are advised to refer to Rule 128 of Income-tax Rules, 1961 given as Annexure 2 at the end of this module.*

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Summary

DT Relief under the Income-tax Act, 1961

Bilateral Relief [Section 90/90A]

Agreement with foreign countries or specified territories

Objective

- **The Central Government may enter into an agreement with the Government of any country outside India or specified territory or specified assn outside India,—**
  - for the granting of relief in respect of doubly taxed income
  - for the avoidance of double taxation of income without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance
  - for exchange of information for the prevention of evasion or avoidance of income-tax
  - for recovery of income-tax

Taxability

- Taxability of income would be detd based on DTAA or the Income-tax Act, 1961, whichever is more beneficial.

Charge of tax on foreign Company

- The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Tax Residency Certificate (TRC)

- In order to claim DT relief, the non-resident to whom such DTAA applies, has to obtain a TRC from the Government of that country or specified territory.
- The non-resident to also provide such other documents and information, as may be prescribed, for claiming treaty benefits.

Unilateral Relief [Section 91]

Countries with which no agreement exists

Applicability

- Assessee, who is a resident in India during the PY

Conditions

- The income accrues or arises to him outside India.
- The income is not deemed to accrue or arise in India during the PY.
- The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.
- The assessee has paid tax on the income in the foreign country.
- There is no agrmt for relief from DT between India and the other country where the income has accrued or arisen.

Computation of Relief

- Doubly taxed income **x** Indian rate of tax or Rate of tax in the said country, whichever is lower

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22.4 CONCEPT OF PERMANENT ESTABLISHMENT

Under the Income-tax Act, 1961, the taxability of business profits is determined by existence of business connection in India under section 9(1)(i). Under the DTAA, taxability of business profits is determined by existence of a Permanent Establishment (PE) in India. It may be noted that the scope of business connection under section 9(1)(i) is wider than that of a PE. Article 5(1) of the DTAA usually provides that for the purpose of this convention, the term 'Permanent Establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term PE is also defined under section 92F(iiia) to include a fixed place of business through which the business of the enterprise is wholly or partly carried on.

According to Article 5(2), the term PE includes

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(1) Permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

(2) Every DTAA has a specific clause, which will deal with an explanation of permanent establishment for the purpose of such DTAA.

(3) Business Income of a non-resident will not be taxed in India, unless such non-resident has a permanent establishment in India.

(4) Taxability of income under business connection and permanent establishment is explained here below:

(5) **Liaison Office – Does it constitute a PE?**

(i) **Liaison Office engaged in remittance services** - In *Union of India v. UAE Exchange Center (2020) 425 ITR 30*, the Supreme Court held that an Indian liaison office of a foreign enterprise engaged in remittance services would **not** constitute a PE. In this case, no permission was given by RBI to the assessee to engage in primary business activity and establish a business connection. The liaison office downloads information (such as names and addresses of beneficiaries, amount to be remitted, etc.) by accessing the main servers of assessee in UAE, prints cheques/draft and dispatches them to the addresses of beneficiaries through courier. The Supreme Court held that even if the activities of LO are regarded as business activities, they were of preparatory or auxiliary character.

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(ii) **Liaison Office as Communication Channel** - In *DIT (International Taxation) v. Samsung Heavy Industries Ltd. (2020) 426 ITR 1 (SC)*, the project office was set up solely as an auxiliary office meant to act as liaison office between ONGC and the assessee. No expenditure relating to execution of contract was incurred by the project office. Only two persons were working in the project office and they were not qualified to perform any core activity of the assessee. Therefore, the Supreme Court held that the project office is not a fixed place of business through which core business of assessee is carried on, and hence, the same would **not** constitute a PE.

Identifying new customers, marketing activities, price negotiation, discussion of commercial issues, securing and processing orders have led to the liaison office forming a PE.

22.5 TAXATION OF BUSINESS PROCESS OUTSOURCING UNITS IN INDIA

The provisions containing taxation of IT-enabled business process outsourcing units are not contained in the Income-tax Act, 1961 but are given in *Circular No.5/2004 dated 28.9.2004* issued by CBDT. The provisions are briefed hereunder –

(a) A non-resident entity may outsource certain services to a resident Indian entity. If there is no business connection between the two, the resident entity may not be a Permanent Establishment of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the non-resident entity will not be liable under the Income-tax Act, 1961.

(b) However, it is possible that the non-resident entity may have a business connection with the resident Indian entity. In such a case, the resident Indian entity could be treated as the Permanent Establishment of the non-resident entity.

(c) The non-resident entity or the foreign company will be liable to tax in India only if the IT enabled BPO unit in India constitutes its Permanent Establishment.

(d) A non-resident or a foreign company is treated as having a Permanent Establishment in India if the said non-resident or foreign company carries on business in India through a

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branch, sales office etc. or through an agent (other than an independent agent) who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India by the Permanent Establishment becomes taxable in India.

(e) If a foreign enterprise carries on business in another country through a Permanent Establishment situated therein, the profits of the enterprise may be taxed in the other country but only so much of them as is attributable to the Permanent Establishment.

(f) Profits are to be attributed to the Permanent Establishment as if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a Permanent Establishment.

(g) In determining the profits of a Permanent Establishment there shall be allowed as deduction, expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere.

(h) The expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income-tax Act, 1961.

(i) The profits to be attributed to a Permanent Establishment are those which that Permanent Establishment would have made if, instead of dealing with its Head Office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the “arm’s length principle”.

(j) Hence, in determining the profits attributable to an IT-enabled BPO unit constituting a Permanent Establishment, it will be necessary to determine the price of the services rendered by the Permanent Establishment to the Head office or by the Head office to the Permanent Establishment on the basis of “arm’s length principle”.

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TEST YOUR KNOWLEDGE

Questions

1. *Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2025. The Indian branch has filed return of income for assessment year 2026-27 disclosing income of ₹ 50 lakhs. It paid tax at the rate applicable to domestic company i.e. 30% plus higher education cess@4% on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:*

   "The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."

   However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 35% plus higher education cess@4%.

   Is the action of the Assessing Officer in accordance with law?

2. *Kalpesh Kumar, a resident individual, is a musician deriving income of ₹ 7,50,000 from concerts performed outside India. Tax of ₹ 1,00,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to ₹ 30,00,000. Compute net tax liability of Kalpesh Kumar for the assessment year 2026-27 assuming he has deposited ₹ 1,50,000 in Public Provident Fund and paid medical insurance premium in respect of his father, resident in India, aged 65 years, ₹ 52,000.*

3. *The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the assessment year 2026-27:*

	(₹ In lakhs)
Income from playing snooker matches in country L	12.00
Tax paid in country L	1.80
Income from playing snooker tournaments in India	19.20
Life Insurance Premium paid	1.10
Medical Insurance Premium paid for her father (resident Indian) aged 62 years (paid through credit card)	0.54

   Compute her total income and net tax liability for the assessment year 2026-27. There is no Double Taxation Avoidance Agreement between India and country L.

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4. *The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Examine the significance thereof, when such transactions are governed by Double Taxation Avoidance Agreements (DTAA).*

5. *An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to examine whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.*

6. *The Income-tax Act, 1961 provides for taxation of a certain income earned in India by Mr. X, a non-resident. The Double Taxation Avoidance Agreement, which applies to Mr. X provides for taxation of such income in the country of residence. Is Mr. X liable to pay tax on such income earned by him in India? Examine.*

7. *Arif is a resident of both India and another foreign country in the previous year 2025-26. He owns immovable properties (including residential house) in both the countries. He earned income of ₹ 50 lakhs from rubber estates in the foreign country during the financial year 2025-26. He also sold some house property situated in foreign country resulting in short-term capital gain of ₹ 10 lakhs during the year. Arif has no permanent establishment of business carried on in India. However, he has derived rental income of ₹ 6 lakhs from property let out in India and he has a house in Lucknow where he stays during his visit to India.*

   Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that "where an individual is a resident of both the Contracting States, then, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)".

   You are required to examine with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

8. *Mr. Kamesh, an individual resident in India aged 52 years, furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2025-26. India has not entered into double taxation avoidance agreement with these two countries.*

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Particulars	₹
Income from profession carried on in India	7,50,000
Agricultural income in Country "X" (gross)	50,000
Dividend from a company incorporated in Country "Y" (gross)	1,50,000
Royalty income from a literary book from Country "X" (gross)	6,00,000
Expenses incurred for earning royalty	50,000
Business loss in Country "Y" (Proprietary business)	65,000
Rent from a house situated in Country "Y" (gross)	2,40,000
Municipal tax paid in respect of the above house in Country "Y" (not allowed as deduction in country "Y")	10,000

Note: Business loss in Country "Y" not eligible for set off against other incomes as per law of that country.

The rates of tax in Country "X" and Country "Y" are 10% and 20%, respectively.

Compute total income and net tax liability of Mr. Kamesh in India for Assessment Year 2026-27, assuming that he opted out of the default tax regime under section 115BAC.

9. Mr. Anil, aged 49 years, a resident individual furnishes the following particulars of income earned by him in India and Country N for the previous year 2025-26. India does not have a double taxation avoidance agreement (DTAA) with Country N.

Particulars	Amount (₹)
Income from profession carried on in Mumbai	8,50,000
Agricultural Income in Country N	1,30,000
Dividend from a company incorporated in Country N (gross)	85,000
Royalty income from a literary book from Country N (gross)	6,25,000
Expenses incurred for earning royalty	75,000
Business loss in Country N	1,10,000

The domestic tax laws of Country N does not permit set-off of business loss against any other income. The rate of income-tax in Country N is 18%. Compute total income and net tax liability of Mr. Anil in India for A.Y. 2026-27, assuming that he satisfies all conditions for the purpose of section 91 and he opted out of the default tax regime under section 115BAC.

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10. *Mr. Ravi, an individual resident in India aged 45 years, furnishes you the following particulars of income earned in India, Foreign Countries "S" and "T" for the previous year 2025-26.*

Particulars	₹
Indian Income:	
Income from business carried on in Mumbai	*4,40,000*
Interest on savings bank with ICICI Bank	*42,000*
Income earned in Foreign Country "S" [Rate of tax – 16%]:	
Agricultural income in Country "S"	*94,000*
Royalty income from a book on art from Country "S" (Gross)	*7,80,000*
Expenses incurred for earning royalty	*50,000*
Income earned in Foreign Country "T" [Rate of tax – 20%]:	
Dividend from a company incorporated in Country "T" (Gross)	*2,65,000*
Rent from a house situated in Country "T" (Gross)	*3,30,000*
Municipal tax paid in respect of the above house (not allowed as deduction in Country "T")	*10,000*

Compute the total income and net tax liability of Mr. Ravi in India for A.Y. 2026-27 assuming that India has not entered into double taxation avoidance agreement with Countries S & T.

Answers

1. Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of Article 24 (Non-discrimination of the DTAA, it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (35%).

However, *Explanation 1* to section 90 clarifies that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company. Therefore, in view of this *Explanation*, the action of the Assessing Officer in levying tax@35% on the Indian branch of Cosmos Ltd. is in accordance with law.

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2. **Computation of net tax liability of Mr. Kalpesh for A.Y.2026-27 under the default tax regime under section 115BAC (assuming that he pays tax under the default tax regime)**

Particulars	₹	₹
Indian Income		30,00,000
Foreign Income		7,50,000
Gross Total Income		**37,50,000**
Less: **Deduction under VI-A [Not available under default tax regime]**		Nil
Total Income		**37,50,000**
Tax on total income		7,05,000
Add: Health and Education cess @4%		28,200
		7,33,200
Average rate of tax in India [i.e., ₹ 7,33,200 /₹ 37,50,000 x 100]	19.552%	
Average rate of tax in foreign country [i.e. ₹ 1,00,000/ ₹ 7,50,000 x 100]	13.333%	
Doubly taxed income	7,50,000	
Deduction under section 91 on ₹ 7,50,000 @13.333% (lower of average Indian tax rate and foreign tax rate]		1,00,000
Net tax liability in India [₹ 7,33,200 – ₹ 1,00,000]		**6,33,200**

Computation of net tax liability of Mr. Kalpesh for A.Y.2026-27 under the normal provisions of the Act (assuming that he has exercised the option to shift out of default tax regime)

Particulars	₹	₹
Indian Income		30,00,000
Foreign Income		7,50,000
Gross Total Income		**37,50,000**
Less: **Deduction under section 80C**		
PPF Contribution	1,50,000	
Deduction under section 80D		
Medical insurance premium of father, being a resident senior citizen, restricted to	50,000	
		2,00,000
Total Income		**35,50,000**

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Tax on total income		8,77,500
Add: Health and Education cess @4%		35,100
		9,12,600
Average rate of tax in India [i.e., ₹ 9,12,600 /₹ 35,50,000 x 100]	25.707%	
Average rate of tax in foreign country		
[i.e. ₹ 1,00,000/ ₹ 7,50,000 x 100]	13.333%	
Doubly taxed income	7,50,000	
Deduction under section 91 on ₹ 7,50,000 @13.333%		
(lower of average Indian tax rate and foreign tax rate]		1,00,000
Net tax liability in India [₹ 9,12,600 – ₹ 1,00,000]		**8,12,600**

Note: An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, Kalpesh Kumar is eligible for deduction under section 91 since all the above conditions are fulfilled.

3. Computation of total income and net tax liability of Miss Vivitha for the A.Y. 2026-27 under the default tax regime under section 115BAC (assuming that she pays tax under the default tax regime)

Particulars	₹	₹
Indian Income [Income from playing snooker tournaments in India]		19,20,000
Foreign Income [Income from playing snooker matches in country L]		12,00,000
Gross Total Income		**31,20,000**
Less: Deduction under Chapter VIA		Nil
Total Income		**31,20,000**

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Tax on Total Income		
Income-tax		5,16,000
Add: Health and education cess @4%		20,640
		5,36,640
Average rate of tax in India	17.20%	
(i.e. ₹ 5,36,640/₹ 31,20,000 × 100)		
Average rate of tax in foreign country	15.00%	
(i.e. ₹ 1,80,000/ ₹12,00,000 ×100)		
Deduction under section 91 on ₹ 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)		1,80,000
Net tax liability in India (₹ 5,36,640 – ₹ 1,80,000)		**3,56,640**

Computation of total income and net tax liability of Miss Vivitha for the A.Y. 2026-27 under the normal provisions of the Act
(assuming that she has exercised the option to shift out of default tax regime)

Particulars	₹	₹
Indian Income [Income from playing snooker tournaments in India]		19,20,000
Foreign Income [Income from playing snooker matches in country L]		12,00,000
Gross Total Income		**31,20,000**
Less: Deduction under Chapter VIA		
Deduction under section 80C		
Life insurance premium of ₹ 1,10,000 paid during the previous year deduction, is within the overall limit of ₹ 1.5 lakh. Hence, fully allowable as deduction	1,10,000	
Deduction under section 80D		
Medical insurance premium of ₹ 54,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of ₹ 50,000. Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.	50,000	1,60,000
Total Income		**29,60,000**
Tax on Total Income		
Income-tax		7,00,500

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Add: Health and education cess @4%		28,020
		7,28,520
Average rate of tax in India (i.e. ₹ 7,28,520/₹ 29,60,000 × 100)	24.61%	
Average rate of tax in foreign country (i.e. ₹ 1,80,000/ ₹12,00,000 ×100)	15.00%	
Deduction under section 91 on ₹ 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)		1,80,000
Net tax liability in India (₹ 7,28,520 – ₹ 1,80,000)		**5,48,520**

Note: Miss Vivitha shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) She is a resident in India during the relevant previous year.

(b) The income accrues or arises to her outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign country L in her hands and she has paid tax on such income in the foreign country L.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country L where the income has accrued or arisen.

4. Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

As per section 92F(iiia), the term "Permanent Establishment" includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs, however, provide that business income is taxable only if there is a permanent establishment in India. As per section 90(2), the provisions of the Income-tax Act, 1961 or the DTAA, whichever is beneficial, shall apply. The PE concept is narrower than the business connection concept. Therefore, in a case where the Indian

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Government has entered into DTAA with a country, unless and until the PE test is satisfied, the business income would not be taxable in the source country.

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

5. The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal. Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income-tax payable by him as per section 91 read with Rule 128 on Foreign Tax Credit.

6. Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where the DTAA has been entered, the assessee can opt to be governed by the provisions of DTAA if the provisions are beneficial in comparison to provisions of Act.

However, as per section 90(4), the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide the following information in Form No. 10F:

(i) Status (individual, company, firm etc.) of the assessee;

(ii) PAN of the assessee, if allotted;

(iii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iv) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;

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(v) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(vi) Address of the assessee in the country or specified territory outside India, during the period for which the certificate, as mentioned in (v) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The Supreme Court has held, in *CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654,* that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961. Mr. X is, therefore, not liable to pay tax on the income earned by him in India provided he submits the Tax Residence Certificate obtained from the government of the other country and provides such other documents and information as may be prescribed.

7. Section 90(2) of the Income-tax Act, 1961 provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

In this case, Arif is resident of both India and the foreign country. Therefore, the DTAA provides for a tie-breaker rule wherein if a person is resident of two countries, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests).

Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore, his personal and economic relations with foreign country are closer, since foreign country is the place where –

(a) the property is located and

(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2026-27.

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The fact of the case and issues arising therefrom are similar to that of *CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654*, where the Supreme Court held that if an assessee is deemed to be a resident of a Contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5. Accordingly, only the income accruing or arising or deemed to accrue or arise in India shall be taxable in India in the hands of Arif.

However, as per section 90(4), in order to claim relief under the agreement, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2026-27 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

8. Computation of total income of Mr. Kamesh for A.Y.2026-27 under normal provisions of the Act

Particulars	₹	₹
Income from House Property [House situated in country Y]		
Gross Annual Value[1]	2,40,000	
Less: Municipal taxes	10,000	
Net Annual Value	2,30,000	
Less: Deduction under section 24 – 30% of NAV	69,000	
		1,61,000
Profits and Gains of Business or Profession		
Income from profession carried on in India	7,50,000	
Royalty income from a literary book from Country X (after deducting expenses of ₹ 50,000)	5,50,000	
	13,00,000	
Less: Business loss in country Y set-off[2]	65,000	
		12,35,000

[1] Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

[2] As per section 70(1), inter-source set-off of income is permitted.

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Income from Other Sources		
Agricultural income in country X	50,000	
Dividend from a company in country Y	1,50,000	2,00,000
Gross Total Income		**15,96,000**
***Less:* Deduction under Chapter VIA**		
Under section 80QQB – Royalty income of a resident from literary work[3]		3,00,000
Total Income		**12,96,000**

Note – Since adjusted total income (i.e., ₹ 15,96,000) does not exceed ₹ 20 lakhs, AMT would not be attracted in this case.

Computation of net tax liability of Mr. Kamesh for A.Y.2026-27

Particulars	₹
Tax on total income [30% of ₹ 2,96,000 + ₹ 1,12,500]	2,01,300
Add: Health and Education cess@4%	8,052
	2,09,352
Less: Deduction under section 91 **(See Working Note below)**	69,739
Net tax liability	**1,39,613**
Net tax liability (rounded off)	1,39,610

Working Note: Calculation of Rebate under section 91

	₹	₹
Average rate of tax in India [i.e., ₹ 2,09,352 / ₹ 12,96,000 x 100]	**16.154%**	
Average rate of tax in country X	**10%**	
Doubly taxed income pertaining to country X		
Agricultural Income	50,000	
Royalty Income [₹ 6,00,000 – ₹ 50,000 (Expenses) – ₹ 3,00,000 (deduction under section 80QQB)][4]	2,50,000	
	3,00,000	
Deduction under section 91 on ₹ 3,00,000 @10% [being the lower of average Indian tax rate (16.154%) and foreign tax rate (10%)]		30,000

[3] It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

[4] Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – *CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).*

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Average rate of tax in country Y	**20%**	
Doubly taxed income pertaining to country Y		
Income from house property	1,61,000	
Dividend	1,50,000	
	3,11,000	
Less: Business loss set-off	65,000	
	2,46,000	
Deduction u/s 91 on ₹ 2,46,000 @16.154% (being the lower of average Indian tax rate (16.154%) and foreign tax rate (20%)]		39,739
Total rebate under section 91 (Country X + Country Y)		**69,739**

Note: Mr. Kamesh shall be allowed deduction u/s 91, since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year (i.e., P.Y.2025-26).

(b) The income in question accrues or arises to him outside India in foreign countries X and Y during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign countries X and Y in his hands and it is presumed that he has paid tax on such income in those countries.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries X and Y where the income has accrued or arisen.

9. Computation of total income of Mr. Anil for A.Y.2026-27 under normal provisions of the Act

Particulars	₹	₹
Profits and Gains of Business or Profession		
Income from profession carried on in India	8,50,000	
Royalty income from a literary book in Country N (after deducting expenses of ₹ 75,000)	5,50,000	
	14,00,000	
Less: Business loss in Country N	1,10,000	12,90,000

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Income from Other Sources		
Agricultural income in Country N [Not exempt u/s 10(1)]	1,30,000	
Dividend received from a company incorporated in Country N	85,000	
		2,15,000
Gross Total Income		**15,05,000**
***Less:* Deduction under Chapter VIA**		3,00,000
Under section 80QQB – Royalty income of a resident from a literary book[5]		
Total Income		**12,05,000**

Note – Since adjusted total income (i.e., ₹ 15,05,000) does not exceed ₹ 20 lakhs, AMT would not be attracted in this case.

Computation of net tax liability of Mr. Anil for A.Y.2026-27

Particulars		₹
Tax on total income [30% of ₹ 2,05,000 plus ₹ 1,12,500]		1,74,000
Add: Health and education cess @4%		6,960
Tax Liability		1,80,960
Calculation of Rebate under section 91:		
Average rate of tax in India [i.e., ₹ 1,80,960 / ₹ 12,05,000 x 100]	**15.017%**	
Average rate of tax in Country N	**18%**	
Doubly taxed income pertaining to Country N	**₹**	
Agricultural Income	1,30,000	
Royalty Income [₹ 6,25,000 – ₹ 75,000 (Expenses) – ₹ 3,00,000 (deduction under section 80QQB)] [6]	2,50,000	
Dividend income	85,000	
	4,65,000	
Less: Business Loss set off	1,10,000	
	3,55,000	

[5] It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

[6] Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).

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Rebate under section 91 on ₹ 3,55,000 @ 15.017% [being the lower of average Indian tax rate (15.017%) and foreign tax rate (18%)]	53,310
Net tax liability	**1,27,650**

10. Computation of total income of Mr. Ravi for A.Y.2026-27 under the default tax regime under section 115BAC (assuming that he pays tax under the default tax regime)

Particulars	₹	₹
Income from House Property [House situated in Country T]		
Gross Annual Value[7]	3,30,000	
Less: Municipal taxes paid in Country T	10,000	
Net Annual Value	3,20,000	
Less: Deduction under section 24 – 30% of NAV	96,000	
		2,24,000
Profits and Gains of Business or Profession		
Income from business carried on in India	4,40,000	
Royalty income from a book on art in Country S (after deducting expenses of ₹ 50,000)	7,30,000	11,70,000
Income from Other Sources		
Interest on savings bank with ICICI Bank	42,000	
Agricultural income in Country S [Not exempt]	94,000	
Dividend from a company in Country T	2,65,000	4,01,000
Gross Total Income		**17,95,000**
Less: Deduction under Chapter VIA [Not available under default tax regime]		Nil
Total Income		**17,95,000**

Computation of tax liability of Mr. Ravi for A.Y.2026-27 under the default tax regime

Particulars		₹
Tax on total income		1,59,000
Add: Health and education cess @4%		6,360
		1,65,360

[7]Rental income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

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Less: Rebate under section 91 **(See Working Note below)**		1,20,954
Net tax liability		**44,406**
Net tax liability (Rounded off)		**44,410**
Calculation of Rebate under section 91:		
Average rate of tax in India [i.e., ₹ 1,65,360 / ₹ 17,95,000 x 100]	**9.212%**	
Average rate of tax in Country S	**16%**	
Doubly taxed income pertaining to Country S	**₹**	
Agricultural Income	94,000	
Royalty Income [₹ 7,80,000 – ₹ 50,000 (Expenses)]	7,30,000	
	8,24,000	
Rebate under section 91 on ₹ 8,24,000 @9.212% [being the lower of average Indian tax rate (9.212%) and Country S tax rate (16%)]		75,907
Average rate of tax in Country T	**20%**	
Doubly taxed income pertaining to Country T		
Income from house property	2,24,000	
Dividend	2,65,000	
	4,89,000	
Rebate under section 91 on ₹ 4,89,000 @9.212% [being the lower of average Indian tax rate (9.212%) and Country T tax rate (20%)]		45,047
Total rebate under section 91 (Country S + Country T)		**1,20,954**

Computation of total income of Mr. Ravi for A.Y.2026-27
under the normal provisions of the Act
(assuming that he has exercised the option to shift out of default tax regime)

Particulars	₹	₹
Income from House Property [House situated in Country T]		
Gross Annual Value[8]	3,30,000	
Less: Municipal taxes paid in Country T	10,000	
Net Annual Value	3,20,000	

[8]Rental income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

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Less: Deduction under section 24 – 30% of NAV	96,000	
		2,24,000
Profits and Gains of Business or Profession		
Income from business carried on in India	4,40,000	
Royalty income from a book of art in Country S (after deducting expenses of ₹ 50,000)	7,30,000	11,70,000
Income from Other Sources		
Interest on savings bank with ICICI Bank	42,000	
Agricultural income in Country S [Not exempt]	94,000	
Dividend from a company in Country T	2,65,000	4,01,000
Gross Total Income		**17,95,000**
***Less:* Deduction under Chapter VIA**		
Under section 80QQB – Royalty income of a resident from a work of art[9]		3,00,000
Under section 80TTA – Interest on savings bank account, subject to a maximum of ₹ 10,000.		10,000
Total Income		**14,85,000**

Note – Since adjusted total income (i.e., ₹ 17,85,000) does not exceed ₹ 20 lakhs, AMT would not be attracted in this case.

Computation of tax liability of Mr. Ravi for A.Y.2026-27 under the normal provisions of the Act

Particulars		₹
Tax on total income [30% of ₹ 4,85,000 + ₹ 1,12,500]		2,58,000
Add: Health and education cess @4%		10,320
		2,68,320
Less: Rebate under section 91 **(See Working Note below)**		1,72,197
Tax Payable		**96,123**
Tax payable (rounded off)		**96,120**
Calculation of Rebate under section 91:		
Average rate of tax in India [i.e., ₹ 2,68,320 / ₹ 14,85,000 x 100]	**18.069%**	

[9] It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

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Average rate of tax in Country S	**16%**	
Doubly taxed income pertaining to Country S[10]	**₹**	
Agricultural Income	94,000	
Royalty Income [₹ 7,80,000 – ₹ 50,000 (Expenses) – ₹ 3,00,000 (deduction under section 80QQB)]	4,30,000	
	5,24,000	
Rebate under section 91 on ₹ 5,24,000 @16% [being the lower of average Indian tax rate (18.069%) and Country S tax rate (16%)]		83,840
Average rate of tax in Country T	**20%**	
Doubly taxed income pertaining to Country T		
Income from house property	2,24,000	
Dividend	2,65,000	
	4,89,000	
Rebate under section 91 on ₹ 4,89,000 @18.069% (being the lower of average Indian tax rate (18.069%) and Country T tax rate (20%)]		88,357
Total rebate under section 91 (Country S + Country T)		**1,72,197**

Note: Mr. Ravi shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) He is a resident in India during the relevant previous year i.e., P.Y. 2025-26.

(b) The income in question accrues or arises to him outside India in foreign countries S & T during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign countries "S" and "T" in his hands and it is presumed that he has paid tax on such income in those countries.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries S and T where the income has accrued or arisen.

[10]Doubly taxed income includes only that part of income which is included in the assessee's total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – *CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).*

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CHAPTER 23

ADVANCE RULINGS

LEARNING OUTCOMES

After studying this Chapter, you will be able to–

- **comprehend** the meaning and scope of the term "advance ruling" and the need for obtaining advance ruling;
- **understand** the constitution of Board for Advance Rulings;
- **appreciate** the procedure for making an application to the Board for Advance Rulings and the procedure to be followed by the Board on receipt of application;
- **know** the circumstances when an advance ruling can be declared void.

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23.1 BOARDS FOR ADVANCE RULINGS – AN INTRODUCTION

Three Boards for Advance Rulings have been constituted for giving advance rulings on or after 1.9.2021. Every such Board shall consist of two members, each being an officer not below the rank of Chief Commissioner, as may be nominated by the Board. The ruling pronounced or order passed by the Board for Advance Rulings is appealable before the High Court. The Finance Act, 2021 has empowered the Central Government to make a scheme by notification in the Official Gazette for the purpose of giving advance ruling by Boards for Advance Rulings to impart greater efficiency, transparency and accountability by eliminating interface between the Boards for Advance Rulings and the applicants to the extent technologically feasible, by optimising utilisation of resources and introducing dynamic jurisdiction.

23.2 CONSTITUTION OF BOARD FOR ADVANCE RULINGS [SECTION 245-OB]

One or more Boards for Advance Rulings, as may be necessary, shall be constituted by the Central Government for giving advance rulings under Chapter XIX-B with effect from a date appointed by notification in the Official Gazette. Accordingly, the Central Government has, in exercise of such powers, vide Notification No.96/2021 dated 1.9.2021, constituted three Boards for Advance Rulings, for the purposes of giving advance rulings under Chapter XIX-B on or after 1.9.2021. Board for Advance Rulings – I and Board for Advance Rulings – II have their headquarters in Delhi and Board for Advance Rulings – III has its headquarters in Mumbai.

Every such Board for Advance Ruling shall consist of two members, each being an officer not below the rank of Chief Commissioner, as may be nominated by the Board.

23.3 DEFINITIONS

(1) Advance Ruling [Section 245N(a)]: The meaning of Advance Ruling is detailed hereunder:

Section	Determination by the Board for Advance Rulings
245N(a)(i)	in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant.

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245N(a)(ii)	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 law or of fact specified in the application.
245N(a)(iia)	in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or of fact specified in the application.
245N(a)(iii)	in respect of an issue relating to computation of total income which is pending before any Income-tax Authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or fact in relation to such computation of total income specified in the application.
245N(a)(iv)	or decision whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

(2) Applicant [Section 245N(b)(A)]: 'Applicant' means any person who –

(i) is a non-resident referred to in section 245N(a)(i) above; or

(ii) is a resident referred to in section 245N(a)(ii) above; or

(iii) is a resident referred to in section 245N(a)(iia) above falling within any such class or category of persons as the Central Government may, by notification in the Official Gazette, specify.

[A resident in relation to his tax liability arising out of one or more transactions valuing ₹ 100 crore or more in total which has been undertaken or is proposed to be undertaken would be an applicant – Notification No.73/2014 dated 28.11.2014]; or

(iv) is a resident falling within such class or category of persons as the Central Government may, by notification in the Official Gazette, specify in this behalf

[Public sector company as defined under section 2(36A) of the Income-tax Act, 1961 would be an applicant – Notification No. 725(E) dated 3.8.2000]; or

(v) is referred to in section 245N(a)(iv) above; and

who makes an application for advance ruling under section 245Q(1).

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Who can be an applicant in relation to different clauses of section 245N(a) defining advance ruling?		
S. No.	**Applicant u/s 245N(b)**	**Advance Ruling u/s 245N(a) means determination by the AAR in relation to**
(i)	Non-resident (NR)	a transaction which has been undertaken or is proposed to be undertaken by him.
(ii)	Resident	the tax liability of a NR arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such NR and such determination shall include the determination of any question of law or of fact specified in the application.
(iii)	Resident of class or category of persons notified by Central Government	the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or of fact specified in the application.
	Note: *The Central Government notified a resident, in relation to his tax liability arising out of one or more transactions valuing ₹100 crore or more in total.*	
(iv)	Resident of class or category of persons notified by Central Government	n issue relating to computation of total income which is pending before any Income-tax Authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or fact in relation to such computation of total income specified in the application.
	Note: *A public sector undertaking has been notified by the Central Government.*	
(v)	Resident or NR	whether an arrangement, which is proposed to be undertaken by any person being a resident or a NR, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

Restrictions on Appellate Authority: Section 245RR provides that where a resident applicant has made an application to the Board for Advance Rulings in respect of an issue for decision of Board for Advance Rulings, then, no Income-tax Authority or Tribunal shall take any decision in respect of such issues. In other words, a resident assessee cannot pursue both the remedies, i.e., an appeal or revision before Income-tax Authority/Appellate Authority as well as an application for Advance Ruling to Board for Advance Rulings, in respect of an issue.

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23.4 VACANCIES, ETC., NOT TO INVALIDATE PROCEEDINGS [SECTION 245P]

A proceeding before, or pronouncement of advance ruling by, the Board for Advance Rulings would not be questioned or would not be invalid on the ground merely of the existence of any vacancy or defect in the constitution of the Board for Advance Rulings.

23.5 APPLICATION FOR ADVANCE RULING [SECTION 245Q]

Section 245Q(1) provides that an applicant desirous of obtaining an advance ruling may make an application stating the question on which the advance ruling is sought in the prescribed form and in the prescribed manner.

As per section 245Q(2), the application shall be made in quadruplicate and be accompanied by a fee of ₹ 10,000 or such fee as may be prescribed, whichever is higher.

Rule 44E prescribes the fees mentioned in column (3) to be paid by the applicant mentioned in column (1) in the cases of column (2).

Category of applicant	Category of case	Fee
(1)	(2)	(3)
An applicant referred to in sub-clauses (i) or (ii) or (iia) of clause (b) of section 245N	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought does not exceed ₹ 100 crore.	₹ 2 lakhs
	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought exceeds ₹ 100 crore but does not exceed ₹ 300 crore.	₹ 5 lakhs
	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which ruling is sought exceeds ₹ 300 crore.	₹ 10 lakhs
Any other applicant	In all cases	₹ 10,000

Rule 44E prescribes the form of application for obtaining an advance ruling. Every application under Rule 44E shall be accompanied by the proof of payment of fees.

Section 245Q(3) provides that an applicant may withdraw an application within 30 days from the date of the application.

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23.6 PROCEDURE ON RECEIPT OF APPLICATION [SECTION 245R]

The Board, on receipt of an application, will send a copy to the Principal Commissioner or Commissioner concerned and wherever considered necessary, also call upon the Principal Commissioner or Commissioner to furnish relevant records. Such records will be returned to the Principal Commissioner or Commissioner as soon as possible.

After examining the application and the records called for, the Board may either allow or reject an application. However, the Board **shall not allow** an application where the question raised in the application is:

Pending with income-tax authorities/ tribunal/court	is already pending before any income-tax authority, or Appellate Tribunal or any court. However, a resident falling within any class or category of persons as notified by the Central Government can seek for advance ruling even if question raised is pending before any income-tax authority or Appellate Tribunal.
Determination of Fair Market Value	involves the determination of the fair market value of any property;
Transaction designed for avoidance of income-tax	relates to a transaction or issue which is designed *prima facie* for avoidance of income-tax (except in case of a resident applicant falling within any class or category of persons as notified by the Central Government or in the case of resident or a non-resident for determination of whether an arrangement, which is proposed to be undertaken, is an impermissible avoidance arrangement).

However, no application shall be rejected unless an opportunity has been given to the applicant of being heard. Further, where an application is rejected, the reason for rejection shall be given in the order. A copy of every order shall be sent to the applicant and to the PCIT/CIT.

Where an application is allowed, the Board would pronounce its advance ruling on that question specified in the application, after examining such further material as may be placed before it by the applicant or obtained by the Board. Where a request is received from an applicant, the Board has to provide an opportunity of being heard, either in person or through a duly authorised representative, before pronouncing its advance ruling.

Time limit for pronouncement of advance Ruling - The Board has to pronounce the advance ruling **within 6 months** from the receipt of application by the Board. A copy of advance ruling pronounced, duly signed by the Members and certified, has to be sent to the applicant and to the PCIT/CIT, as soon as may be, after pronouncement.

Faceless Scheme for Advance Rulings - The Central Government is empowered to make a scheme by notification in Official Gazette for the purpose of giving advance rulings so as to

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impart greater efficiency, transparency and accountability by:

(i) eliminating the interface between the Board for Advance Rulings and the applicant in the course of proceedings to the extent technologically feasible;

(ii) optimising utilisation of the resources through economies of scale and functional specialisation;

(iii) introducing a system with dynamic jurisdiction.

Applicability or non-applicability of other provisions of the Act [Section 245R(10)] - The Central Government may, for the purpose of giving effect to the above scheme, by notification in the Official Gazette, direct that any of the provisions of the Income-tax Act, 1961 would not apply or would apply with such modification, exceptions and adaptations as specified.

Though no such direction can be issued by the Central Government after 31st March, 2023, the Central Government may amend any direction, issued on or before 31.3.2023, by notification.

Notification issued above to be laid before each House of Parliament [Section 245R(11)] - Every such notification issued by the Central Government either under sub section (9) or (10) of the section 245R has to be laid before each House of Parliament as soon as may be after issue of such notification.

23.7 ADVANCE RULING TO BE VOID IN CERTAIN CIRCUMSTANCES [SECTION 245T]

Where the Board for Advance Rulings finds, on a representation made to it by the PCIT/CIT or otherwise, that an advance ruling pronounced has been obtained by the applicant by fraud or misrepresentation of facts, the Board may, by order, declare such ruling to be *void ab initio*.

The provisions of the Income-tax Act, 1961 would apply (after excluding the period beginning with the date of such advance ruling and ending with the date of order under this section) to the applicant as if such advance ruling had never been made.

A copy of this order has to be sent to the applicant and the Principal Commissioner or Commissioner.

23.8 POWERS OF THE BOARD FOR ADVANCE RULINGS [SECTION 245U]

The Board for Advance Rulings shall have all the powers of the Civil Court in respect of discovery and inspection, enforcing the attendance of any person, including any officer of a banking

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company and examining on oath, issuing commissions and compelling the production of books of accounts and other documents. The Board shall be deemed to be a Civil Court for the purposes of section 195 of the Code of Criminal Procedure, 1973 which provides for prosecution for contempt of lawful authority of public servants, for offences against public justice. Every proceeding before the Board shall be deemed to be a judicial proceeding under the Indian Penal Code.

However, the Board shall not be deemed to a Civil Court for the purpose of Chapter XXVI of the Code of Criminal Procedure, 1973 containing the provisions as to offences affecting the administration of justice.

23.9 APPEAL [SECTION 245W]

Appeal to High Court by applicant [Section 245W(1)] - The applicant who is aggrieved by any ruling pronounced or order passed by the Board for Advance Rulings or the Assessing Officer, on the directions of the Principal Commissioner or Commissioner, may appeal to the High Court against such ruling or order of the Board of Advance Rulings. He has to do so within **sixty days from the date of the communication** of that ruling or order, in the prescribed form and manner.

However, where the High Court is satisfied, on an application made by the appellant in this behalf, that the appellant was prevented by sufficient cause from presenting the appeal within the 60 day period as specified above, it may grant further period of 30 days for filing such appeal.

Appeal to High Court by Assessing Officer [Section 245W(2)] - For the purpose of appeal to the High Court by the Assessing Officer, the Central Government is empowered to make a scheme by notification in Official Gazette so as to impart greater efficiency, transparency and accountability by:

(i) optimising utilisation of the resources through economies of scale and functional specialisation;

(ii) introducing a team-based mechanism with dynamic jurisdiction.

Applicability or non-applicability of other provisions of the Act [Section 245W(3)] - The Central Government may, for the purpose of giving effect to the above scheme, by notification in the Official Gazette, direct that any provision of the Income-tax Act, 1961, would not apply or would apply with such modification, exceptions and adaptations as specified.

No such direction can, however, be issued by the Central Government after 31st March, 2023.

Notification issued above to be laid before each House of Parliament [Section 245W(4)] -Every such notification issued by the Central Government either under section 245W(2)/(3) has to be laid before each House of Parliament as soon as may be after issue of the said notification.

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TEST YOUR KNOWLEDGE

Questions

1. *Q, a non-resident, made an application to the Board for Advance Rulings on 3.4.2025 in relation to a transaction proposed to be undertaken by him. On 1.5.2025, he decides to withdraw the said application. Can he withdraw the application on 1.5.2025?*

2. *Examine when can an advance ruling pronounced by the Board for Advance Rulings be declared void. What is the consequence?*

3. *The Board for Advance Rulings has the powers of compelling the production of books of account – Examine the correctness or otherwise of this statement.*

4. *The term 'Advance Ruling' includes within its scope, a determination by the Board for Advance Rulings only in relation to a transaction undertaken by a non-resident applicant. Examine the correctness of this statement, with reference to the provisions of the Income-tax Act 1961.*

5. *What is the remedy available to an applicant who is aggrieved by the ruling of Board for Advance Rulings? Also, state the time limit within which he should exercise this remedy.*

Answers

1. Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since the 30 day period from the date of application by Q to the Board for Advance Rulings has not lapsed, he can withdraw the application.

2. As per section 245T, an advance ruling can be declared to be *void ab initio* by the Board for Advance Rulings if, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, it finds that the ruling has been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply (after excluding the period beginning with the date of such advance ruling and ending with the date of order under this section) as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and the Principal Commissioner or Commissioner.

3. **The statement is correct.**

Under section 245U, the Board for Advance Rulings shall have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.

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Accordingly, the Board for Advance Rulings shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -

(1) discovery and inspection;

(2) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

(3) compelling the production of books of account and other documents; and

(4) issuing commissions.

Therefore, the Board for Advance Ruling has the powers of compelling the production of books of account.

4. The statement is **not** correct. As per section 245N, advance ruling not only includes a determination by the BAR in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant, but also includes*, inter alia*, determination by the BAR –

(i) 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 law or of fact specified in the application

(ii) in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant and such determination shall include the determination of any question of law or of fact specified in the application.

5. An applicant who is aggrieved by any ruling pronounced by the Board for Advance Rulings may appeal to the High Court against such ruling of the Board of Advance Rulings. He has to do so within sixty days from the date of the communication of that ruling, in the prescribed form and manner.

However, where the High Court is satisfied, on an application made by the appellant in this behalf, that the appellant was prevented by sufficient cause from presenting the appeal within the 60 day period as specified above, it may grant further period of 30 days for filing such appeal.

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CHAPTER 24

TRANSFER PRICING

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **appreciate** the need for incorporation of transfer pricing provisions in the Income-tax Act, 1961;
- **comprehend** the meaning and significance of arm's length principle and the practical difficulties in application of arm's length principle;
- **appreciate** the meaning and significance of the terms "associated enterprise", "international transaction" and "specified domestic transaction";
- **determine** the arm's length price using different methods prescribed under the income-tax law;
- **appreciate** the meaning of safe harbour and rules for safe harbor incorporated in the income-tax law;
- **appreciate** the benefits of entering into advance pricing agreements;
- **identify** the cases where secondary adjustments have to be made;
- **pinpoint** the responsibilities of a person entering into an international transaction to keep and maintain prescribed information and documents;

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- **identify** the circumstances when the Assessing Officer can invoke the power to determine the arm's length price;
- **comprehend and appreciate** the country-by-country reporting requirements and related matters incorporated in the income-tax law in compliance with BEPS Action Plan 13;
- **appreciate** the specific anti-avoidance measures incorporated in the Income-tax Act, 1961 in respect of transactions with persons located in notified jurisdictional areas;
- **appreciate** the provisions incorporated in the Income-tax Act, 1961 restricting interest deduction claimed by an entity in respect of borrowings from an associated enterprise in line with BEPS Action Plan 4.

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24.1 INTRODUCTION

In the present age of globalisation, Multinational Companies (MNCs) have branches/subsidiaries/divisions operating in more than one country. There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction where the tax liability is minimum. This results in base erosion of the high tax jurisdiction by shifting the profits to the low tax jurisdiction, thereby minimizing the taxes. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group.

In order to curb such tax avoidance measures, Arm's Length Principle (ALP) is used internationally to substitute the transfer price adopted by the MNCs to price the intra-group transfer of goods or provision of services. Generally, the arm's length price refers to the price an unrelated enterprise would be willing to pay in comparable circumstances.

The OECD guidelines define the "Transfer prices" as the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises. Two enterprises are "associated enterprises" if one of the enterprises participates directly or indirectly in the management, control or capital of the other or if both enterprises are under common control. Since international transfer pricing involves more than one tax jurisdiction, any adjustment to the transfer price in one jurisdiction requires a corresponding adjustment in the other jurisdiction. If a corresponding adjustment is not made, double taxation will result.

24.2 MEANING OF "ARM'S LENGTH PRINCIPLE"

The Arm's Length Price (ALP) of a transaction between two associated enterprises is the price that would be paid if the transaction had taken place between two comparable independent and unrelated parties.

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The Arm's Length Principle, in the context of taxation, is explained in the OECD Model Tax Convention as under:

Arm's Length Principle

"Where conditions are made or imposed between two associated enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

The OECD transfer pricing guidelines provides guidance on the application of the arm's length principle in order to arrive at the proper transfer pricing range between associated enterprises. Market forces determine business relations between independent parties. The arm's length principle seeks to adjust the profits between two associated enterprises by comparing the same as if the transaction is carried out between two independent enterprises. It treats each enterprise as a separate independent entity rather than as inseparable parts of a single unified business.

24.3 SIGNIFICANCE OF ARM'S LENGTH PRINCIPLE

There are several reasons as to why the OECD member countries and other countries have adopted the arm's length principle.

Parity between MNCs and independent enterprises – A major reason is that the ALP provides broad parity of tax treatment for MNCs and independent enterprises. Since the ALP puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages and disadvantages that would otherwise distort the relative competitive positions of these entities. The ALP, thus promotes the growth of international trade and investment by removing these tax considerations from economic decisions.

Determines real taxable profits - The transfer price adopted by a multinational has a direct bearing on the proportional profit it derives in each country in which it operates. If inadequate or excessive consideration is paid for the transfer of goods, services or intangible property between the members of an MNC group, the income calculated for each of those members will be inconsistent with their relative economic contributions. An 'arm's length' price is needed to determine real taxable profits earned in each country. The arm's length doctrine permits the taxing authorities to rectify the accounts of the enterprise so as to reflect correctly the income that the establishment would have earned if they were an independent enterprise.

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Reduction of artificial price distortion - If the ALP is not followed, an MNC will sell goods/ provide services to a controlled entity in a high tax jurisdiction at a high price (which exceeds the market price) and to an entity in a low-tax jurisdiction or a tax haven at a low price (which is lower than the market price). This would result in extreme price distortion of goods and services in the international market.

Accurate measurement of economic contribution – The ALP provides accurate measurement of the fair market value of the economic contribution units of an MNC. The focus of the ALP is to ensure that the proper amount of income is attributed to where it is earned. This result in each unit of the MNC earning a return commensurate with its economic contribution and risk assumed.

24.4 PRACTICAL DIFFICULTIES IN APPLICATION OF ALP

There are, however, certain practical difficulties in applying the ALP, which are described hereunder:

True comparison difficult in certain cases – The commercial and financial conditions governing a transaction between independent enterprises are, by and large, never similar to those existing between associated enterprises. As a result, there cannot be a true comparison. The economies of scale and integration of various business activities of the associated enterprise may not be truly appreciated by arm's length principle. Further, associated enterprises may enter into transactions which independent enterprises may not enter into, like say, licensing of valuable intangible or sharing the benefits of research. The owner of an intangible may be hesitant to enter into licensing arrangements with independent enterprises for fear of the value of the intangible being degraded. In contrast, he may be prepared to offer terms that are less restrictive to associated enterprises because the use of the intangible can be closely monitored. Further, there is no risk to the overall group's profit from a transaction of this kind between members of an MNC group. In such situations, where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the ALP is difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises.

Availability of data and reliability of available data – There may be difficulty in getting adequate and reliable information and data in order to apply arm's length principle. The information regarding the comparable companies, their profit margins, the pricing charged by them in independent and comparable circumstances may be difficult to obtain. Further, the differences in the accounting of the data could result in difficulty as the reliable adjustments may not be possible to be made.

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Absence of comparable market price for "intangible" transactions - The ALP reaches a comparable uncontrolled market price that is reasonably reliable for standard transactions where the price range is narrow and market price is certain. However, the ALP generally fails to achieve a comparable market price for transactions involving intangibles because they are unique. The unique nature of these transactions creates a very wide price range.

Administrative burden – Due to the subjectivity in selection of comparables and the methods, the application of arm's length principle results in administrative burden for the tax administration as well as the taxpayers.

Time lag - Although an associated enterprise normally establishes the conditions for a transaction at the time it is undertaken, at some point the enterprise may be required to demonstrate that these are consistent with the arm's length principle. The tax administration may also have to engage in the verification process perhaps some years after the transactions have taken place. It may result in substantial cost being incurred by the taxpayer and the tax administration. It is also difficult to appreciate the business realities which prevailed at the time when the transactions were entered into. This may lead to bias against the taxpayer.

In spite of the practical difficulties listed above, OECD member countries are of the view that the ALP does provide a sound basis to appreciate the transfer pricing between associated enterprises. It has so far provided acceptable solutions to both taxpayers and the tax administrations. The experience gained so far should be effectively used to remove the practical difficulties and improve the administration.

24.5 THE INDIAN SCENARIO

(1) Transfer pricing in relation to International Transactions

Finance Act, 2001 has introduced Chapter X to the Income-tax Act, 1961 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India so as to curb the pricing strategies adopted by the MNCs resulting in base erosion and profit shifting.

These provisions are contained in sections 92 to 92F of the Income-tax Act, 1961. Rules 10A to 10E have been inserted in the Income-tax Rules, 1962. These sections and rules of the Income-tax Act, 1961 and the Income-tax Rules, 1962, respectively, will affect all non-corporate and corporate assessees who have dealings with non-residents for import or export of goods, properties or services.

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The following conditions must be satisfied in order to attract the special provisions of Chapter X relating to avoidance of tax:

(i) There must be an international transaction;

(ii) Such international transaction should be between two or more associated enterprises either or both of whom are non-residents;

(iii) Such international transaction should be in the nature of:

- (a) purchase, sale or lease of tangible or intangible property; or
- (b) provision of service; or
- (c) lending or borrowing money; or
- (d) any other transaction having a bearing on the profits, income, losses or assets of such enterprise.

(iv) Further, such transaction can also involve allocation or apportionment of, or any contribution to any cost or expenses incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of the associated enterprises on the basis of mutual agreement or arrangement between such associated enterprises.

(v) Such international transaction must be done at arm's length price and if such international transaction has been done at less than the arm's length price, it shall require determination of income or apportionment of cost or expense on the basis of arm's length price.

(vi) The above adjustment should either result in an increase of income or decrease of loss returned by the assessee. In other words, the adjustment should not have the effect of reducing the income chargeable to tax or increasing the loss.

I. Computation of income from transaction with non-resident [Section 92]: Section 92 provides that any income arising from an "international transaction" shall be computed having regard to "the arm's length price". For this purpose, the allowance for any expense or interest shall be determined on the basis of arm's length price.

Transactions with associate enterprises should be at ALP

The section further provides that in an international transaction between two or more 'associated enterprises" when there is a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expenses in connection with a benefit, service or facility provided to any one or more of such enterprises, the

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allocation of cost, expenses etc. shall be determined having regard to arm's length price of such benefit, service or facility.

The objective of transfer pricing provisions is to protect the tax base of India and to ensure that due to inter-company transactions, there is no reduction in the taxable profits or the taxes paid by the Indian taxpayer.

It is, however, pertinent to note that the transfer pricing provisions would not be applicable if substitution of the ALP has the effect of reducing the income chargeable to tax or increasing the loss.

The Assessing Officer will have wide powers to determine what is an arm's length price for such transactions and make adjustments for computation of income. The keywords in section 92 are

(i) associated enterprises,

(ii) international transactions and

(iii) arm's length price.

These terms are defined in sections 92A, 92B and 92C.

II. Associated Enterprises [Section 92A]: Section 92A(1) defines the associated enterprises generally. Section 92A(2) provides 13 relationships between the enterprises which constitutes deemed associated enterprises.

The term "associated enterprise" in relation to another enterprise is defined in section 92A(1). Associated enterprises are those which are owned or controlled by the same or common entity/ person.

Associated Enterprises [Section 92A(1)]		
	Condition	**Example**
(1)	An enterprise which participates, directly or indirectly, or through one or more intermediaries, in: • management of the other enterprise, or • control of other enterprise, or • capital of other enterprise	*Where A Ltd. directly participates in the management of B Ltd. and B Ltd. directly participates in the management of C Ltd. In such situation, A Ltd. has direct participation in management of B Ltd. but has an indirect participation in management of C Ltd.* A → B → C *In such scenario, both B Ltd. and C Ltd. would be associated enterprises of A Ltd.*

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(2)	If one or more persons participates, directly or indirectly, or through one or more intermediaries in: • management/control/capital of the two different enterprises Then, those two enterprises are AEs.	*Mr. A directly has control in A Ltd. and B Ltd. In such a scenario, both A Ltd. & B Ltd. are associated enterprises since there is a common person i.e., Mr. A, who controls both entities A Ltd. & B Ltd.*

Two enterprises are deemed to be associated enterprises if they fall under any one or more of the situations contained in section 92A(2). This section provides 13 such situations during which associated enterprise relationship is deemed to be established. Two enterprises are deemed to be associated enterprise if:

Deemed Associated Enterprises [Section 92A(2)]		
Condition	**Situation**	**Example**
Enterprise ownership	**One enterprise holds 26% or more of the voting power,** directly or indirectly, in the **other enterprise.**	*A Ltd. holds 33% of Voting Power in B Ltd. and B Ltd. holds 80% Voting Power in C Ltd.* *In above situation, A Ltd. holds 26% or more voting power in B Ltd., directly and in C Ltd. indirectly (i.e. through B Ltd.). Therefore, both B Ltd. & C Ltd. are deemed associated enterprises of A Ltd.*
Substantial voting power in two entities by common person	Any person or enterprise **holds 26% or more of the voting power**, directly or indirectly, in each of **two different enterprises.**	*Mr. A holds 40% of voting power in both X Ltd. and Y Ltd. where neither X Ltd. has any holding in Y Ltd. nor Y Ltd. has any holding in X Ltd.* *In this situation, since Mr. A directly holds 40% of voting power in both X Ltd. and Y Ltd., X Ltd. & Y Ltd. will be deemed associated enterprises.*

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Advancing of substantial sum of money	One enterprise advances loan to the other enterprise of an amount of **51% or more** of the book value of **the total assets of other enterprise**	*Book Value of total assets of Y Ltd. is ₹ 100 crores. X Ltd. advances loan of ₹ 60 crores to Y Ltd.* *In this case, X Ltd. advances loan of ₹ 60 crores to Y Ltd, which is 60% of the book value of total assets of Y Ltd. Hence, X Ltd. & Y Ltd. are deemed associated enterprises.*
Guaranteeing borrowings	One enterprise guarantees **10% or more** of the **total borrowings** of the **other enterprise**.	*P Inc. has total loan of 1 million dollars from XYZ Bank of America. Out of that, A Ltd., an Indian company, guarantees 20% of total borrowings in case of any default made by P Inc. In such case, since A Ltd. guarantees 20% of total borrowings of P Inc., P Inc. and A Ltd. are deemed associated enterprises.*
Appointment of majority directors of other enterprise	One enterprise 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 **other enterprise**.	*X Ltd. has 15 directors on its Board. Out of that, Y Ltd. has appointed 8 directors. In such case, X Ltd. and Y Ltd. are deemed associated enterprises.*
Appointment of majority directors of two different enterprises by same person(s)	**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(s).**	*Mr. A appointed 9 directors out of 15 directors of X Ltd. and appointed 2 executive directors on the board of Y Ltd. In such case, since a common person i.e. Mr. A appointed more than half of the directors in X Ltd. and appointed 2 executive directors in Y Ltd., both X Ltd. and Y Ltd. are deemed associated enterprises.*
Dependence on intangibles w.r.t which other enterprise has exclusive rights	The **manufacture or processing of goods** or articles or business carried out by one enterprise is **wholly dependent (i.e. 100%) on the know-how**, patents, copyrights, trade-marks, licenses, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other entity is the owner or in respect of which the other enterprise has exclusive rights.	
Dependence on raw material supplied by	**90% or more of 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	

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other enterprise	enterprise, where the prices and other conditions relating to the supply are influenced by such other enterprise.	
Dependence on sale	The **goods or articles manufactured** or processed by one enterprise, **are sold to the other enterprise** or to persons specified by the other enterprise, and the **prices and other conditions** relating thereto are **influenced by such other enterprise.**	
Control by common individual	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 his relatives.	*Mr. A and Mr. B are relatives. Mr. A has control over X Ltd. and Mr. B has control over Y Ltd. Therefore, both X Ltd. and Y Ltd. will be deemed associated enterprises.*
Control by HUF or member thereof	Where one enterprise is **controlled by a HUF** and the **other enterprise is controlled** by a **member** of such HUF or by **relative of a member** of such HUF or jointly by such member and his relative.	 *A Ltd & B Ltd are deemed associated enterprises*
Interest in a firm, AOPs or BOIs	Where one enterprise is a firm, AOPs or BOIs, the **other enterprise** holds **10% or more interest** in **firm/AOPs/BOIs**.	
Mutual interest relationship	There exists **b/w the two enterprises**, any **relationship of mutual interest**, as may be **prescribed**.	

Meaning of Enterprise

The term "enterprise" is defined in section 92F(iii) to mean a person (including its certain specified Permanent Establishment) who is, or has been, or is proposed to be, engaged in any activity,

- relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copy rights, trade-marks, licences, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of

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which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or

- the provision of services of any kind, or in carrying out any work in pursuance of a contract, or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate,

whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places.

Meaning of PE

"Permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

III. Definition of International Transaction [Section 92B]

International Transaction

- As per section 92B, an international transaction means:
  - (i) a transaction between two or more associated enterprises, either or both of whom are non-residents; and
  - (ii) transaction in the nature of:
    - (a) sale/purchase/lease of tangible property; or
    - (b) sale/purchase/lease of intangible property; or
    - (c) provision of services; or
    - (d) lending/borrowing money; or
    - (e) any other transaction having a bearing on profits, income, losses or assets of such enterprises; or
    - (f) mutual agreement or arrangement between two or more associated enterprise 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

- Where, in respect of a transaction entered into by an enterprise with a person other than an associated enterprise (hereinafter referred to as "other person"),

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- there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise **or**,
- where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise; **and**
- either the enterprise or the associated enterprise or both of them are non-residents,

then such transaction entered into between the enterprise and the other person shall be **deemed to be an international transaction** entered into between two associated enterprises, **whether or not such other person is a non-resident.**

Example:

If A Ltd., an Indian company, has entered into an agreement for sale of product X to Mr. B, an unrelated party, on 1/6/2025 and Mr. B has entered into an agreement for sale of product X with C Inc., a non-resident entity, which holds 27% of the voting power in A Ltd., on 30/5/2025, then, the transaction between A Ltd. and Mr. B shall be deemed to be an international transaction entered into between two associated enterprises, irrespective of whether or not Mr. B is a non-resident.

Note *– C Inc. is deemed to be an associated enterprise of A Ltd. since it holds 26% or more of the voting power A Ltd.*

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- The scope of **"international transaction"** shall include:

	Transactions	Amplification of scope of terms used
(1)	Purchase, sale, transfer, lease or use of tangible property	Tangible property includes - • building, • transportation vehicle, • machinery, equipment, tools, plant, • furniture, • commodity or • any other article, product or thing;
(2)	Purchase, sale, transfer, lease or use of intangible property, including transfer of ownership or the provision of use of certain rights	"Use of certain rights" refer to – • land use, • copyrights, patents, trademarks, licences, franchises, • customer list, marketing channel, brand, commercial secret, • know-how, • industrial property right, • exterior design or practical and new design or • any other business or commercial rights of similar nature.
(3)	Capital financing	• any type of long-term or short-term borrowing, • lending or guarantee, • purchase or sale of marketable securities or • any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business.
(4)	Provision of services	• provision of market research, • market development, • marketing management, • administration, • technical service, • repairs, • design, • consultation,

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		• agency, • scientific research, • legal or accounting service.
(5)	Business restructuring or reorganization entered into by an enterprise with an associated enterprise	All such transactions are included in the definition of "international transaction", whether or not it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.

- The expression "**intangible property"** shall include:

	Type of intangible asset in relation to	Examples of each type of intangible asset
(1)	Marketing	• Trademarks • trade names • brand names • logos
(2)	Technology	• Process patents • patent applications • technical documentation such as laboratory notebooks • technical know-how
(3)	Artistic	• literary works and copyrights • musical compositions • copyrights • maps • engravings
(4)	Data processing	• proprietary computer software • software copyrights • automated databases • integrated circuit masks and masters
(5)	Engineering	• industrial design • product patents • trade secrets • engineering drawing and schematics • blueprints • proprietary documentation

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(6)	Customer	• customer lists • customer contracts • customer relationship • open purchase orders
(7)	Contract	• favourable supplier • contracts, • licence agreements • franchise agreements • non-compete agreements
(8)	Human capital	• trained and organised work force • employment agreements • union contracts
(9)	Location	• leasehold interest • mineral exploitation rights • easements • air rights • water rights
(10)	Goodwill	• institutional goodwill • professional practice goodwill • personal goodwill of professional • celebrity goodwill • general business going concern value
(11)	methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, or technical data;	
(12)	any other similar item that derives its value from its intellectual content rather than its physical attributes.	

- **Transaction:** The word "transaction" has been defined in section 92F to include an arrangement, understanding or action in concert

  (i) whether or not such arrangement, understanding or action is formal or in writing; or

  (ii) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings."

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Section 92F(v) provides an inclusive definition of the term "transaction". Based on the reading of the section, it is evident that it is not necessary that for a transaction undertaken between two enterprises there needs to be a formal written agreement between them. It is only relevant whether a transaction has been entered into in substance. The section also negates the requirement as to the legal enforceability of agreement or understanding.

It may be noted that one of the parties to the international transaction should be a non-resident. Therefore, transactions between a resident assessee ("A" Ltd.) and its foreign branches or between its two or more foreign branches will not be considered as international transactions. This is for the reason that when "A" Ltd. is a resident in India, all its foreign branches will be deemed to be resident in India and transactions between Head Office and branches or between branches *inter se* will be considered as transactions between residents. Even otherwise there can be no avoidance of income in the transactions between Indian Head Office and foreign branches.

On the other hand, if an Indian branch of a foreign company ("B" Ltd.) is having a transaction with the Head Office, the same will be covered by the definition of international transaction between associated enterprises. This is because the Indian branch (permanent establishment of "B" Ltd.) will be liable to tax in India in respect of its Indian operations and, therefore, any transaction between the Indian branches of "B" Ltd. with its head office in foreign country or with any of the branches of "B" Ltd. outside India will be considered as an international transaction and it will have to establish that the transaction is at an arm's length price. This will be the position even in respect of transactions between a parent company ("A" Ltd.) and its foreign subsidiary and, therefore, such transactions will have to comply with the provisions of transfer pricing regulations.

IV. Arm's Length Price [Section 92C]: "Arm's length price" is defined in section 92F(ii) to mean price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions. Section 92C deals with the method for determining arm's length price and the factors which are to be considered for applicability or non-applicability of a particular method to a given situation. The factors as well as methods incorporated in this section are not exhaustive and the CBDT may prescribe further factors and methods. It provides that the arm's length price in relation to an international transaction would be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of

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transaction or class of associated persons or functions performed by such persons or such other relevant factors as the CBDT may prescribe, 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.

Accordingly, the CBDT has prescribed that the other method for determination of arm's length price in relation to an international transaction would be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts [Rule 10AB].

Section 92C(2) provides that the most appropriate method out of the above methods has to be applied for determination of arm's length price, in the prescribed manner.

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Rule 10B(1) prescribed the manner to determine the arm's length price under the five methods as stated in above diagram in respect of any goods, property or services purchased or sold under any international transaction.

(a) Comparable Uncontrolled Price Method

ILLUSTRATION 1

US Ltd., a US company has a subsidiary, IND Ltd. in India. US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd. also sells computer monitors to CMI Ltd., another computer reseller. It sells 50,000 computer monitors to IND. Ltd. at ₹ 11,000 per unit. The price fixed for CMI Ltd. is ₹ 10,000 per unit. The warranty in case of sale of monitors by IND Ltd. is handled by IND Ltd. However, for sale of monitors by CMI Ltd., US Ltd. is responsible for the warranty for 3 months. Both US Ltd. and IND Ltd. offer extended warranty at a standard rate of ₹ 1,000 per annum. On these facts, how is the assessment of IND Ltd. going to be affected?

SOLUTION

US Ltd., the foreign company and IND Ltd., the Indian company are associated enterprises since US Ltd. is the holding company of IND Ltd. US Ltd. sells computer monitors to IND Ltd. for resale in India. US Ltd. also sells identical computer monitors to CMI Ltd., which is not an associated enterprise. The price charged by US Ltd. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm's length price can be applied.

While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e. transaction between US Ltd. and IND Ltd.) and uncontrolled transaction (i.e. transaction between US Ltd. and CMI Ltd.) and the price so adjusted shall be the arm's length price for the international transaction.

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For sale of monitors by CMI Ltd., US Ltd. is responsible for warranty for 3 months. The price charged by US Ltd. to CMI Ltd. includes the charge for warranty for 3 months. Hence arm's length price for computer monitors being sold by US Ltd. to IND Ltd. would be:

Particulars	No.	₹
Sale price charged by US Ltd. to CMI Ltd.		10,000
Less: Cost of warranty included in the price charged to CMI Ltd. (₹ 1,000 x 3 /12)		250
Arm's length price		**9,750**
Actual price paid by IND Ltd. to US Ltd.		11,000
Difference per unit		**1,250**
No. of units supplied by US Ltd. to IND Ltd.	50,000	
Addition required to be made in the computation of total income of IND Ltd. (₹ 1,250 × 50,000)		6,25,00,000

No deduction under Chapter VI-A would be allowable in respect of the enhanced income of ₹ 6.25 crores.

Note: *It is assumed that IND Ltd. has not entered into an advance pricing agreement or opted to be subject to Safe Harbour Rules.*

(b) Resale Price Method

Under this method, 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 should be identifiable.

The following adjustments can be made to such resale price.

- For normal gross profit margin
- For expenses incurred in connection with the purchase of property or obtaining of services.
- For functional and other differences, including differences in accounting practices which could materially affect the gross profit margin in the open market.

The adjusted price as stated above will be considered as the arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

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ILLUSTRATION 2

Earth (P) Ltd., Calcutta is engaged in trading of electronic goods. It purchased goods from its associated enterprise Sun Pte. Ltd., Singapore, and also from unrelated party, Oceania Ltd., UK. For the F.Y.2025-26, the gross profit margin was 15% on the sale of goods of Sun Pte Ltd., whereas it was 20% in the case of Oceania Ltd. After-sales warranty of 6 months was provided by Sun Pte Ltd. whereas Oceania Ltd. gave after-sales warranty of 1 year. The cost of warranty may be taken as 2% of the sale price. The Sun Pte. Ltd.'s brand value is internationally known and the benefit of the brand value can be taken as 1% of sale price. During the F.Y.2025-26, it sold goods of Sun Pte Ltd. for ₹ 20 crores and of Oceania Ltd. for ₹ 15 crores. As regards transport cost of the goods purchased, there was no difference between related and unrelated party. Compute the ALP of the transaction between Earth (P) Ltd. and Sun Pte Ltd., Singapore by applying the Resale Price Method, considering the facts of the case.

SOLUTION

As per section 92B, the transactions entered into between Earth (P) Ltd., an Indian company, and Sun Pte. Ltd., Singapore, being associated enterprises, for purchase of electronic goods would be international transaction.

Since Earth (P) Ltd. purchased similar electronic goods from Oceania Ltd., an unrelated entity, and sold the same to unrelated parties, this transaction can be considered as uncontrolled transaction and the gross profit margin of 20% earned on sale of such goods can be considered for the purpose of determining the arm's length price of the transactions between Earth (P) Ltd. and Sun Pte. Ltd. However, functional adjustments need to be given effect to in arriving at the ALP.

Computation of ALP of transaction between Earth (P) Ltd. and Sun Pte. Ltd.

Particulars	Amount (In ₹)
Resale price of goods purchased from Sun Pte. Ltd.	20,00,00,000
Less: Profit margin with reference to uncontrolled transaction between Earth (P) Ltd. and Oceania Ltd. (20% on sale)	4,00,00,000
	16,00,00,000
Add: Adjustment for benefit of brand value of Sun Pte. Ltd. [Sun Pte. Ltd has its brand value internationally. Therefore, adjustment of benefit of brand value has to be carried out to arrive at ALP (1% of sale price)]	20,00,000
Less: Adjustment of cost of warranty [Sun Pte. Ltd. provides warranty for 6 months whereas unrelated party has provided warranty of 12 months. Therefore, adjustment for the cost of such warranty has to be carried out to arrive at arm's length price (2% of sale price x 6/12)]	(20,00,000)
Arm's length price	**16,00,00,000**

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(c) Cost Plus Method

ILLUSTRATION 3

ABC Ltd., Canada holds 35% shares in LMN Ltd., India. LMN Ltd. develops software and does both onsite and offsite consultancy services for the customers. LMN Ltd. during the year billed ABC Ltd. Canada for 120 man-hours at the rate of ₹1,800 per man hour. The total cost (direct and indirect) for executing this work amounted to ₹2,25,000.

However, LMN Ltd. billed XYZ Ltd., India at the rate of ₹2,800 per man hour for the similar level of manpower and earned a Gross Profit of 50% on its cost.

The transactions of LMN Ltd. with ABC Ltd. and XYZ Ltd. are comparable, subject to the following differences:

- *While LMN Ltd. derives technology support from the ABC Ltd., there is no such support from XYZ Ltd. The value of technology support received from ABC Ltd. may be put at 18% of normal gross profits.*
- *As ABC Ltd. gives business in large volumes, LMN Ltd. offered to ABC Ltd., a quantity discount which may be valued at 10% of normal gross profits.*
- *In the case of rendering services to ABC Ltd., LMN Ltd. neither runs any risk nor incurs any marketing costs. On the other hand, in the case of services to XYZ Ltd., LMN Ltd. has to*

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assume all the risk and costs associated with the marketing function which may be estimated at 12% of the normal gross profits.

- *LMN Ltd. offered one month credit to ABC Ltd. The cost of providing such credit may be valued at 2% of the gross profits. No such credit was given to XYZ Ltd.*

Compute the Arm's Length Price along with income to be increased under the Cost Plus Method.

SOLUTION

LMN Ltd, an Indian company and ABC Ltd., a Canadian company, are deemed to associated enterprises as per section 92A(2), since ABC Ltd. holds shares carrying 35% of the voting power (i.e., not less than 26% of voting power) in LMN Ltd. Further, the transaction of developing software and providing consultancy services (both onsite and offsite) fall within the meaning of "international transaction" under section 92B. Hence, transfer pricing provisions would be attracted in this case.

Computation of Arm's Length Price as per Cost Plus Method		
Gross Profit mark-up on cost in case of XYZ Ltd. [an unrelated party]		50%
Less: Adjustments for functional and other differences		
- Value of technology support [ABC Ltd. provides technology support, but XYZ Ltd. does not provide such support. Therefore, value of technology support shall be adjusted] [18% of 50%, being gross profit]	9%	
- Quantity discount to ABC Ltd. [Quantity discount is allowed to ABC Ltd. as it gives business in large volumes, but the same is not provided to XYZ Ltd. Therefore, it shall be adjusted] [10% of 50%, being gross profit]	5%	
- Risk and cost associated with marketing [LMN Ltd. has to bear all the risk and costs associated with the marketing function in case of XYZ Ltd., while there is no such risk in case of services to ABC Ltd. Therefore, market risk and cost shall be adjusted] [12% of 50%, being gross profit]	6%	
		20%
		30%
Add: Cost of credit to ABC Ltd. [LMN Ltd has provided credit of 1 month to ABC Ltd. but not to the unrelated party. Therefore, adjustment for the cost of such credit has to be carried out to arrive at the ALP] [(2% of 50%, being gross profit]		1%
Arm's length gross profit mark up to cost		**31%**

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Cost incurred by LMN Ltd. for executing ABC Ltd.'s work		2,25,000
Add: Adjusted gross profit (₹ 2,25,000 x 31%)		69,750
Arm's length billed value		**2,94,750**
Less: Actual Billed Income from ABC Ltd. (₹ 1800 x 120 man hours)		2,16,000
Total Income of LMN Ltd to be increased by		**78,750**

(d) Profit Split Method

This is a method which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction.

Under this method, combined net profit of the associated enterprises arising from the international transactions in which they are engaged is first determined.

The relative contribution of each associated enterprise to the earning of such combined net profit is then evaluated on the basis of the functions performed, assets employed and risks assumed by each enterprise. This evaluation is to be made on the basis of reliable external market data which can indicate how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances.

The combined net profit is then split amongst the enterprises in proportion to their relative contributions. The profit thus apportioned to the assessee is taken into consideration to arrive at an arm's length price in relation to the international transaction.

In certain cases the combined net profit referred to in second box may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged. This has to be determined with reference to market returns achieved for similar types of transactions by independent enterprises. Thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises as stated in third and fourth box. In such a case the aggregate of net profit allocated in the first instance together with the residual profit apportioned should be considered for arriving at the arm's length price of the international transaction.

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(e) Transactional Net Margin Method

In this method, the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise is computed having regard to costs incurred or sales effected or assets employed or having regard to any other relevant base.

The net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction by applying the same base as computed above. This profit margin is adjusted to take into account the differences which could materially affect the net profit margin in the open market having regard to international transaction and comparable uncontrolled transactions or having regard to the enterprise entering into such transactions.

If the net profit margin realised by the enterprise as in first box is established to be the same as the net profit margin as in second box, then the same is taken into consideration to arrive at an arm's length price in relation to the international transaction.

ILLUSTRATION 4

Andes Inc. having its business in Malaysia has advanced a loan of MD 1,60,000 to Andes Ltd, India. Book value of total assets of Andes Ltd was ₹ 125 lakhs. Andes Ltd provides software backup support to Andes Inc. Andes Ltd has spent 50,000 man hours during the financial year 2025-26 for the services rendered to Andes Inc. The cost for Andes Ltd is MD 75/manhour. Andes Ltd has billed Andes Inc. at MD 90.75/manhour.

Gama Ltd. in India which has a similar business model, provides software backup support to Olive Inc. in Penang, Malaysia. Gama Ltd.'s cost and operating profits are as hereunder:

Particulars	₹ in lakhs
Direct costs	600
Indirect costs	200
Operating profits	200

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(1) Calculate Arm's Length Price for the transaction between Andes Ltd. and Andes Inc. based on the above data of Gama Ltd. using the Transactional Net Margin Method. Assume 1 MD = ₹ 45.

(2) Explain, if there is any adjustment to be made to the total income of Andes Ltd.

Note: *MD = Malaysia Dollars*

SOLUTION

Two enterprises are deemed to be associated enterprises where one enterprise advances loan constituting not less than 51% of the book value of the total assets of the other enterprise.

In this case, since Andes Inc., a foreign company, has advanced loan to Andes Ltd., an Indian company, and such loan constitutes 57.6% [(₹ 45 x 1,60,000 x 100/1,25,00,000] of the book value of total assets of Andes Ltd., Andes Inc and Andes Ltd. are deemed to be associated enterprises. Since the transaction of provision of software backup support by Andes Ltd. to Andes Inc. is an international transaction between associated enterprises the provisions of transfer pricing would be attracted in this case.

Determination of Operating Margin of transaction of provision of software backup support by Andes Ltd. to Andes Inc

Particulars	₹
Billing per manhour [MD 90.75/hour x ₹ 45]	4,083.75
Cost per man hour [MD 75/hour x ₹ 45]	3,375.00
Operating profit per manhour	**708.75**
Operating profits to cost (%) **[708.75 x 100/3375] = 21%**	

Determination of Operating Margin of Comparable Uncontrolled transaction i.e., provision of software backup support. by Gama Ltd. to Olive Inc.

Particulars	₹ in lakhs
Direct Cost	600
Indirect Cost	200
Total cost	**800**
Operating profits	200
Operating profits to cost (%) **[200 x 100/800] = 25%**	

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(1) Computation of Arm's Length Price of provision of software backup support provided by Andes Ltd. to Andes Inc. by applying TNMM

Particulars	₹
Cost for Andes Ltd. (per man hour) [MD 75 x ₹ 45/MD]	3,375.00
Add: Arm's length operating profit margin as % of cost (25% of ₹ 3,375)	843.75
Arm's length price (per manhour) in ₹	**4,218.75**
Arm's length price of total manhours spent by Andes Ltd. for providing software backup support to Andes Inc. [₹ 4,218.75 x 50,000 man hours] = ₹ 21,09,37,500	

(2) Adjustment to be made to the total income of Andes Ltd.

Particulars	₹
Arm's length price of total manhours spent by Andes Ltd. for providing software backup support to Andes Inc.	21,09,37,500
Less: Amount actually billed [90.75 MD x ₹ 45/MD x 50,000 manhours]	20,41,87,500
Arm's length adjustment to be made to the total income of Andes Ltd.	**67,50,000**

(f) Other Method as may be prescribed by the CBDT

The Other method allows the use of 'any method' which takes into account

(i) the price which has been charged or paid or

(ii) would have been charged or paid for the same or similar uncontrolled transactions with or between non-associated enterprises, under similar circumstances.

The various data which may possibly be used for comparability purposes under this method could be third party quotations, valuation reports, tender/Bid documents, documents relating to the negotiations, standard rate cards, commercial & economic business models; etc.

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Methods for computing ALP [Section 92C]

CUP Method	Resale Price Method(RPM)	Cost Plus Method (CPM)	Profit Split Method (PSM)	Transactional Net Margin Method (TNMM)
This method is applied where there are similar transaction(s) b/w unconnected parties	This method is applied where item obtained from AE is resold to unrelated party	This method is generally applied where semi-finished goods are sold to AEs	This method is applied where there is transfer of unique intangibles or in multiple International Transaction	Compute Net Profit (NP) margin of the enterprise from International Transaction with AE having regard to cost incurred/sales effected/ assets employed
Identify price in a comparable uncontrolled transaction (CUCT)	Identify the Resale Price (RP) at which the item is resold to unrelated party	Identify direct & indirect cost of production incurred for property transferred or services provided to AE	Determine combined NP of the AEs arising out of International Transaction	Compute the NP margin realised by the enterprise or unrelated enterprise in a CUCT by applying the same base
	Reduce the RP by the normal Gross Profit (GP) margin on CUCT & expenditure incurred (customs duty) w.r.t. purchase	Determine normal GP mark up to such costs by an unrelated enter in CUCT	Evaluate the relative contribution of each enterprise to the earning of combined NP on the basis of FAR	Adjust NP margin realised from CUCT to a/c for differences affecting NP margin in the OM
Adjust the price for material differences in terms of contract, credit, transport etc.	Adjust the price for functional & other differences materially affecting GP margin in open market (OM)	Adjust the normal GP mark-up for functional and other differences materially affecting GP mark-up in OM	Split the combined NP amongst the enterprise in proportion to market returns; & residual profits in proportion to their relative contribution	Compare NP margin relative to costs/sales/assets of the AE with NP margin of uncontrolled party in comparable transactions
Adjusted price is ALP	Adjusted price is ALP	Total Costs ↑d by adjusted mark up = ALP	ALP to be detd. on the basis of profit apportioned.	Adjusted NP margin taken into A/c to arrive at ALP

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Determination of the most appropriate method: Rule 10C deals with the determination of most appropriate method. Under this Rule, the method which is best suited to the facts and circumstances and which provides the most reliable measure of an arm's length price in relation to the international transaction will be considered to be the most appropriate method.

For the purpose of selecting the most appropriate method, the following factors should be taken into account.

(i) The nature and class of the international transaction;

(ii) The class, or classes of associated enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises;

(iii) The availability, coverage and reliability of data necessary for application of the method;

(iv) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions;

(v) The extent to which reliable and accurate adjustments can be made to account for difference, if any, between the international transaction and the comparable uncontrolled transaction or between the enterprises entering into such transactions;

(vi) The nature, extent and reliability of assumptions required to be made in application of a method.

Manner of computation of Arm's length price (Applicable for international transactions and specified domestic transactions undertaken on or after 1.4.2014) [Third proviso to section 92C(2)]

In case of an international transaction or specified domestic transaction[1] undertaken on or after 1.4.2014, where more than one price is determined by the most appropriate method, the ALP would be computed in the prescribed manner specified in Rule 10CA.

Computation of arm's length price in certain cases [Rule 10CA]

[1] discussed later in this Chapter

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Rule 10CA(1) provides that where in respect of an international transaction or a specified domestic transaction, the application of the most appropriate method referred to in section 92C(1) results in determination of more than one price, then, the arm's length price in respect of such international transaction or specified domestic transaction has to be computed on the basis of the dataset constructed by placing such prices in an ascending order as provided in Rule 10CA(2).

Application of multiple year data for construction of dataset

Multiple year data allowed only in cases where determination of ALP is done using TNMM, RPM or CPM

Data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction

The data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction should relate to the financial year (current year) in which the international transaction has been entered into.

In case the most appropriate method for determination of ALP of a transaction entered into on or after 1.4.2014 is the **resale price method** or **cost plus method** or **the transactional net margin method**, then, the data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction shall be –

(a) the data relating to the current year; or

(b) the data relating to the financial year immediately preceding the current year, if the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the assessment year relevant to the current year.

However, where the data relating to the **current year is subsequently available** at the time of determination of arm's length price of an international transaction **during the course of any assessment proceeding** for the assessment year relevant to the current year, then, **such data shall be used** for such determination **irrespective of the fact that the data was not available** at the time of furnishing the return of income of the relevant assessment year.

For the data relating to the current year, where the comparable uncontrolled transaction has been identified and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred

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to in sub-rule (1)], has in either or both of the two financial years immediately preceding the current year undertaken the same or similar comparable uncontrolled transaction then,-

(i) the most appropriate method used to determine the price of the comparable uncontrolled transaction undertaken in the aforesaid period and the price in respect of such uncontrolled transactions has to be determined; and

(ii) the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the current year and in the aforesaid period preceding it has to be included in the dataset instead of the price referred to in sub-rule (1).

Further, where the comparable uncontrolled transaction has been identified **on the basis of the data relating to the financial year immediately preceding the current year** and the enterprise undertaking the said uncontrolled transaction, [not being the enterprise undertaking the international transaction or the specified domestic transaction referred to in sub-rule (1)], has in the financial year immediately preceding the said financial year undertaken the same or similar comparable uncontrolled transaction then, -

(i) the price in respect of such uncontrolled transaction shall be determined by applying the most appropriate method in a similar manner as it was applied to determine the price of the comparable uncontrolled transaction undertaken in the financial year immediately preceding the current year; and

(ii) the weighted average of the prices, computed in accordance with the manner provided in sub-rule (3), of the comparable uncontrolled transactions undertaken in the aforesaid period of two years shall be included in the dataset instead of the price referred to in sub-rule (1).

Also, in such cases, where the use of data relating to the current year for determination of ALP subsequently at the time of assessment establishes that,-

(i) the enterprise has not undertaken same or similar uncontrolled transaction during the current year; or

(ii) the uncontrolled transaction undertaken by an enterprise in the current year is not a comparable uncontrolled transaction,

then, irrespective of the fact that such an enterprise had undertaken comparable uncontrolled transaction in the financial year immediately preceding the current year or the financial year immediately preceding such financial year, the price of comparable uncontrolled transaction or the

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weighted average of the prices of the uncontrolled transactions, as the case may be, undertaken by such enterprise shall **not** be included in the dataset.

Rule 10CA(3) provides that where an enterprise has undertaken comparable uncontrolled transactions in more than one financial year, then for the purposes of constructed the dataset, the weighted average of the prices of such transactions would be computed in the following manner, namely:-

	Method used to determine the prices	Manner of computation of weighted average of the prices
(i)	The resale price method	By assigning weights to the quantum of sales which has been considered for arriving at the respective prices
(ii)	The cost plus method	By assigning weights to the quantum of costs which has been considered for arriving at the respective prices
(iii)	The transactional net margin method	By assigning weights to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices.

Range Concept: Rule 10CA(4) provides that where the most appropriate method applied is –

(i) a method other than the profit split method or a method prescribed by the CBDT under section 92C(1)(d)/(f); and

(ii) the dataset constructed in accordance with sub-rule (2) consists of six or more entries,

an arm's length range beginning from the thirty-fifth percentile of the dataset and ending on the sixty-fifth percentile of the dataset would be constructed.

If the price at which the international transaction or the specified domestic transaction has actually been undertaken is within the said range, then, the price at which such international transaction or the specified domestic transaction has actually been undertaken would be deemed to be the arm's length price [Rule 10CA(5)].

If the price at which the international transaction or the specified domestic transaction has actually been undertaken is outside the said arm's length range, the arm's length price shall be taken to be the median of the dataset [Rule 10CA(6)].

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When to apply range concept?

- Most appropriate method selected is Comparable uncontrolled price method, resale price method, cost plus method or transactional net margin method and
- The dataset constructed has six or more entries.

How to apply?

- Arrange the values in the dataset in the ascending order.
- Where the actual transaction price falls within 35th and 65th percentile of the dataset, the value of transaction will be accepted to be arm's length price.
- Where the transfer price does not fall within the above range, then median of dataset shall be taken as the Arm's Length price.

Range concept not applicable:

In a case where the provisions of Rule 10CA(4) are not applicable [i.e. most appropriate method is profit split method or any other method or the dataset has less than 6 entries], the arm's length price shall be the arithmetical mean of all the values included in the dataset. However, if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed such percentage not exceeding 3% of the latter, as may be notified by the Central Government in the Official Gazette in this behalf, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price [Rule 10CA(7)].

Meaning of certain terms [Rule 10CA(8)]

	Term	Meaning
(a)	the thirty-fifth percentile of a dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 35% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the thirty-fifth percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.
(b)	the sixth-fifth percentile of a dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 65% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the sixty-fifth percentile shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.

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(c)	the median of the dataset (having values arranged in an ascending order)	The lowest value in the dataset such that at least 50% of the values included in the dataset are equal to or less than such value. However, if the number of values that are equal to or less than the aforesaid value is a whole number, then, the median shall be the arithmetic mean of such value and the value immediately succeeding it in the dataset.

Comparability Analysis

The comparability of the international transaction with an uncontrolled transaction is to be judged with reference to the following factors:

(i) The specific characteristics of the property transferred or services provided in either transaction;

(ii) The functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(iii) The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

(iv) Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, the laws and Government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

As per Rule 10B(3), an uncontrolled transaction should be considered comparable to the international controlled transaction only if there are no material differences (in terms of functions, assets and risks) between the transactions being compared or the enterprises entering into such transactions which would materially affect the prices or costs charged or paid in, or the profit arising from, such transactions in the open market.

It, further, provides that in a case there are any such material differences, reasonably accurate adjustments should be made to eliminate such material differences in order to compare the controlled and the uncontrolled transactions.

Comparable uncontrolled transactions could be of two types - Internal or external.

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(a) **Internal comparables:** These are the comparable transactions between one of the parties to the controlled transaction, (taxpayer or the AE) and an independent third party. These comparables are considered a good measure of comparability as it is likely that the Functions, Assets, Risks analysis (FAR analysis) of the comparable transaction would be similar to that of the controlled transaction due to the involvement of a common entity to the said two transactions. Even though internal comparables may offer a higher degree of comparability, there is a need of rigorous scrutiny like in external comparables and suitable adjustments should be made, wherever necessary.

(b) **External comparables:** These are the comparable transactions between two independent parties, neither of which is a party to the controlled transaction. Generally, the level of comparability offered in the external comparables is not as precise as internal comparables; however, this rule is not absolute. For instance, it may so happen that an entity offers a certain variation of its product exclusively to its AE and a slightly different variation to unrelated parties. In such a situation, preference should be given to external comparables involving the identical product and identical contractual terms than accepting the internal comparable.

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In the above example, Transaction between AE1 and AE2 are subject to transfer pricing. AE1 and AE2 are parties to a controlled transaction. Transaction #1 and #2 are internal uncontrolled transactions since it is entered by AEs with unrelated parties.

Transaction #3 is external uncontrolled transactions since it is entered between unrelated parties.

Process for identification and selection of external comparables:

Wherever internal comparables are available, preference should be given to internal comparables in the process of determination of ALP. However, in the absence of the same, recourse has to be taken to search for external comparables. The transfer pricing legislation in India does not prescribe a particular process for selection of such comparables. However, various decisions of the judicial authorities have provided guidance on how to carry out such process based on the data available in public domain. The major steps involved in the search process are discussed hereunder:

Step 1: Selection of database

A database is a domain where information (financial and non-financial) about companies is maintained in an organised manner so as to facilitate easy search for data and also for the application of the relevant filters. Some of the commonly used databases in India are as under:

(a) **Capitaline Plus/ Capitaline TP:** It contains digital database of over 35,000 companies. It includes information of public, private, co-operative and joint sector companies, listed or otherwise.

(b) **Prowess:** Prowess is a database of the financial performance of Indian companies. Audited Annual Reports of companies and information submitted to the MCA; and in the case of listed companies, company filings with stock exchanges and prices of securities listed on the major stock exchanges are the sources of the database. The database contains information on all listed companies and a larger set of unlisted companies.

(c) **ACE TP Database:** ACE TP database contains information, both financial and non-financial of companies and sectors. It also contains information regarding equity and commodity and derivative markets.

There are other available Indian and foreign databases also like Prowess Pro, Amadeus, Royalty Stat, Compustat Global, Osiris, ktmine, Oriana, Bloomberg etc. which can be referred.

Step 2: Application of quantitative filters

The application of the quantitative filters help in filtering the companies available in the database based on the similarity of the quantitative information

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between the tested party and the potential comparables. Some of the commonly used quantitative filters are:

(a) **Availability of financial data:** The companies whose financial information for the relevant period (financial year of the controlled transaction or the preceding two years as the case may be) are not available in the public domain should not be considered in the comparability analysis.

(b) **Industry of the tested party:** The appropriate industry head should be selected. For instance, if the tested party operates in the seed segment, it should be ensured that various industry heads which could include comparable companies should be chosen, i.e. seeds, agriculture etc. Therefore, while applying this filter, the parameters should be fairly broad.

(c) **Turnover filter:** This is perhaps the most commonly used quantitative filter in the search process. This is for the reason that companies which are operating in the same range of turnover would have similar share in the market and thus are more likely to have somewhat similar margins. On the other hand, companies with extremely high or low turnover would not provide an effective base for comparison since their margins would not only reflect the efficiency of their business but also the scale of the operations. The range of the filter is very subjective and varies with the facts of each case.

(d) **Net worth filter:** Net worth of a company can be used to determine the creditworthiness of the company. Negative net worth would indicate that the debts of the company have surpassed its assets. Therefore, a company with consistent negative net worth should be rejected in the comparability analysis since its margins would be adversely affected and it would ordinarily be difficult to quantify and adjust the effect of its negative worth on the margins. Companies with negative net worth are usually rejected in this filter.

(e) **Export filter:** The parameter of 'geographic location of market' has lead to adoption of 'export turnover filter' whereby Transfer Pricing Officers ('TPOs') insist that if the taxpayer is an exporter then the comparables should also have export earnings of a certain degree. The export activity levels, by itself, cannot be a valid filter unless it is established that the market to which the exports are made are materially different from the domestic market.

(f) **Employee expense filter:** The employee expense ratio helps to analyse the level of activities and intensity of employee dependence.

(g) **Related party transactions:** As already discussed, a transaction between two related parties cannot be taken as a comparable uncontrolled transaction for the purpose of benchmarking a controlled transaction. This filter finds its application on the same principle,

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i.e., if a potential comparable has substantial related party transactions, it can be inferred that its margins are contaminated with transactions which are not entirely governed by the market forces and thus such a company should be rejected in the search process.

(h) **Consistently loss making companies:** The companies which are incurring losses on a consistent basis cannot be considered as good comparables as their profitability is adversely impacted by factors which are not specific to the industry but to the entity. However, loss in just one year would not be indicative of any extra ordinary factors surrounding the company and therefore such a company should not be rejected on that count alone.

Step 3: Application of qualitative filters

The entities remaining after the application of the quantitative filters are further narrowed down by applying the qualitative filters. Some of the commonly used qualitative filters are as under:

(a) **Product filter:** Although the industry filter excludes the companies not operating in the same industry but at the same time there are entities producing a variety of products in the same industry and therefore in order to reach a precise measure of comparability, the list of companies should be further shortlisted to exclude the companies not dealing in the same/similar products as that of the tested party. For instance, for a tested party trading in seeds, the industry filter to be applied could be agri-trading. However, this filter might result in companies engaged in various types of agricultural products such as fertilizers, pesticides etc. In order to remedy this, product criteria would be applied to only select the companies engaged in trading of seeds in the agriculture industry.

(b) **Functional filter:** The chosen companies must be further analyzed to select only those companies which are functionally similar to the tested party. The functions could be in the form of manufacturing of goods, rendering of services, trading in goods etc. Thus, the filter to be applied depends on the functions performed by the tested party to find transactions which are functionally similar.

(c) **Ownership (Government or private):** Generally, entities in the private sector exist for generating profits. Government owned entities on the other hand, function to serve the society and are not necessarily driven by the profit motive. Accordingly, such companies should be included/ excluded based on their comparability analysis like the other private companies.

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V. Reference to Transfer Pricing Officer [Section 92CA]: This section provides for a procedure for reference to a Transfer Pricing Officer (TPO) of any issue relating to computation of arm's length price in an international transaction. The procedure is as under -

(1) The option to make reference to TPO is given to the Assessing Officer. Where the assessee has entered into an international transaction in any previous year and if Assessing Officer considers it necessary or expedient to do so, he may refer the computation of the arm's length price in relation to the said international transaction to the TPO. This option is not, however, available to the assessee.

(2) The Assessing Officer has to take the approval of the Principal Commissioner of Income-tax (PCIT)/Commissioner of Income-tax (CIT) before making such a reference.

(3) Any Joint/Deputy/Assistant Commissioner of Income-tax, authorised by CBDT, can be appointed as TPO.

(4) When such reference is made, TPO would serve a notice to the assessee requiring him to produce on a date specified in the notice, any evidence on which the assessee relied in support of the computation of arm's length price made by him in relation to the international transaction.

(5) The TPO can also determine the ALP of other international transactions identified subsequently in the course of proceedings before him as if such transaction is an international transaction referred to the TPO by the Assessing Officer under section 92CA(1) [Sub-section (2A)].

(6) Where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the TPO during the course of proceeding before him, the transfer pricing provisions shall apply as if such transaction is an international transaction referred to the TPO by the Assessing Officer under section 92CA(1) [Sub-section (2B)].

(7) The TPO has to pass an order determining the arm's length price after considering the evidence, documents, etc. produced by the assessee and after considering the material gathered by him. He has to send a copy of his order to Assessing Officer as well as the assessee.

(8) The order of the Transfer Pricing Officer determining the arm's length price of an international transaction is binding on the Assessing Officer and the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer [Sub-section (4)].

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(9) In order to provide sufficient time to the Assessing Officer to complete the assessment in a case where reference is made to the Transfer Pricing Officer, section 92CA(3A) provides for determination of arm's length price of international transactions by the Transfer Pricing Officer at least 60 days before the expiry of the time limit under section 153 or section 153B for making an order of assessment by the Assessing Officer.

(10) In many cases, it becomes necessary to seek information from foreign jurisdictions for the purpose of determining the arm's length price by the TPO. At times, proceedings before the TPO may also be stayed by a court order.

Taking into consideration such cases, it has been provided that where assessment proceedings are stayed by any court or where a reference for exchange of information has been made by the competent authority under an agreement referred to in section 90 or 90A, the time available to the Transfer Pricing Officer for making an order after excluding the time for which assessment proceedings were stayed or the time taken for receipt of information, as the case may be, is less than 60 days, then, such remaining period shall be extended to 60 days.

(11) The TPO has power to rectify his order under section 154 if any mistake apparent from the record is noticed. If such rectification is made, the Assessing Officer has to rectify the assessment order to bring it in conformity with the same.

(12) The TPO can exercise all or any of the powers specified in clause (a) to (d) of section 131(1) or section 133(6) or section 133A for determination of arm's length price once the above reference is made to him.

(13) The Central Government may make a scheme, by way of notification for the purposes of determination of the arm's length price, so as to impart greater efficiency, transparency and accountability by –

(a) eliminating the interface between the Transfer Pricing Officer and the assessee or any other person to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialisation;

(c) introducing a team-based determination of arm's length price with dynamic jurisdiction [Sub-section (8)].

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(14) The Central Government may, for the purpose of giving effect to the scheme made, direct that any of the provisions of this Act would not apply or would apply with such exceptions, modifications and adaptations as may be specified.

(15) Every notification so issued shall, as soon as may be after the notification is issued, be laid before each House of Parliament [Sub-section (10)].

To reduce the compliance burden on the assessee as well as administrative burden on the TPOs, the concept of block transfer pricing assessment has been introduced by the Finance Act, 2025 which allows to apply the ALP determined in relation to an international transaction for any previous year to the similar transaction for the two consecutive previous years immediately following such previous year. The provisions related block transfer pricing assessment are as follow:

(1) ***The ALP determined in relation to the international transaction under sub-section (3) for any previous year shall apply to similar international transaction for the two consecutive previous years immediately following such previous year, on fulfilment of the following conditions:***

(a) the assessee exercises an option or options to the above effect for the said two consecutive previous years;

(b) such option or options are exercised in prescribed form, manner and within prescribed period; and

(c) the TPO shall, within one month from the end of the month in which such option or options are exercised, by an order in writing, declare that such option or options are valid subject to the prescribed conditions.

However, these provisions shall not apply to any proceedings for assessment of search cases [Sub-section (3B)].

(2) ***If the TPO has declared that option exercised by the assessee in sub-section (3B) in relation to such transaction is valid for such previous year, no reference for computation of the arm's length price in relation to an international transaction shall be made.***

Moreover, where any reference for an international transaction in respect of a previous year, for which the option is declared valid under sub-section (3B) is made before or after such declaration by the TPO, it will be treated as no reference is made for such transaction [Provisos to sub-section (1)].

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(3) ***Where the TPO has declared an option exercised by the assessee as valid option under sub-section (3B), he shall examine and determine the arm's length price in relation to such similar transaction for two consecutive previous years immediately following such previous year, in the order referred to in sub-section (3) and on receipt of such order, the Assessing Officer shall proceed to recompute the total income of the assessee for the said two consecutive previous years as per the provisions of section 155(21) [Sub-section (4)].***

(4) ***In case there is any difficulty in giving effect to the provisions of sub-section (3B) and (4A), the Board may, with the previous approval of the Central Government, issue guidelines for the purpose of removing such difficulty:***

However, no such guideline shall be made after the expiration of two years from 1st April, 2026.

VI. Safe Harbour Rules for determination of arm's length price in case of international transactions [Section 92CB]

Section 92CB provides that determination of

- income referred to in section 9(1)(i); or
- arm's length price under section 92C or Section 92CA

shall be subject to Safe Harbour rules. Section 92CB(2) empowers the CBDT to prescribe safe harbour rules[2].

Safe Harbour means circumstances in which the income-tax authorities shall accept the transfer price or income, deemed to accrue or arise under section 9(1)(i), as the case may be, declared by the assessee.

Accordingly, the CBDT has, vide notification no. 124/2024 dated 29.11.2024, inserted Rules 10TI, 10TIA, 10TIB and 10TIC providing the safe harbour rules for income referred to in section 9(1)(i) chargeable to tax under the head "Profits and gains of business or profession".

Rule	Rule heading	Particulars
10TI	**Definitions:**	
	Eligible assessee	*A foreign company engaged in the business of diamond mining which has exercised an option for application of safe harbour rules in accordance with rule 10TIA.*

2.

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	Eligible business	*A business of selling raw diamonds in any notified special zone as referred to in clause (e) of Explanation 1 to section 9(1)(i).*
	Gross receipts	*Aggregate of –* *(i) the amount paid or payable to the eligible assessee or to any person on his behalf on account of sale of raw diamonds by such eligible assessee and* *(ii) the amount received or deemed to be received by the eligible assessee or by any person on his behalf on account of sale of raw diamonds by such eligible assessee.*
	Relevant previous year	*The previous year relevant to the assessment year in which the option for safe harbour is exercised*
	Raw diamonds	*Diamonds that are, -* *(i) uncut or unpolished;* *(ii) unassorted;* *(iii) unworked or simply sawn, cleaved or bruted;* *(iv) not conflict diamonds as defined by the Kimberley Process;* *(v) accompanied by Kimberley Process Certificate issued by the Kimberley Process authority in the exporting country; and* *(vi) falling under Tariff Heading 7102 of the First Schedule to the Customs Tariff Act, 1975.*
10TIA	***Safe harbour***	*(1) If an eligible assessee declared income from an eligible business in accordance with the circumstances as specified in Rule 10TIA(2), the option for safe harbour exercised by such eligible assessee in any relevant previous year under rule 10TIB shall be accepted by the income-tax authorities, unless such safe harbour is declared invalid under Rule 10TIB(3).* *(2) Circumstances in respect of the eligible business is -* *The profits and gains of the eligible business chargeable to tax under the head "Profits and gains of business or profession" shall be 4% or more of the gross receipts from such business.* *(3) Where the eligible assessee has exercised the option for safe harbour under rule 10TIB in respect of the eligible business in any relevant previous year and such option is not declared invalid –*

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		(a) any deduction allowable under the provisions of sections 30 to 38 shall be deemed to have been already given full effect to and no further deduction under those sections shall be allowed; *(b) the written down value of any asset of such 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 such previous year;* *(c) no set off of unabsorbed depreciation under section 32(2) or carried forward loss under section 72(1) shall be allowed to such assessee; and* *(d) no set off of loss from other business under section 70(1) or other head under section 71(1)/(2) shall be allowed to such assessee for income chargeable to tax under the head "Profits and gains of business or profession" in respect of such business.* *(4) The provisions of sections 92D relating to maintenance, keeping and furnishing of information and document and section 92E for submission of report from an accountant in respect of an international transaction shall apply, if the eligible assessee enters into such transaction while carrying on the eligible business.*
10TIB	***Procedure***	***Furnishing of Form 3CEFC for exercising the option*** *The assessee has to furnish Form 3CEFC, complete in all respects, to the Assessing Officer before furnishing the return of income under section 139 for the relevant previous year, for exercising the option of safe harbour.* *If the assessee does not exercise option for safe harbour, the income from eligible business shall be determined in accordance with other provisions of the Act.* ***Circumstances when option exercised can be declared invalid*** *The Assessing Officer may declare the option for safe harbour as invalid by an order in writing, where the assessee has -* *(a) availed the safe harbour by furnishing incorrect facts; or* *(b) concealed facts related to his business.*

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		The Assessing Officer has to afford a reasonable opportunity of being heard to the assessee before declaring the option for safe harbour invalid. ***Order by Assessing Officer to declare option invalid*** *The Assessing Officer has to serve a copy of the order to declare option invalid to the assessee and the other provisions of the Act shall apply accordingly.*
10TIC	***Mutual Agreement Procedure not to apply***	*The assessee is not entitled to invoke mutual agreement procedure under an agreement for avoidance of double taxation as referred to in section 90 or section 90A in relation to an eligible business, if the assessee has exercised the option for safe harbour under rule 10TIB in respect of such business and such option is not declared invalid.*

Further, the CBDT has, vide notification no. 21/2025 dated 25.03.2025 prescribed Rule 10TD read with Rule 10TA, Rule 10TB and Rule 10TC providing the safe harbour rules for determination of arm's length price under section 92C or section 92CA.

Where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances mentioned below:

S. No.	Eligible International Transaction[3]	Circumstances	Definition
(1)	[Rule 10TC] (2)	[Rule 10TD] (3)	[Rule 10TA] (4)
(i)	Provision of software development services	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is-	"Software development services" means,- (i) business application software and information system development using known methods and existing software tools;

[3] Eligible international transaction means an international transaction between the eligible assesee and its associated enterprise, either or both of whom are non-residents, and which comprises of the transactions described in column (2) of the above table.

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<tr><th>Not less than the prescribed percentage</th><th>Where the value of international transaction entered</th></tr>
<tr><td>17%</td><td>does not exceed a sum of ₹ 100 crore;</td></tr>
<tr><td>18%</td><td>exceeds a sum of ₹ 100 crore but does not exceed ₹ 300 crore.</td></tr>
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<tr><td>(ii)</td><td>support for existing systems;</td></tr>
<tr><td>(iii)</td><td>Converting or translating computer languages;</td></tr>
<tr><td>(iv)</td><td>adding user functionality to application programmes;</td></tr>
<tr><td>(v)</td><td>debugging of systems;</td></tr>
<tr><td>(vi)</td><td>adaptation of existing software; or</td></tr>
<tr><td>(vii)</td><td>preparation of user documentation.</td></tr>
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It, however, does not include any R&D services whether or not in the nature of contract R&D services.
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<td>(ii)</td>
<td>Provision of information technology enabled services</td>
<td>
The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is –
<table>
<tr><th>Not less than the prescribed percentage</th><th>Where the aggregate value of such transactions entered into during the previous year</th></tr>
<tr><td>17%</td><td>does not exceed a sum of ₹ 100 crore;</td></tr>
<tr><td>18%</td><td>exceeds a sum of ₹ 100 crore but does not exceed ₹ 300 crore.</td></tr>
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"Information technology enabled services" means the following business process outsourcing services provided mainly with the assistance or use of information technology, namely:-
<table>
<tr><td>(i)</td><td>back office operations</td></tr>
<tr><td>(ii)</td><td>call centres or contact centre services</td></tr>
<tr><td>(iii)</td><td>data processing and data mining</td></tr>
<tr><td>(iv)</td><td>insurance claim processing</td></tr>
<tr><td>(v)</td><td>legal databases</td></tr>
<tr><td>(vi)</td><td>creation and maintenance of medical transcription excluding medical advice</td></tr>
<tr><td>(vii)</td><td>translation services</td></tr>
<tr><td>(viii)</td><td>payroll</td></tr>
<tr><td>(ix)</td><td>remote maintenance</td></tr>
<tr><td>(x)</td><td>revenue accounting</td></tr>
<tr><td>(xi)</td><td>support centres</td></tr>
<tr><td>(xii)</td><td>website services</td></tr>
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<tr><td>(xiii)</td><td>data search integration and analysis</td></tr>
<tr><td>(xiv)</td><td>remote education excluding education content development</td></tr>
<tr><td>(xv)</td><td>clinical database management services excluding clinical trials</td></tr>
</table>
It, however, does not include any R & D services whether or not in the nature of contract R & D services.
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<tr>
<td>(iii)</td>
<td>Provision of knowledge process outsourcing services</td>
<td>The value of international transaction does not exceed ₹ 300 crore and the operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is –
<table>
<tr><th>Not less than the prescribed percentage</th><th>Employee Cost in relation to the Operating Expense</th></tr>
<tr><td>24%</td><td>at least 60%;</td></tr>
<tr><td>21%</td><td>40% or more but less than 60%;</td></tr>
<tr><td>18%</td><td>does not exceed 40%.</td></tr>
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</td>
<td>“Knowledge process outsourcing services” means the following business process outsourcing services provided mainly with the assistance or use of information technology requiring application of knowledge and advanced analytical and technical skills, namely:-
<table>
<tr><td>(i)</td><td>geographic information system</td></tr>
<tr><td>(ii)</td><td>human resources services</td></tr>
<tr><td>(iii)</td><td>engineering and design services</td></tr>
<tr><td>(iv)</td><td>animation or content development and management</td></tr>
<tr><td>(v)</td><td>business analytics</td></tr>
<tr><td>(vi)</td><td>financial analytics</td></tr>
<tr><td>(vii)</td><td>market research</td></tr>
</table>
It, however, does not include any R&D services whether or not in the nature of contract R&D services.
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<td>(iv)</td>
<td>Advancing of intra-group loans where the amount of loan is denominated in</td>
<td>The interest rate declared in relation to the eligible international transaction is not less than the one-year marginal cost of funds</td>
<td>“Intra-group loan" means loan advanced to an associated enterprise being a non-resident, where the loan–</td>
</tr>
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<td>Indian Rupees (INR)</td>
<td>lending rate of SBI as on 1st April of the relevant previous year plus
<table>
<tr><th>%</th><th>Credit rating of Associated Enterprise or its equivalent</th></tr>
<tr><td>1.75%</td><td>Between AAA to A</td></tr>
<tr><td>3.25%</td><td>BBB-, BBB, BBB+</td></tr>
<tr><td>4.75%</td><td>Between BB to B</td></tr>
<tr><td>6.25%</td><td>C to D</td></tr>
<tr><td>4.25%</td><td>Where no credit rating is available and the loan to AE including loans to all AEs in Indian rupees does not exceed ₹ 100 crore in aggregate as on 31st March of the relevant P.Y.</td></tr>
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<table>
<tr><td>(i)</td><td>is not advanced by an enterprise, being a financial company including a bank or a financial institution or an enterprise engaged in lending or borrowing in the normal course of business; and</td></tr>
<tr><td>(ii)</td><td>does not include credit line or any other loan facility which has no fixed term for repayment;</td></tr>
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<tr>
<td>(v)</td>
<td>Advancing of intra-group loans where the amount of loan is denominated in foreign currency</td>
<td>The interest rate declared in relation to the eligible international transaction is not less than the reference rate of the relevant foreign currency as on 30th September of the relevant previous year plus
(a) If amount of loan advanced to the associated enterprise including loans to all associated enterprises does not exceed a sum equivalent to ₹ 250 crore in the aggregate as on 31st March of the relevant previous year:</td>
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%	Credit rating of Associated Enterprise or its equivalent
1.50%	Between AAA, AA+, AA, AA-, A+, A, A-
3.00%	BBB+, BBB, BBB-
4.00%	BB+, BB, BB-, B+, B, B-, C+, C, C-, D

(b) If amount of loan advanced to the associated enterprise including loans to all associated enterprises exceeds a sum equivalent to ₹ 250 crore in the aggregate as on 31st March of the relevant previous year:

%	Credit rating of Associated Enterprise or its equivalent
1.50%	AAA, AA+, AA, AA-, A+, A, A-
3.00%	BBB+, BBB, BBB-
4.50%	BB+, BB, BB-, B+, B, B-
6.00%	C+, C, C-, D or where the credit rating of the associated enterprise is not available.

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(vi)	*Providing corporate guarantee*	***Where the amount guaranteed-***	***The commission or fee declared in relation to the eligible international transaction is at the rate not less than -***	*"Corporate guarantee" means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing.* *Explicit corporate guarantee, however, does not include–* *(i) letter of comfort;* *(ii) implicit corporate guarantee;* *(iii) performance guarantee; or* *(iv) any other guarantee of similar nature.*
		does not exceed ₹ 100 crores.	*1% p.a. on the amount guaranteed*	
		exceeds ₹ 100 crore and the credit rating of the associated enterprise done by an agency registered with the SEBI is of the adequate to the highest safety		
(vii)	*Provision of contract R & D services wholly or partly relating to software development*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24%, where the value of the international transaction does not exceed ₹ 300 crore.*		*"Contract research and development (R&D) services wholly or partly relating to software development" means the following, namely:-* *(i) R & D producing new theorems and algorithms in the field of theoretical computer science;* *(ii) development of information technology at the level of operating systems, programming languages, data management, communications software*

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				and software development tools;
			(iii)	*development of Internet technology;*
			(iv)	*research into methods of designing, developing, deploying or maintaining software;*
			(v)	*software development that produces advances in generic approaches for capturing, transmitting, storing, retrieving, manipulating or displaying information;*
			(vi)	*experimental development aimed at filling technology knowledge gaps as necessary to develop a software programme or system;*
			(vii)	*R & D on software tools or technologies in specialized areas of computing (image processing, geographic data presentation, character recognition, artificial intelligence and such other areas); or*
			(viii)	*upgradation of existing products where source code has been made available by the principal except where the source code has been made available to carry out routine functions like debugging of the software.*

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(viii)	*Provision of contract R&D services wholly or partly relating to generic pharmaceutical drugs*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24%, where the value of the international transaction does not exceed ₹ 300 crore.*	*"Generic pharmaceutical drug" means a drug that is comparable to a drug already approved by the regulatory authority in dosage form, strength, route of administration, quality and performance characteristics, and intended use.*
(ix)	*Manufacture and export of core auto components*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12%.*	*"Core auto components" means,* *(i) engine and engine parts, including piston and piston rings, engine valves and parts cooling systems and parts and power train components;* *(ii) transmission and steering parts, including gears, wheels, steering systems, axles and clutches;* *(iii) suspension and braking parts, including brake and brake assemblies, brake linings, shock absorbers and leaf springs; or* *(iv) lithium ion batteries for use in electric or hybrid electric vehicles.*
(x)	*Manufacture and export of non-core auto components*	*The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 8.5%.*	*"Non-core auto components" mean auto components other than core auto components.*
(xi)	*Receipt of low value-adding intra group*	*The entire value of the international transaction, including a mark-up not*	*"Low value-adding intra group services" means services that are performed by one or more*

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	services from one or more members of its group	*exceeding 5%, does not exceed ₹ 10 crore.* *However, the method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assessee by the overseas associated enterprise, is certified by an accountant.*	*members of a multinational enterprise group on behalf of one or more other members of the same multinational enterprise group and which,* *(i) are in the nature of support services;* *(ii) are not part of the core business of the multinational enterprise group, i.e., such services neither constitute the profit-earning activities nor contribute to the economically significant activities of the multinational enterprise group;* *(iii) are not in the nature of shareholder services or duplicate services;* *(iv) neither require the use of unique and valuable intangibles nor lead to the creation of unique and valuable intangibles;* *(v) neither involve the assumption or control of significant risk by the service provider nor give rise to the creation of significant risk for the service provider; and* *(vi) do not have reliable external comparable services that can be used for determining their arm's length price,* *However, it does not include the following services, namely:* *(i) research and development services;*

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			(ii) manufacturing and production services; *(iii) information technology (software development) services;* *(iv) knowledge process outsourcing services;* *(v) business process outsourcing services;* *(vi) purchasing activities of raw materials or other materials that are used in the manufacturing or production process;* *(vii) sales, marketing and distribution activities;* *(viii) financial transactions;* *(ix) extraction, exploration, or processing of natural resources; and* *(x) insurance and reinsurance;"*
Meaning of certain terms:			
	Term	***Meaning***	
(i)	***Eligible assessee***	*"Eligible assessee" means a person who has exercised a valid option for application of safe harbor rules and* *(i) is engaged in providing software development services or information technology enabled services or knowledge process outsourcing services, with insignificant risk, to a non-resident associated enterprise;* *(ii) has made any intra-group loan;* *(iii) has provided a corporate guarantee;* *(iv) is engaged in providing contract research and development services wholly or partly relating to software development, with insignificant risk, to a non-resident associated enterprise;* *(v) is engaged in providing contract research and development services wholly or partly relating to generic pharmaceutical drugs, with insignificant risk, to a non-resident associated enterprise;*	

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		(vi) is engaged in the manufacture and export of core or non-core auto components and where ninety per cent or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales; or *(vii) is in receipt of low value-adding intra-group services from one or more members of its group*
(ii)	***Reference rate***	*It means –* *For US dollar: 6-month Term Secured Overnight Financing Rate (SOFR), currently administered by Chicago Mercantile Exchange (CME), as increased by 0.45%* *For Euro: 6-month Euro Inter Bank Offered Rate (EURIBOR), currently administered by European Money Markets Institute* *For UK Pound Sterling: 6-month Term Sterling Overnight Index Average (SONIA), currently administered by ICE Benchmark Administration/ Refinitiv, as increased by 0.30%* *For Japanese Yen: 6-month Tokyo Term Risk Free Rate (TORF), currently benchmarked by QUICK Benchmarks Inc, as increased by 0.10%* *For Australian dollar: 6-month Bank Bill Swap Rates (BBSW) currently administered by Australian Securities Exchange* *For Singapore dollar: 6-month Compounded Singapore Overnight Rate Average (SORA), currently administered by Monetary Authority of Singapore, as increased by 0.45%*
(iii)	***Credit rating***	*The credit rating assigned to the associated enterprise by a SEBI and RBI accredited credit rating agency which is applicable for the relevant previous year, so however that—* *(i) where the associated enterprise has only one credit rating, then such rating shall be taken as its credit rating; and* *(ii) where the associated enterprise has a credit rating from more than one such credit rating agency, then the least of such ratings shall be taken as its credit rating*
(iv)	***Operating expense***	*The costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including*

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		- costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee, *- reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee,* *- amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of those associated enterprises and which relate to normal operations of the assessee and* *- depreciation and amortisation expenses relating to the assets used by the assessee,* *but not including the following, namely:—* *(i) interest expense;* *(ii) provision for unascertained liabilities;* *(iii) pre-operating expenses;* *(iv) loss arising on account of foreign currency fluctuations;* *(v) extraordinary expenses;* *(vi) loss on transfer of assets or investments other than assets, on which depreciation is included in the operating expense;* *(vii) expense on account of income-tax; and* *(viii) other expenses not relating to normal operations of the assessee:* *However, reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee shall be at cost.* *Further, amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of the associated enterprises and which relate to normal operations of the assessee shall be at cost.*
(v)	***Operating revenue***	*The revenue earned by the assessee in the previous year in relation to the international transaction during the course of its normal operations including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee but not including the following, namely:—* *(i) interest income;* *(ii) income arising on account of foreign currency fluctuations;* *(iii) income on transfer of assets or investments other than assets, on which depreciation is included in the operating expense;;*

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		(iv) refunds relating to income-tax; *(v) provisions written back;* *(vi) extraordinary incomes; and* *(vii) other incomes not relating to normal operations of the assessee*
(vi)	***Operating profit margin***	*In relation to operating expense, "operating profit margin" means the ratio of operating profit, being the operating revenue in excess of operating expense, to the operating expense expressed in terms of percentage*
(vii)	***Accountant***	*An accountant referred to in the Explanation below section 288(2) of the Act and includes any person recognised for undertaking cost certification by the Government of the country where the associated enterprise is registered or incorporated or any of its agencies, who fulfils the following conditions, namely:—* *(I) if he is a member or partner in any entity engaged in rendering accountancy or valuation services then,—* *(i) the entity or its affiliates have presence in more than two countries; and* *(ii) the annual receipt of the entity in the year preceding the year in which cost certification is undertaken exceeds ₹10 crore;* *(II) if he is pursuing the profession of accountancy individually or is a valuer then,—* *(i) his annual receipt in the year preceding the year in which cost certification is undertaken, from the exercise of profession, exceeds ₹1 crore; and* *(ii) he has professional experience of not less than 10 years.*
(viii)	***Employee cost***	*It includes,—* *(i) salaries and wages;* *(ii) gratuities;* *(iii) contribution to Provident Fund and other funds;* *(iv) the value of perquisites as specified in clause (2) of section 17;* *(v) employment related allowances, like medical allowance, dearness allowance, travel allowance and any other allowance;* *(vi) bonus or commission by whatever name called;*

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		(vii) lump sum payments received at the time of termination of service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and similar payments; *(viii) expenses incurred on contractual employment of persons performing tasks similar to those performed by the regular employees;* *(ix) outsourcing expenses, to the extent of employee cost, wherever ascertainable, embedded in the total outsourcing expenses:* *However, where the extent of employee cost embedded in the total outsourcing expenses is not ascertainable, 80% of the total outsourcing expenses shall be deemed to be the employee cost embedded in the total outsourcing expenses;* *(x) recruitment expenses;* *(xi) relocation expenses;* *(xii) training expenses;* *(xiii) staff welfare expenses; and* *(xiv) any other expenses related to employees or the employment.*
(ix)	***No tax or low tax country or territory***	*A country or territory in which the maximum rate of income-tax is less than 15%.*
(x)	***Relevant previous year***	*The previous year relevant to the assessment year in which the option for safe harbour is validly exercised.*

Procedure [Rule 10TE][4]

Furnishing of Form 3CEFA

For exercising the option of safe harbor, the assessee has to furnish Form 3CEFA, complete in all respects, to the Assessing Officer on or before the due date specified in section 139(1) for furnishing the return of income for

- *the relevant assessment year, in case the option is exercised only for that assessment year or*
- *the first of the assessment years, in case the option is exercised for more than one assessment year.*

The return of income for the relevant assessment year or the first of the assessment years, as the case may be, should be furnished on or before the date of submitting the Form 3CEFA.

[4] For detailed reading of Rule 10TE of the Income-tax Rules, 1962, students may visit https://www.incometaxindia.gov.in/Pages/default.aspx

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The option for safe harbour validly exercised would continue to apply for the period specified in the form or 3 years, whichever is less.

Verification by the Assessing Officer

Before treating the option for safe harbor by the assessee as validly exercised, the Assessing Officer shall verify whether the assessee exercising the option is an eligible assessee and the transaction in respect of which the option is exercised is an eligible international transaction.

Reference to Transfer Pricing Officer by the Assessing Officer in case of a doubt on validity

The Assessing Officer shall make a reference to the Transfer Pricing Officer for determination of the eligibility of the assessee or the international transaction or both for the purposes of the safe harbor, where he has doubts the valid exercise of the option for the safe harbour by an assessee.

Time limit for reference to Transfer Pricing Officer by Assessing Officer

No reference shall be made to the Transfer Pricing Officer by the Assessing Officer after the expiry of 2 months from the end of the month in which Form 3CEFA is received by him.

Documents or information required by the Transfer Pricing Officer

Transfer Pricing Office may issue a notice to the assessee to furnish such information or documents or other evidence as he may consider necessary. The assessee has to furnish the same within the specified time in such notice.

Circumstances when option declared to be Invalid

The Transfer Pricing Officer shall, by order in writing, declare the option exercised by the assessee as invalid and cause a copy of the order has to be served on the assessee and the Assessing Officer, if –

(i) the assessee does not furnish the information or documents or other evidence required by the Transfer Pricing Officer

(ii) the Transfer Pricing Officer finds that the assessee is not an eligible assessee

(iii) the Transfer Pricing Officer finds that the international transaction in respect of which option has been exercised is not an eligible international transaction.

Order by Transfer Pricing Officer

The Transfer Pricing Officer shall pass the order declaring the option exercised by the assessee as invalid within a period of 2 months from the end of the month in which reference from the Assessing Officer is received by him.

No order can be passed declaring the option exercised by the assessee invalid unless an opportunity of being heard is given to him.

Filling of objections against the order of Transfer Pricing Officer by the assessee

If the assessee objects to the order of the Transfer Pricing Officer declaring the option to be invalid, he may file his objections with the Commissioner to whom the Transfer Pricing Officer is subordinate, ***within 15 days of receipt of the order of the*** *Transfer Pricing Officer.*

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On receipt of objection, the Commissioner shall, after providing an opportunity of being heard to the assessee, pass appropriate orders, ***within a period of 2 months from the end of the month*** *in which the objection filed by the assessee is received by him, in respect of the validity or otherwise of the option exercised by the assessee. A copy of the said order has to be served on the assessee and the Assessing Officer.*

If the Assessing Officer or the Transfer Pricing Officer or the Commissioner, as the case may be, does not make a reference or pass an order within the specified time, then, the option for safe harbour exercised by the assessee shall be treated as valid.

Notes:

(1) The second proviso to section 92C(2) provides that if the variation between the arm's length price determined and the price at which the transaction has been undertaken does not exceed such percentage, not exceeding 3%, as may be notified by the Central Government in the Official Gazette, the price at which the transaction has actually been undertaken shall be deemed to be the arm's length price. However, no comparability adjustment and allowance under the second proviso to section 92C(2) shall be made to the transfer price declared by the eligible assessee and accepted under the Safe Harbour Rules given above.

(2) Section 92D requiring every person who has entered into an international transaction to keep and maintain the prescribed information and documents and section 92E requiring such person to obtain a report from an accountant and furnish such report on or before the specified date in prescribed form and manner, shall apply irrespective of the fact that the assessee exercises his option for safe harbor in respect of such transaction.

(3) Safe harbor rules shall not be applicable in respect of eligible international transaction entered into with an associated enterprise located in any country or territory notified under section 94A as notified jurisdictional area or in a no tax or low tax country or territory [Rule 10TF].

(4) The assessee would not be entitled to invoke mutual agreement procedure (MAP) under a DTAA entered with a country outside India, if the transfer price in relation to eligible international transaction declared by an eligible assessee is accepted by the income-tax authority under safe harbour rules [Rule 10TG].

VII. Introduction of Advance Pricing Agreements [Sections 92CC & 92CD]

(1) An Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future. They offer better assurance on transfer pricing methods and provide certainty and unanimity of approach.

Advance Pricing Agreements

(2) Keeping in mind the benefits offered by the APAs, sections 92CC and section 92CD have been introduced in the transfer pricing regime to provide a framework for formulation of APAs between the tax payer and the income-tax authorities.

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(3) Section 92CC enables the CBDT (with the approval of the Central Government), to enter into an APA with any person determining the –

- arm's length price or specifying the manner in which the arm's length price is to be determined, in relation to an international transaction to be entered into by that person;
- income referred to in section 9(1)(i), or specifying the manner in which said income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of that person, being a non-resident.

(A) Purpose of APA: The APA shall relate to an international transaction to be entered into by such person. The APA shall be entered into for the purpose of determination of the

(a) arm's length price or specifying the manner in which arm's length price shall be determined, in relation to such international transaction.

(b) income referred to in section 9(1)(i), or specifying the manner in which said income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of that person, being a non-resident.

(B) Manner of determination of Arm's Length Price in APA: The manner of determination of arm's length price or the income referred above may include methods referred to in section 92C(1) or any other method provided by rules made under the Act with necessary adjustments or variations.

(C) Provisions of APA to apply notwithstanding anything contained in sections 92C or 92CA: In case an APA has been entered, the arm's length price in relation to that transaction or the income referred to in section 9(1)(i) shall be determined in accordance with that APA notwithstanding any contrary provisions contained in section 92C or section 92CA i.e., the provisions of the APA shall override the provisions of section 92C or section 92CA, which are normally applicable for determination of arm's length price.

(D) Validity of APA: The APA shall be valid for such period as specified in the agreement, which shall in no case exceed five consecutive previous years.

(E) Binding nature of APA: The APA so entered into shall be binding on:

(a) the person in whose case, and in respect of the transaction in relation to which, the APA has been entered into; and

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(b) the Principal Commissioner or Commissioner and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(F) Not binding of APA: The APA shall not be binding if there is any change in law or facts having bearing on such APA.

(G) Conditions to declare APA as *void ab initio*: In case the Board finds that the APA so entered into has been obtained by the person by way of fraud or misrepresentation of facts, the Board is empowered to pass an order declaring any such APA to be *void ab initio*, with the approval of Central Government.

(H) Consequences of declaration of an APA as *void ab initio*: As a result of declaration of an APA as *void ab initio*:

(a) all the provisions of the Act shall apply to such person as if such APA had never been entered into.

(b) The period beginning with the date of such APA and ending on the date of order declaring the APA as *void ab initio*, shall be excluded for the purpose of computation of any period of limitation under this Act (for example period of limitation specified in the section 153, 153B etc.). This is irrespective of anything contained in any other provision of the Act.

(c) In case the period of limitation after exclusion of the above mentioned period is less than 60 days, such remaining period of limitation shall be extended to 60 days.

(I) If an application is made by a person for entering into an APA, then, the proceeding, in respect of such person for the purpose of the Act, shall be deemed to be pending.

(J) Prescribed scheme for APA: The Board is empowered to prescribe a scheme specifying the manner, form, procedure and any other matter generally in respect of the APA[5].

Prescribed Advance Pricing Agreement Scheme for the purpose of section 92CC [Rule 10F to 10T]: In exercise of the powers conferred in section 92CC(9)

[5] Rules prescribing the scheme to enter into an APA for the purpose of determining income referred to in section 9(1)(i), or the manner in which said income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of that person, being a non-resident are yet to be notified by the CBDT as on the date of release of the Study Material. These rules, when notified, will form part of the webhosted Statutory Update.

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read with section 295 of the Income-tax Act, 1961, the CBDT has prescribed rules specifying an Advance Pricing Agreement (APA) Scheme. Some of the important provisions of the scheme are briefed hereunder –

(1) **Persons eligible to apply [Rule 10G]:** Any person who has undertaken an international transaction or is contemplating to undertake an international transaction, shall be eligible to enter into an agreement under these rules.

(2) **Pre-filing Consultation [Rule 10H]:**

(a) Any person proposing to enter into an agreement under these rules may, by an application in writing, make a request for a pre-filing consultation in the prescribed form to the Director General of Income-tax (International Taxation).

(b) The pre-filing consultation shall, among other things,-

(i) determine the scope of the agreement;

(ii) identify transfer pricing issues;

(iii) determine the suitability of international transaction for the agreement;

(iv) discuss broad terms of the agreement.

(c) The pre-filing consultation shall –

(i) not bind the Board or the person to enter into an agreement or initiate the agreement process;

(ii) not be deemed to mean that the person has applied for entering into an agreement.

(3) **Application for advance pricing agreement [Rule 10-I]**

(a) Any person who is eligible to enter into agreement may, if he desires to enter into an agreement furnish an application in the prescribed form along with proof of payment of requisite fee as specified, to the Director General of Income-tax (International Taxation) in case of unilateral agreement and to the competent authority in India in case of bilateral or multilateral agreement.

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(b) The application may be filed at any time -

(i) before the first day of the previous year relevant to the first assessment year for which the application is made, in respect of transactions which are of a continuing nature from dealings that are already occurring; or

(ii) before undertaking the transaction in respect of remaining transactions.

ILLUSTRATION 5

XYZ (P) Ltd. has been supplying goods to its Associate Enterprise (AE) in foreign country. It has applied for Advance Pricing Agreement ('APA') in respect of the transactions with its AE. Application for APA was filed on 15th March, 2025 and the APA was signed on 2nd June, 2025. Discuss from which previous year APA would be applicable.

SOLUTION

XYZ (P) Ltd. has filed APA application in respect of transactions with its AE which are of a continuing nature from dealings that are already occurring. Since the application was filed on 15th March, 2025 i.e., before 1.4.2025, APA would be applicable from P.Y. 2025-26.

(4) Applicable Fee: The application has to be accompanied by proof of payment of fees as given below:

Amount of international taxation entered into or proposed to be undertaken in respect of which agreement is proposed during the proposed period of agreement	Fee
Amount ≤ ₹ 100 crores	₹ 10 lakhs
Amount > ₹ 100 crores but not exceeding ≤ ₹ 200 crores	₹ 15 lakhs
Amount > ₹ 200 crores	₹ 20 lakhs

(5) Withdrawal of application for agreement [Rule 10J]

The applicant may withdraw the application for agreement at any time before the finalisation of the terms of the agreement. However, application fees paid shall not be refunded on withdrawal of application by the applicant.

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(6) **Approval of Central Government:** The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.

(7) **Terms of the agreement [Rule 10M]**

(a) An agreement may among other things, include –

(i) the international transactions covered by the agreement;

(ii) the agreed transfer pricing methodology, if any;

(iii) determination of arm's length price, if any;

(iv) definition of any relevant term to be used in item (ii) or (iii);

(v) critical assumptions i.e., the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed;

(vi) rollback provision referred to in Rule 10MA;

(vii) the conditions, if any, other than provided in the Act or these rules.

(b) The agreement shall not be binding on the Board or the assessee if there is a change in any of critical assumptions or failure to meet conditions subject to which the agreement has been entered into.

(c) The binding effect of agreement shall cease only if any party has given due notice of the concerned other party or parties.

(d) In case there is a change in any of the critical assumptions or failure to meet the conditions subject to which the agreement has been entered into, the agreement can be revised or cancelled, as the case may be.

(8) **Furnishing of Annual Compliance Report [Rule 10-O]:** The assessee shall furnish an annual compliance report in quadruplicate in the prescribed form to Director General of Income-tax (International Taxation) for each year covered in the agreement, within 30 days of the due date of filing income-tax return for that year, or within 90 days of entering into an agreement, whichever is later.

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(9) Compliance Audit of the agreement [Rule 10P]:

(a) The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement. For this purpose, the Transfer Pricing Officer may require –

(i) the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;

(ii) the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.

(b) The compliance audit report shall be furnished by the Transfer Pricing Officer within six months from the end of the month in which the Annual Compliance Report is received by the Transfer Pricing Officer.

(10) Revision of an agreement [Rule 10Q]:

(a) An agreement, after being entered, may be revised by the Board either *suo moto* or on request of the assessee or the competent authority in India or the Director General of Income-tax (International Taxation), if –

(i) there is a change in critical assumptions or failure to meet a condition subject to which the agreement has been entered into;

(ii) there is a change in law that modifies any matter covered by the agreement but is not of the nature which renders the agreement to be non-binding; or

(iii) there is a request from competent authority in the other country requesting revision of agreement, in case of bilateral or multilateral agreement.

(b) Except when the agreement is proposed to be revised on the request of the assessee, the agreement shall not be revised unless an opportunity of being heard has been provided to the assessee and the assessee is in agreement with the proposed revision.

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(c) The revised agreement shall include the date till which the original agreement is to apply and the date from which the revised agreement is to apply.

(11) Cancellation of an agreement [Rule 10R]:

(a) An agreement shall be cancelled by the Board for any of the following reasons:

(i) the compliance audit has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;

(ii) the assessee has failed to file the annual compliance report in time;

(iii) the annual compliance report furnished by the assessee contains material errors; or

(iv) the assessee is not in agreement with the revision proposed in the agreement or the agreement is to be cancelled under rule 10RA(7);.

(b) The Board shall give an opportunity of being heard to the assessee, before proceeding to cancel an application.

(c) The order of cancellation of the agreement shall be in writing and shall provide reasons for cancellation and for non-acceptance of assessee's submission, if any.

(d) The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.

(e) The order under the Act, declaring the agreement as void ab initio, on account of fraud or misrepresentation of facts, shall be in writing and shall provide reason for such declaration and for non-acceptance of assessee's submission, if any.

(12) Mere filing of an application for an agreement under these rules shall not prevent the operation of Chapter X of the Act for determination of arms' length price under that Chapter till the agreement is entered into. [Rule 10T(1)].

(13) The negotiation between the competent authority in India and the competent authority in the other country or countries, in case of bilateral or multilateral

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agreement, shall be carried out in accordance with the provisions of the tax treaty between India and the other country or countries. [Rule 10T(2)].

(K) Provision for Roll back in APA Scheme [Section 92CC(9A)]

(a) In order to reduce current pending as well as future litigation, section 92CC(9A) provides roll back mechanism in the APA scheme

(b) Accordingly, the APA may, subject to such prescribed conditions, procedure and manner, provide for determining the

- ALP or for specifying the manner in which ALP is to be determined in relation to an international transaction entered into by the person
- income referred to in section 9(1)(i), or specifying the manner in which the said income is to be determined, as is reasonably attributable to the operations carried out in India by or on behalf of that person, being a non-resident,

during any period not exceeding four previous years preceding the first of the previous years for which the APA applies in respect of the international transaction to be undertaken.

The CBDT has, vide *Notification No.23/2015 dated 14.3.2015*, in exercise of the powers conferred by 92CC(9A) read with section 295, notified following conditions, procedure and manner for determining the arm's length price or for specifying the manner in which arm's length price is to be determined in relation to an international transaction:

Rule	Particulars	Conditions, Procedure & Manner of determination of ALP
10F(ba)	**Definition of Applicant**	A person who has made an application.
10F(ha)	**Definition of Rollback year**	Any previous year, falling within the period **not exceeding four previous years,** preceding the first of the five consecutive previous years referred to in section 92CC(4).
10MA	**Roll back of the agreement**	The said rule provides the following: **1.** The agreement may provide for determining the arm's length price or specify the manner in which arm's length price shall be determined in relation to the international transaction entered into by the person during the rollback year (hereinafter referred as "rollback provision").

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		2. Conditions for applying for rollback provisions: The agreement shall contain rollback provision in respect of an international transaction subject to the following, namely:- (i) the international transaction is same as the international transaction to which the agreement (other than the rollback provision) applies; (ii) the return of income for the relevant rollback year has been or is furnished by the applicant before the due date as specified in *Explanation 2* of section 139(1). (iii) the report in respect of the international transaction had been furnished in accordance with section 92E; (iv) the applicability of rollback provision, in respect of an international transaction, has been requested by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant; and (v) the applicant has made an application seeking rollback in Form 3CEDA in accordance with sub-rule (5); **3. Non-applicability of Rollback provision**: Rollback provision shall not be provided in respect of an international transaction for a rollback year, if,- (i) the determination of arm's length price of the said international transaction for the said year has been subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement; or (ii) the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. **4. Manner for determining arm length price to be the same for rollback years and other previous years:** Where the rollback provision specifies the manner in which arm's length price shall be determined in relation to an international transaction undertaken in any rollback year then such manner shall be the same as

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		the manner which has been agreed to be provided for determination of arm's length price of the same international transaction to be undertaken in any previous year to which the agreement applies, not being a rollback year. **5. Time limit for filling application for rollback provision:** The applicant may furnish along with the application for advance pricing agreement, the request for rollback provision in Form No. 3CEDA with proof of payment of an additional fee of ₹ 5 lakh.
10RA	**Procedure for giving effect to rollback provision of an Agreement**	Rule 10RA lays down the "Procedure for giving effect to rollback provision of an Agreement" as follows: (i) The applicant shall furnish modified return of income referred to in section 92CD in respect of a rollback year to which the agreement applies along with the proof of payment of any additional tax arising as a consequence of and computed in accordance with the rollback provision. (ii) The modified return in respect of rollback year shall be furnished along with the modified return to be furnished in respect of first of the previous years for which the agreement has been requested for in the application. (iii) If any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is the subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant before furnishing the modified return for the said year. (iv) If any appeal filed by the Assessing Officer or the Principal Commissioner or Commissioner is pending before the Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement, shall be withdrawn by the Assessing Officer or the Principal Commissioner or the Commissioner, as the case may be, within three months of filing of modified return by the applicant. (v) The applicant, the Assessing Officer or the Principal Commissioner or the Commissioner, shall inform the

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		Dispute Resolution Panel or the Commissioner (Appeals) or the Appellate Tribunal or the High Court, as the case may be, the fact of an agreement containing rollback provision having been entered into along with a copy of the same as soon as it is practicable to do so. (vi) In case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled.

Subsequent to the notification of the rules, the CBDT has issued *Circular No. 10/2015 dated 10.6.2015* adopting a Question and Answer format to clarify certain issues arising out of the said Rules. The questions raised and answers to such questions as per the said Circular are given hereunder:

Question 1

Under rule 10MA(2)(ii) there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to section 139(1). It is not clear as to whether applicants who have filed returns under section 139(4) or 139(5) of the Act would be eligible for roll back.

Answer

The return of income under section 139(5) can be filed only when a return under section 139(1) has already been filed. Therefore, the return of income filed under section 139(5) of the Act, replaces the original return of income filed under section 139(1). Hence, if there is a return which is filed under section 139(5) to revise the original return filed before the due date specified in *Explanation 2* to sub-section (1) of section 139, the applicant would be entitled for rollback on this revised return of income.

However, rollback provisions will not be available in case of a return of income filed under section 139(4) because it is a return which is not filed before the due date.

Note – *A belated return filed under section 139(4) can also be revised under section 139(5). In such a case, the revised return would replace the belated return. Therefore, an applicant would not be entitled for roll back provisions on a revised return which replaces a belated return.*

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Question 2

Rule 10MA(2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word "same". Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies.

The word "materially" is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word "materially" will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.

Question 3

Rule 10MA(2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some

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disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Question 4

Rule 10MA(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm's length price of the said international transaction for the said year has been the subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement. Further, Rule 10 RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant.

There is a need to clarify the phrase "Tribunal has passed an order disposing of such appeal" and on the mismatch, if any, between Rule 10MA(3) and Rule 10RA(4).

Answer

The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given.

There is no mismatch between Rule 10MA(3) and Rule 10RA(4).

Question 5

Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. It may be clarified whether

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the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is ₹ 100, the income as adjusted by the TPO is ₹ 120, and the application of the rollback provisions results in reducing the income to ₹ 90, then the rollback for that year would be determined in a manner that the declared income ₹ 100 would be treated as the final income for that year.

Question 6

Rule 10RA(7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer

The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled.

This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub-rules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

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Question 7

If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities, if MAP has already been concluded for a rollback year?

Answer

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year, subject to fulfilment of specified conditions in Rules 10MA and 10RA. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Question 8

Rule 10MA(1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA(4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Question 9

Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Question 10

Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

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Answer

The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

Question 11

For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer

The second proviso to Rule 10MA(5) provides for revision of APAs already concluded to include rollback provisions.

Question 12

For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer

The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Question 13

In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

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To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Question 14

In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

(4) Section 92CD provides for the following procedure for giving effect to an APA -

(i) In case a person has entered into an APA and prior to the date of entering into such APA, he has furnished the return of income under the provisions of section 139 in respect of any assessment year relevant to a previous year to which the APA applies, then, such person shall, within a period of three months from the end of the month in which the said agreement was entered into, furnish a modified return, notwithstanding any contrary provision contained in section 139.

(ii) Such modified return shall be in accordance with and limited to the provisions of such APA i.e., modifications can only be made on account of such APA in the return to be filed.

(iii) All other provisions of this Act shall apply as if the modified return is a return furnished under section 139, unless anything to the contrary is provided in this section.

(iv) If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the APA applies have been completed before the expiry of period allowed for furnishing of modified return, the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of this section, pass

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an order modifying the total income of the relevant assessment year determined in such assessment or reassessment, as the case may be, having regard to and in accordance with the APA, instead of proceeding to assess or reassess the total income.

Such order for assessment or reassessment or re-computation of total income shall be passed within a period of 1 year from the end of the financial year in which the modified return was furnished. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

The appeal against such order shall lie to Commissioner (Appeals) [Section 246A]

(v) Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the APA applies, are pending on the date of filing of modified return, the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the APA taking into consideration the modified return so furnished.

In this case, the time period of completion of pending assessment or reassessment mentioned under section 153 or 153B or 144C shall be extended by 12 months. This shall apply notwithstanding the period of limitation contained under section 153 or 153B or 144C.

(vi) The assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where -

(a) an assessment or reassessment order has been passed; or

(b) no notice has been issued under section 143(2) till the expiry of the limitation period provided under the said section.

VIII. Secondary Adjustment [Section 92CE]

(1) Meaning of Primary Adjustment and Secondary Adjustment

"Primary adjustment" to a transfer price means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee.

"Secondary adjustment" means an adjustment in the books of accounts of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as

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a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

(2) **Forms of Secondary Adjustment** - As per the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD transfer pricing guidelines), secondary adjustment may take the form of constructive dividends, constructive equity contributions, or constructive loans.

(3) **Alignment of economic benefit of the transaction with the arm's length position** - The provisions of secondary adjustment are internationally recognised and are already part of the transfer pricing rules of many leading economies in the world. Whilst the approaches to secondary adjustments by individual countries vary, they represent an internationally recognised method to align the economic benefit of the transaction with the arm's length position.

(4) **Cases where secondary adjustment has to be made** - In order to align the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices, section 92CE provides that the assessee shall be required to carry out secondary adjustment where the primary adjustment to transfer price:

(a) has been made *suo motu* by the assessee in his return of income; or

(b) made by the Assessing Officer has been accepted by the assessee; or

(c) is determined by an advance pricing agreement entered into by the assessee under section 92CC on or after the 1.4.2017; or

(d) is made as per the safe harbour rules framed under section 92CB; or

(e) is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or 90A for avoidance of double taxation.

(5) **No requirement of secondary adjustment in certain cases** - Such secondary adjustment, however, shall not be carried out if, the amount of primary adjustment made in the case of an assessee in any previous year does not exceed ₹ 1 crore **or** the primary adjustment is made in respect of A.Y.2016-17 or an earlier assessment year.

(6) **Non-repatriation of excess money by the associated enterprise deemed to be an advance** - Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money or part thereof, as the case may be, which is available with its associated

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enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed as the income of the assessee, in the prescribed manner.

Such excess money or part thereof may be repatriated from any of the associated enterprises of the assessee which is not resident in India.

"Excess money" means the difference between the arm's length price determined in primary adjustment and the price at which the international transaction has actually taken place.

(7) Time limit for repatriation of excess money or part thereof

Rule 10CB(1) prescribes the time limit for repatriation of excess money or part thereof i.e., on or before **90 days** from the date given in column (3) in the cases mentioned in column (2) of the table below. The period from which interest is chargeable on the excess money or part thereof which is not repatriated in such cases is given in column (4).

	Case	Date	Period
(1)	(2)	(3)	(4)
(i)	Where primary adjustments to transfer price has been made *suo-motu* by the assessee in his return of income	the due date of filing of return u/s 139(1)	the due date of filing of return u/s 139(1)
(ii)	If primary adjustments to transfer price as determined in the order of the Assessing Officer or the appellate authority has been accepted by the assessee	the date of the said order	the date of the said order
(iii)	Where primary adjustment to transfer price is determined by an advance pricing agreement (APA) entered into by the assessee under section 92CC in respect of a previous year -		

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	• If the APA has been entered into on or before the due date of filing of return for the relevant P.Y.	the date of filing of return u/s 139(1)	the due date of filing of return u/s 139(1)
	• If the APA has been entered into on or after the due date of filing of return for the relevant P.Y.	The end of the month in which the APA has been entered into	The end of the month in which the APA has been entered into
(iv)	Where option has been exercised by the assessee as per the safe harbour rules under section 92CB	the due date of filing of return u/s 139(1)	the due date of filing of return u/s 139(1)
(v)	Where the primary adjustment to the transfer price is determined by a resolution arrived at under Mutual Agreement Procedure under a DTAA has been entered into u/s 90 or 90A	the date of giving effect by the A.O. under Rule 44H to such resolution	the date of giving effect by the A.O. under Rule 44H to such resolution

(8) Rate of interest for the purpose of computation on interest on excess money or part thereof, if not repatriated within the prescribed time

Rule 10CB(2) prescribes the rate at which the per annum interest income shall be computed in case of failure to repatriate the excess money or part thereof within the above time limit. The interest would be computed at the rates mentioned in column (3) in respect of the cases mentioned in column (2) of the table below:

	Case	Rate
(1)	(2)	(3)
(i)	Where the international transaction is denominated in Indian rupee	At the one year marginal cost of fund lending rate of SBI as on 1st April of the relevant previous year + 3.25%
(ii)	Where the international transaction is denominated in foreign currency	At six month London Interbank Offered Rate (LIBOR) as on 30th September of the relevant previous year + 3.00%

Note *– In case (ii) above, the rate of exchange for the calculation of the value of international transaction denominated in foreign currency shall be the telegraphic transfer buying rate of such currency on the last day of the previous year in which such international transaction was undertaken.*

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(9) **Option to pay additional income-tax, if the excess money not repatriated:** In a case where the excess money or part thereof has not been repatriated within the prescribed time as mentioned above, the assessee has the option to pay additional income-tax @ **20.9664%** (i.e., tax@18% plus surcharge@12% plus cess@4%) on such excess money or part thereof, as the case may be.

Where additional income-tax is so paid by the assessee, he will **not** be required to make secondary adjustment and compute interest from the date of payment of such tax. This implies that he would, in any case, be required to compute interest upto the date of payment of such additional tax.

The additional income-tax so paid by the assessee shall be treated as the final payment of tax in respect of excess money or part thereof not repatriated and no further credit would be allowed to the assessee or to any other person in respect of the amount of additional income-tax so paid.

Further, no deduction in respect of the amount on which such additional income-tax has been paid, would be allowed under any other provision of the Act.

ILLUSTRATION 6

On 1.4.2025, PQR Ltd., an Indian company, advanced a loan of ₹ 6 crores to XYZ Inc., a company resident in Singapore. As on the date of loan, the book value of total assets in the books of XYZ Inc. was ₹ 10 crores. XYZ Inc. paid the entire loan along with interest thereon on 31st August, 2025. During the Financial Year 2025-26, PQR Ltd. also entered into an agreement with XYZ Inc. to provide 20,000 medical equipments at a cost of ₹ 7,400 per unit. The Assessing Officer treats them as associate enterprises and wants to re-compute the income of PQR Ltd. at arms' length price. You are required to answer the following questions in this respect:

(1) Would PQR Ltd. and XYZ Inc. be treated as associate enterprises for the purpose of transfer pricing adopted by the Assessing Officer? If yes, why?

(2) Calculate the arms length price of PQR Ltd. which sells the same equipment at the rate of ₹ 9,000 per unit to Y Ltd. and at the rate of ₹ 9,500 per unit to X LLP (both of them are unrelated parties in respect of PQR Ltd.). PQR Ltd. is not a wholesale dealer.

(3) What are the options available to PQR Ltd. in respect of such increase in transfer price by income tax authorities, if PQR Ltd. accepts such transfer price?

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SOLUTION

(1) Two enterprises are deemed to be associated enterprises as per section 92A(2)(c), if a loan advanced by one enterprise to the other enterprise constitutes not less than 51% of the book value of total assets of the other enterprise at any time during the previous year. Since PQR Ltd., an Indian company, advanced loan of an amount of ₹ 6 crores to XYZ Inc., a Singapore company, which is 60% of the book value of the total assets of XYZ Inc. (i.e., 60% of ₹ 10 crores), PQR Ltd. and XYZ Inc. are deemed to be associated enterprises.

(2) PQR Ltd. sells equipment at the rate of ₹ 9,000 per unit to Y Ltd. and at ₹ 9,500 per unit to X LLP, both of them being unrelated parties. Since the transactions can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price, Comparable Uncontrolled Price (CUP) method would be most appropriate method.

Since two prices are determined by the most appropriate method, and data set comprises of only two entries, the arm's length price shall be the arithmetical mean of both the values included in the dataset.

Accordingly, arm's length price would be ₹ 9,250 [(₹ 9,000 + ₹ 9,500)/2]. Since the deviation between the arm's length price and actual sale price of the equipment to XYZ Inc. i.e., ₹ 7,400 per unit is 25%, which far exceeds the maximum percentage deviation which can be notified by the Central Government[6], the arm's length price would be ₹ 9,250 per unit and the total income would increase by ₹ 3.7 crores [i.e. ₹ 1,850 (₹ 9,250 – ₹ 7,400) x 20,000 units]

(3) On account of the primary adjustment of ₹ 3.7 crores (₹ 1850 x 20,000 units) made by the Assessing Officer, in the total income of PQR Ltd. for A.Y.2026-27, secondary adjustment has to be made under section 92CE, since –

(1) The company has accepted the primary adjustment made by the Assessing Officer;

(2) The primary adjustment is in respect of A.Y.2026-27; and

(3) The primary adjustment exceeds ₹ 100 lakhs.

Accordingly, the excess money i.e., ₹ 3.7 crores available with the XYZ Inc. has to be repatriated to India within 90 days of the date of the order of the Assessing Officer.

In case of non-repatriation, ₹ 3.7 crores would be deemed as an advance made by the PQR Ltd. to its associated enterprise, XYZ Inc. Interest would be calculated on such advance at

[6] Which cannot exceed 3% in any case

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one year marginal cost of fund lending rate of SBI as on 1st April of the relevant previous year + 3.25%, since the international transaction is denominated in Indian rupee.

Alternatively, PQR Ltd. can opt to pay additional income-tax @20.9664% (tax @18% *plus* surcharge @12% *plus* cess@4%) on ₹ 3.7 crores, which amounts to ₹ 77,57,568.

IX. Records to be maintained [Section 92D]: A taxpayer undertaking international transaction with the associated enterprise has to compute the income, expense or allocation of cost arising from such international transaction having regard to the arm's length price. To substantiate the arm's length price, the taxpayer is required to maintain the three tier documentation i.e. a Master file, a local file as prescribed under section 92D of the Act and Country by country report as prescribed under section 286 of the Act.

(1) Persons responsible for keeping and maintaining prescribed information and document - Section 92D imposes responsibility on every person

(i) who **enters into an international transaction** to keep and maintain such information and documents in respect thereof as may be prescribed;

(ii) being a **constituent entity of an international group**, to keep and maintain the prescribed information and document **in respect of an international group**.

The constituent entity is required to keep and maintain the information and document irrespective of the fact **whether or not any international transaction is undertaken** by such constituent entity.

The constituent entity has to furnish the information and document to the authority prescribed under section 286(1), i.e., Joint Director as designated by PDGIT (Systems) or DGIT(Systems) in the prescribed manner, on or before prescribed date.

(2) Information and documents to be kept and maintained for prescribed period - The CBDT is empowered to prescribe the period for which the information and documents shall be kept and maintained.

(3) Assessing Officer & Commissioner (Appeals) empowered to require persons entering into international transaction to furnish prescribed information and documents - The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceedings under the Income-tax Act, require any person who has entered into an international transaction to furnish any such prescribed information or documents within a period of **10 days** from the date of receipt of a notice issued in this regard. The requisition period

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may, on request, be extended further for a period not exceeding thirty days by the Assessing Officer or the Commissioner (Appeals).

Information to be kept and maintained under section 92D [Rule 10D]

Rule 10D (1) provides for the information and documents to be kept and maintained by the assessee under section 92D(1)(i). Under this Rule, the following information and documents have to be maintained:

(i) A description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;

(ii) A profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them;

(iii) A broad description of the business of the assessee and the industry in which the assessee operates, and the business of the associated enterprises with whom the assessee has transacted;

(iv) The nature and terms (including prices) of international transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;

(v) A description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transactions;

(vi) A record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions entered into by the assessee;

(vii) A record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions;

(viii) A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;

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(ix) A description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanation as to why such method was so selected, and how such method was applied in each case;

(x) A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used to apply the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;

(xi) The assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;

(xii) Details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under the Income-tax Rules and consequent adjustment made to the total income for tax purposes;

(xiii) Any other information, data or documents, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Threshold limit for maintenance of prescribed information and documents [Rule 10D(2)]

Rule 10D(2) provides that in a case where the aggregate value of international transactions does not exceed ₹ 1 crore, it will not be obligatory for the assessee to maintain the above information and documents.

Threshold limit for maintenance of records

However, it is provided that in the above cases also the assessee will have to substantiate that the income arising from the international transactions with associated enterprises, as disclosed by the accounts, is in accordance with section 92. This will mean that, even if the aggregate value of the international transactions is less than ₹ 1 crore, the assessee will have to maintain adequate records and evidence to show that the international transactions with associated enterprises are on the basis of arm's length principle.

Information to be supported by authentic documents [Rule 10D(3)]

The information to be maintained by the assessee, is to be supported by authentic documents. These documents may include the following:

(i) Official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;

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(ii) Reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

(iii) Price publications including stock exchange and commodity market quotations;

(iv) Published accounts and financial statements relating to the business affairs of the associated enterprises;

(v) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;

(vi) Letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;

(vii) Documents normally issued in connection with various transactions under the accounting practices followed.

It is also provided that the information and documents to be maintained should be contemporaneous and should exist latest by the specified date.

Meaning of specified date

The date one month prior to the due date for furnishing the return of income under section 139(1) for the relevant assessment year i.e., 31st October of the relevant assessment year.

In the case of international transactions which continue to have effect over more than one financial year, fresh documents will not be required to be maintained for each year if there are no significant change which may affect the determination of arm's length price.

The above information and documents are required **to be maintained for a period of eight years** from the end of the relevant assessment year.

X. Audit Report [Section 92E]

Under section 92E, every person who enters into an international transaction during a previous year is required to obtain a report from a chartered accountant and furnish such report on or before the specified date in the prescribed form.

Rule 10E provides that the auditor's report shall be in Form No.3CEB. It requires the auditor to state that he has examined the accounts and records of the assessee relating to the international transactions entered into by the assessee during the relevant year. He has also to give his opinion whether the prescribed information and documents relating to the above transactions have been kept by the assessee. Further, he has to state that the particulars stated in the Annexure to his report are true and correct.

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In Part A of the Annexure, general information of the assessee (Name of the assessee, address, PAN or Aadhaar No., nature of business etc.) is required to be reported.

In Part B of the Annexure, the particulars about the international transactions are required to be stated. Broadly, these particulars include list of associated enterprises, particulars and description of transactions in tangible property, intangible property, particulars in respect of lending or borrowing of money, particulars of deemed international transaction etc.

In Part C of the Annexure, particulars related to list of associated enterprises with whom the assessee has entered into specified domestic transactions, particulars in respect of transactions in the nature of transfer or acquisition of goods or services, etc. are required to be reported.

"Specified date" means the date one month prior to the due date for furnishing the return of income under section 139(1) for the relevant assessment year. The due date for filing of transfer pricing report under section 92E in Form 3CEB is 31st October of the assessment year.

XI. Power of Assessing Officer: Section 92C(3) and (4) gives power to the Assessing Officer to determine the arm's length price under the following circumstances and also empowers the Assessing Officer to re-compute total income of the assessee having regard to arm's length price determined by him. It also provides that deduction under section 10AA and Chapter VI-A shall not be allowed from the additional income computed by him.

For example, if the total income declared by the assessee in his return of income is, say ₹ 7 lakhs and the total income computed by the Assessing Officer applying the arm's length principle is, say ₹ 9 lakhs, the difference of ₹ 2 lakhs will not qualify for deduction under section 10AA or Chapter VI-A.

The Assessing Officer may invoke the power to determine arm's length price, if during the course of any proceeding, he is of the opinion that, on the basis of material or information or documents in his possession:

(a) The price charged or paid in an international transaction has not been determined in accordance with section 92C(1) and (2); or

(b) Any information and documents relating to an international transaction has not been kept and maintained by the assessee in accordance with the provisions contained in section 92D(1) and the rules made in this behalf (Rule 10D); or

(c) The information or data used in computation of the arm's length price is not reliable or correct; or

(d) The assessee has failed to furnish within the specified time, any information or documents which he was required to furnish by a notice issued under section 92D(3).

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Before invoking the power to determine arm's length price, an opportunity of being heard is to be given to the assessee.

Second proviso to section 92C(4) provides that if the total income of an associated enterprise is computed under this section on the determination of arm's length price paid to another associated enterprise, from which tax is deducted or deductible at source, the income of the other associated enterprise shall not be recomputed on this count.

For example, if "A" Ltd. has paid royalty to "B" Ltd. (Non-Resident) @10% of sales and tax is deducted at source, "B" Ltd. cannot claim refund if the Assessing Officer has determined 8% as arm's length price in the case of "A" Ltd. and disallowed 2% of the royalty amount.

Bright Line Test – To cater to the Indian market, MNC sets up subsidiaries in India. The Indian subsidiaries act as a distributor/provider of goods/services and generally incurred certain expenses for promoting the brand or product of the foreign company, which are popularly known as Advertisement, marketing and sale promotion expenditure (**"AMP expenses"**). The intellectual property rights (**"IPR"**) in products/services and the brands lies with the parent entities. To test that whether the transaction is at ALP or not and to determine the excess/non-routine advertising, marketing and promotion (AMP) expenditure incurred by the taxpayer for building brand of its associated enterprises in India, Revenue Authorities' sometimes adopt the Bright Line Test (**"BLT"**). The issue under consideration is whether bright line test can be used by the Assessing Officer to determine the excess/non-routine advertising, marketing and promotion (AMP) expenditure incurred by the taxpayer for building brand of its associated enterprises in India.

The Delhi High Court, in *Bausch & Lomb Eyecare (India) (P.) Ltd. v. Addl. CIT [2016] 381 ITR 227*, held that advertisement expense is not an international transaction and there is no machinery provision for computation of AMP expense adjustment.

In *Sony Ericsson Mobile Communications India (P) Ltd v. CIT (2015) 374 ITR 118*, the Delhi High Court held that bright line test has no statutory mandate and a broad-brush approach is not mandated or prescribed. It further opined that the exercise to separate "routine" and "non-routine" advertising, marketing and promotion or brand building exercise by applying the bright line test of non-comparables should not be sanctioned.

Applying the rationale of the above rulings of the High Court, the Revenue Authorities' are not justified in adopting the "Bright Line Test" for disallowing or adjusting the advertisement expenditure in computing arm's length price.

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XII. Penalties

Stringent penalties are provided in various sections for non-compliance with the requirements provided under the transfer pricing provisions. These are as under:

Penalty for failure to report any international transaction or any transaction deemed to be an international transaction: Under section 270A, penalty@50% of tax payable on under-reported income is leviable. However, the amount of under-reported income represented by any addition made in conformity with the arm's length price determined by the Transfer Pricing Officer would not be included within the scope of under-reported income under section 270A, where the assessee had maintained information and documents, as prescribed under section 92D, declared the international transactions under Chapter X and disclosed all material facts relating to the transaction.

Interestingly, clause (d) of section 270A(6) does not provide similar immunity from penalty if the addition/disallowance is made by TPO in relation to a specified domestic transaction.

Further, failure to report any international transaction or any transaction deemed to be an international transaction or specified domestic transaction to which the provisions of Chapter X applies would constitute **'misreporting of income'** under section 270A(9), in respect of which penalty@200% would be attracted.

Penalty for failure to keep and maintain information and documentation [Section 271AA]: In order to ensure compliance with the transfer pricing regulations, section 271AA provides that, the Assessing Officer or Commissioner (Appeals) may direct the person entering into an international transaction to pay a penalty@2% of the value of each international transaction entered into by him, if the person:

(1) fails to keep and maintain any such document and information as required by section 92D(1) or section 92D(2);

(2) fails to report such international transaction which is required to be reported; or

(3) maintains or furnishes any incorrect information or document.

Penalty for failure to furnish information or document under section 92D [Section 271G]

Section 271G provides that if any person who has entered into an international transaction fails to furnish any such information or document as required by Assessing Officer or TPO or Commissioner (Appeals) within a period of 10 days from the date of receipt of a notice issued in this regard, then such person shall be liable to a penalty up to 2% of the value of each international transaction.

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Penalty for failure to furnish report under section 92E [Section 271BA]

If any person fails to furnish a report from an accountant, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of ₹ 1 lakh.

Penalty for failure to comply with TP provisions : A Summary		
Section	**Nature of default**	**Penalty**
270A(9)	Failure to report any International transaction or deemed International transaction to which the provision of Chapter X applies would constitute 'misreporting of income'	200% of the tax payable on under-reported income
271BA	Failure to furnish a report from an accountant as required under section 92E	₹ 1 lakh
271G	Failure to furnish info or doc as required by Assessing Officer or CIT(A) u/s 92D(3) within 10 days from the date of receipt of notice or extended period not exceeding 30 days, as the case may be.	2% of the value of the international transaction for each failure
271AA	(1) Failure to keep and maintain any such document and information as required by section 92D(1)/(2); (2) Failure to report such international transaction which is required to be reported; or (3) Maintaining or furnishing any incorrect information or document.	2% of the value of each such international transaction
Notes: • ***The penalty u/s 271AA is in addition and not in substitution of penalty u/s 271BA.*** • ***If the assessee proves that there was reasonable cause for the failure, no penalty would be leviable under section 271BA, 271G and 271AA.***		

(2) Furnishing of report in respect of international group in line with BEPS Action Plan – Country by Country Report and Master File

(i) Transfer Pricing provisions under the Income-tax Act, 1961

Chapter X of the Income-tax Act, 1961 comprising sections 92 to 92F contain provisions relating to transfer pricing regime.

Section 92D requires maintenance of prescribed information and document relating to the international transaction and specified domestic transaction.

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(ii) Requirements as per OECD report on Action 13 of BEPS Action Plan

In order to tackle the base erosion and profit shifting by the MNCs, the OECD/G20 BEPS Action Plan 13 report provides for:

(a) detailed transfer pricing documentation; and

(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

This measure is recommended to ensure that the MNEs are reporting the profits in the jurisdiction where the economic activities are performed.

(iii) Three-tier structure mandated by BEPS

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure:-

	Document	Information
(1)	Master File	Standardised information relevant for all multinational enterprises (MNE) group members
(2)	Local file	Specific reference to material transactions of the local taxpayer
(3)	Country-by-country report	Information relating to the global allocation of the MNE's income and taxes paid; and Indicators of the location of economic activity within the MNE group.

(iv) Advantages of the three tier structure [as per BEPS Report]:

(a) Taxpayers will be required to articulate consistent transfer pricing positions;

(b) Tax administrations would get useful information to assess transfer pricing risks;

(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

(v) Country-by-country Report: Reporting Requirements of MNEs

The Country-by-Country (CbC) report has to be submitted by parent entity of an international group to the prescribed authority in its country of residence. This report is to be based on consolidated financial statement of the group.

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(a) MNEs have to report annually and for each tax jurisdiction in which they do business:

(1) the amount of revenue;

(2) profit before income tax; and

(3) income tax paid and accrued.

(b) MNEs have to report their total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction.

(c) MNEs have to identify each entity within the group doing business in a particular tax jurisdiction and provide an indication of the business activities each entity engages in.

(vi) Master File: Objective & Features

(a) The master file would provide an overview of the MNE groups business, including:

(1) the nature of its global business operations,

(2) its overall transfer pricing policies, and

(3) its global allocation of income and economic activity

in order to assist tax administrations in evaluating the presence of significant transfer pricing risk.

(b) The master file is intended to provide a high-level overview in order to place the MNE group's transfer pricing practices in their global economic, legal, financial and tax context.

(c) The master file shall contain information which may not be restricted to transaction undertaken by a particular entity situated in particular country.

(d) Thus, information in master file would be more comprehensive than the existing regular transfer pricing documentation.

(e) The master file shall be furnished by each entity to the tax authority of the country in which it operates.

(vii) Implementation of international consensus in India

India is one of the active members of BEPS initiative and part of international consensus. For the purpose of implementing the international consensus, a specific reporting regime in respect of CbC reporting and also the master file has been incorporated in the Income-tax Act, 1961.

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(viii) Elements relating to CbC reporting requirement and related matters which have been incorporated in the Income-tax Act, 1961 [Section 286]

(a) Threshold limit for applicability of CbC reporting [Sub-section (7)]: The reporting provision shall apply in respect of an international group for an accounting year, if the total consolidated group revenue as reflected in the consolidated financial statement (CFS) for the accounting year preceding such accounting year is above a threshold to be prescribed ***i.e., ₹6,400 crore***.

Where the total consolidated group revenue of the international group, as reflected in the consolidated financial statement, is in foreign currency, the rate of exchange for the calculation of the value in rupees of such total consolidated group revue shall be the telegraphic transfer buying rate (TTBR) of such currency on the last day of the accounting year preceding the accounting year [Rule 10DB(7)].

(b) Time limit for furnishing CbC report [Sub-section (2)]: The parent entity of an international group or the alternate reporting entity, if it is resident in India shall be required to furnish the report in respect of the group to the Joint Director, designated by the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be, for every reporting accounting year, within a period of twelve months from the end of the said reporting accounting year for which the report is being furnished, in Form No. 3CEAD.

(c) Details to be furnished by constituent entity resident in India [Sub-section (1)]: Every constituent entity, resident in India, of an international group having parent entity that is not resident in India, shall notify the Joint Director, designated by the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be, at least two months prior to the due date for furnishing CbC report –

(1) whether it is the alternate reporting entity of the international group; or

(2) the details of the parent entity or the alternate reporting entity, if any of the international group, and the country of territory of which the said entities are resident.

The report shall be furnished in Form No.3CEAC.

(d) Details/ information to be included in CbC report [Sub-section (3)]: It should contain aggregate information in respect of:

(1) the amount of revenue,

(2) profit and loss before income-tax,

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(3) amount of income-tax paid and accrued,

(4) details of stated capital, accumulated earnings, number of employees, tangible assets other than cash or cash equivalent in respect of each country or territory along with details of each constituent's incorporation country and residential status, nature and details of main business activity or activities of each constituent entity and any other information as may be prescribed.

This shall be based on the template provided in the OECD BEPS report on Action Plan 13.

(e) Furnishing of CbC report by resident constituent entity [Sub-section (4): A constituent entity of an international group resident in India, other than the parent entity or the alternate reporting entity, shall be required to furnish CbC report within the twelve months from the end of the reporting accounting year to the Joint Director, designated by the Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems), if the parent entity of the group is resident of a country or territory,-

(1) in which it is not obligated to file report of the nature of CbC report;

(2) with which India does not have an arrangement for exchange of the CbC report; or

(3) there has been a systemic failure of the country or territory i.e., such country is not exchanging information with India even though there is an agreement and this fact has been intimated to the entity by the prescribed authority.

However, in case the parent entity of the constituent entity is resident of a country or territory, where, there has been a systemic failure of the country or territory and the said failure has been intimated to such constituent entity, the period for submission of the report would be **six months from the end of the month in which said systemic failure has been intimated**.

(f) Nomination of one constituent entity for furnishing CbC report [Proviso to sub-section (4)]: If there are more than one such constituent entity of the group, resident in India, other than the parent entity or the alternate reporting entity, then, the report shall be furnished by any one constituent entity, if the group has nominated such entity on behalf of all the constituent entities resident in India and information has been conveyed in writing on behalf of the group to the prescribed authority in Form No. 3CEAE.

(g) No obligation to furnish CbC report in certain cases [Sub-section (5)]: If an international group, having parent entity which is not resident in India, had designated an alternate entity for filing its report with the tax jurisdiction in which the alternate entity is resident and such alternate entity has furnished such report on or before the date specified

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by that country or territory, then, the entities of such group operating in India would not be obliged to furnish report if -

- the report is required to be furnished under the law for the time being in force in the said country or territory
- the report can be obtained under the agreement of exchange of such reports by Indian tax authorities
- No systemic failure in respect of the said country or territory has been conveyed to any constituent entity of the group that is resident in India
- the said country or territory has been informed in writing by the constituent entity that it is the alternative reporting entity on behalf of the international group
- the same has been informed to the prescribed authority by the entity in accordance with section 286(1).

(h) Entity to furnish documents and information called for [Sub-section (6)]: The Joint Director, designated by the PDGIT (Systems) or DGIT (Systems) may call for such document and information from the entity furnishing the report as it may specify in notice in writing for the purpose of verifying the accuracy. The entity shall be required to make submission within thirty days of receipt of notice or further period if extended by the prescribed authority, but extension shall not be beyond a further period of 30 days.

(ix) Penalty for non-furnishing of the report by any reporting entity which is obligated to furnish such report [Section 271GB(1) & (3)]

	Period of delay/ default	Penalty
(a)	Not more than a month	₹ 5,000 per day
(b)	beyond one month	₹ 15,000 per day for the period exceeding one month
(c)	Continuing default even after service of order levying penalty either under (a) or under (b)	₹ 50,000 per day of continuing failure beginning from the date of service of order

(x) Penalty for failure to produce information and documents within prescribed time [Section 271GB(2) & (3)]

	Default	Penalty
(a)	Failure to produce information and documents before	₹ 5,000 per day of continuing failure, from the day immediately following the day on

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	prescribed authority within the period allowed u/s 286(6)	which the period for furnishing the information and document expires.
(b)	Continuing default even after service of penalty order	₹ 50,000 per day for the period of default beyond the date of service of order.

(xi) Penalty for submission of inaccurate information in the CBC report [Section 271GB(4)]

If the reporting entity has provided any inaccurate information in the report, the penalty would be ₹ 5,00,000 if,-

(a) the entity has knowledge of the inaccuracy at the time of furnishing the report but does not inform the prescribed authority; or

(b) the entity discovers the inaccuracy after the report is furnished and fails to inform the prescribed authority and furnish correct report within a period of fifteen days of such discovery; or

(c) the entity furnishes inaccurate information or document in response to notice of the prescribed authority under section 286(6).

(xii) Non-levy of penalty if reasonable cause for failure is proved [Section 273B]

Section 273B provides for non-levy of penalty under various sections if the assessee proves that there was reasonable cause for such failure. Section 271GB has been included within the scope of section 273B. Therefore, the entity can offer reasonable cause defence for non-levy of penalties mentioned above.

(xiii) Maintenance and furnishing of Master file: Consequent amendments in the Income-tax Act, 1961

	Section	Provision
(1)	92D(1)(ii)	Every person, being constituent entity of an international group, has to keep and maintain the prescribed information and document in respect of the international group. Constituent entity has to keep and maintain such prescribed information and document irrespective of the fact whether or not any international transaction is undertaken by such constituent entity. The rules shall, thereafter, prescribe the information and document as mandated for master file under OECD BEPS Action 13 report;
(2)	92D(4)	The information and document shall also be furnished to the prescribed authority u/s 286(1) within such period as may be prescribed and the manner of furnishing may also be provided for in the rules

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(3)	271AA(2)	For non-furnishing of the information and document to the prescribed authority, a penalty of ₹ 5 lakh shall be leviable.
(4)	273B	Reasonable cause defence against levy of penalty shall be available to the entity.

(xiv) Maintenance and furnishing of information and documents by certain person under section 92D [Rule 10DA]

Rule	Particulars
10DA(1)	**Persons required to keep and maintain the information and documents:** Every person, being a constituent entity of an international group shall – (i) if the consolidated group revenue of the international group, of which such person is a constituent entity, as reflected in the consolidated financial statement of the international group for the accounting year, exceeds ₹ 500 crore; and (ii) the aggregate value of international transactions – (A) during the accounting year, as per the books of accounts, exceeds ₹ 50 crore, or (B) in respect of purchase, sale, transfer, lease or use of intangible property during the accounting year, as per the books of accounts, exceeds ₹ 10 crore keep and maintain information and documents of the international group. **Note –** The rate of exchange for the calculation of the value in rupees of the consolidated group revenue in foreign currency shall be the telegraphic transfer buying rate (TTBR) of such currency on the last day of the accounting year. [Rule 10DA(7)] Part A of Form No. 3CEAA **(Master File)**, however, shall be furnished by every person, being a constituent entity of an international group, whether or not the above conditions are satisfied [Rule 10DA(3)].
	Information and documents required to be kept and maintained: The constituent entity shall keep and maintain the following information and documents of the international group, namely:- (a) a list of all entities of the international group along with their addresses; (b) a chart depicting the legal status of the constituent entity and ownership structure of the entire international group; (c) a description of the business of international group during the accounting year including,-

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(I) the nature of the business or businesses;

(II) the important drivers of profits of such business or businesses;

(III) a description of the supply chain for the five largest products or services of the international group in terms of revenue and any other products including services amounting to more than five per cent. of consolidated group revenue;

(IV) a list and brief description of important service arrangements made among members of the international group, other than those for research and development services;

(V) a description of the capabilities of the main service providers within the international group;

(VI) details about the transfer pricing policies for allocating service costs and determining prices to be paid for intra-group services;

(VII) a list and description of the major geographical markets for the products and services offered by the international group;

(VIII) a description of the functions performed, assets employed and risks assumed by the constituent entities of the international group that contribute at least ten per cent. of the revenues or assets or profits of such group; and

(IX) a description of the important business restructuring transactions, acquisitions and divestments;

(d) a description of the overall strategy of the international group for the development, ownership and exploitation of intangible property, including location of principal research and development facilities and their management;

(e) a list of all entities of the international group engaged in development and management of intangible property along with their addresses;

(f) a list of all the important intangible property or groups of intangible property owned by the international group along with the names and addresses of the group entities that legally own such intangible property;

(g) a list and brief description of important agreements among members of the international group related to intangible property, including cost contribution arrangements, principal research service agreements and license agreements;

(h) a detailed description of the transfer pricing policies of the international group related to research and development and intangible property;

(i) a description of important transfers of interest in intangible property, if any, among entities of the international group, including the name and

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	address of the selling and buying entities and the compensation paid for such transfers; (j) a detailed description of the financing arrangements of the international group, including the names and addresses of the top ten unrelated lenders; (k) a list of group entities that provide central financing functions, including their place of operation and of effective management; (l) a detailed description of the transfer pricing policies of the international group related to financing arrangements among group entities; (m) a copy of the annual consolidated financial statement of the international group; and (n) a list and brief description of the existing unilateral advance pricing agreements and other tax rulings in respect of the international group for allocation of income among countries.
10DA(2)	**Due date for furnishing report:** The information and document shall be furnished in Form No. 3CEAA to the Joint Director as may be designated by PDGIT (Systems) or DGIT (Systems), as the case may be, and it shall be furnished on or before the due date for furnishing the return of income specified under section 139(1).
10DA(4)/ (5)	**Furnishing of report in case of more than one constituent entity:** Where there are more than **one constituent entities of an international group required to file the information and document under sub-rule (2)**, then, the Form No 3CEAA may be furnished by any one constituent entity, if, - (a) the international group has designated such entity for this purpose and (b) the information has been conveyed to the Joint Director as may be designated by PDGIT (Systems) or DGIT (Systems), as the case may be, in Form No 3CEAB, in this behalf at least 30 days before the due date of furnishing the Form No. 3CEAA.
10DA(6)	**Period for which such information and document to be kept or maintained:** The information and documents shall be kept and maintained for a period of eight years from the end of the relevant assessment year.

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(xv) Meaning of certain terms [Section 286(9)]

<table>
<tr><th></th><th>Term</th><th>Meaning</th></tr>
<tr><td>(a)</td><td>Accounting year</td><td>
<table>
<tr><th>Case</th><th>Accounting year</th></tr>
<tr><td>In a case where the parent entity is resident in India; or</td><td>A previous year</td></tr>
<tr><td>In any other</td><td>An annual accounting period, with respect to which the parent entity of the international group prepares its financial statements under any law for the time being in force or the applicable accounting standards of the country or territory of which such entity is resident.</td></tr>
</table>
</td></tr>
<tr><td>(b)</td><td>Agreement</td><td>A combination of all of the following agreements, namely –
(i) an agreement referred to in section 90(1) or section 90A(1); or
(ii) an agreement for exchange of the CbC report referred to in section 286(2) as may be notified by the Central Government.</td></tr>
<tr><td>(c)</td><td>Alternate reporting entity</td><td>Any constituent entity of the international group that has been designated by such group, in the place of the parent entity, to furnish the CbC report in the country or territory in which the said constituent entity is resident on behalf of such group.</td></tr>
<tr><td>(d)</td><td>Constituent entity</td><td>(i) any separate entity of an international group that is included in the consolidated financial statement of the said group for financial reporting purposes, or may be so included for the said purpose, if the equity share of any entity of the international group were to be listed on a stock exchange;
(ii) any such entity that is excluded from the consolidated financial statement of the international group solely on the basis of size or materiality; or
(iii) any permanent establishment of any separate business entity of the international group included in sub clause (i) or sub clause (ii), if such business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting or internal management control purposes</td></tr>
</table>

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(e)	**Group**	This includes a parent entity and all the entities in respect of which, for the reason of ownership or control, a consolidated financial statement for financial reporting purposes,— (i) is required to be prepared under any law for the time being in force or the accounting standards of the country or territory of which the parent entity is resident; or (ii) would have been required to be prepared had the equity shares of any of the enterprises were listed on a stock exchange in the country or territory of which the parent entity is resident.
(f)	**Consolidated financial statement**	The financial statement of an international group in which the assets, liabilities, income, expenses and cash flows of the parent entity and the constituent entities are presented as those of a single economic entity
(g)	**International group**	Any group that includes,— (i) two or more enterprises which are resident of different countries or territories; or (ii) an enterprise, being a resident of one country or territory, which carries on any business through a permanent establishment in other countries or territories;
(h)	**Parent entity**	A constituent entity, of an international group holding, directly or indirectly, an interest in one or more of the other constituent entities of the international group, such that,— (i) it is required to prepare a consolidated financial statement under any law for the time being in force or the accounting standards of the country or territory of which the entity is resident; or (ii) it would have been required to prepare a consolidated financial statement had the equity shares of any of the enterprises were listed on a stock exchange, and, there is no other constituent entity of such group which, due to ownership of any interest, directly or indirectly, in the first mentioned constituent entity, is required to prepare a consolidated financial statement, under the circumstances referred to in sub clause (i) or sub clause (ii), that includes the separate financial statement of the first mentioned constituent entity.
(i)	**Permanent establishment**	Meaning assigned to it in clause (iiia) of section 92F i.e., includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

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(j)	**Reporting accounting year**	The accounting year in respect of which the financial and operational results are required to be reflected in the report to be furnished every year by the parent entity or the alternate reporting entity, resident in India, in respect of the international group of which it is a constituent under section 286(2) or by a constituent entity of an international group referred to in section 286(4).
(k)	**Reporting entity**	The constituent entity including the parent entity or the alternate reporting entity, that is required to furnish a report referred to in section 286(2).
(l)	**Systemic failure**	Systemic failure, with respect to a country or territory, means that the country or territory has an agreement with India providing for exchange of report of the nature referred to in section 286(2), but— (i) in violation of the said agreement, it has suspended automatic exchange; or (ii) has persistently failed to automatically provide to India the report in its possession in respect of any international group having a constituent entity resident in India

(3) Transfer pricing for Specified Domestic Transactions

(i) Income from domestic related party transactions to be subject to transfer pricing [Section 92(2A)]: Section 92 provides that any income arising from an international transaction shall be computed having regard to the arm's length price. Even in case of certain domestic transaction, the tax arbitrage takes place due to differences in tax rates. For example, if the entity has two units – one in DTA and other in non-DTA, the entity can undertake the transfer of goods at price which results in lower profits in taxable unit and higher profits in non-taxable unit. In order to ensure objectivity in determination of income from domestic related party transactions and determination of reasonableness of expenditure between related domestic parties, the provisions of section 92 have been extended to include within its ambit the specified domestic transactions. Section 92(2A) provides that, any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price. However, as per section 92(3), the provisions of this section would not apply if such allowance for expense or interest under section 92(2A) has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be.

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(ii) **Meaning of "specified domestic transaction" [Section 92BA]:** Section 92BA provides the meaning of "specified domestic transaction". As per section 92BA, for the purpose of sections 92, 92C (Computation of arm's length price), 92D (Maintenance and keeping of information and documents) and 92E (Furnishing of report from an accountant), in case of an assessee the specified domestic transaction shall mean any of the following transactions, not being an international transaction, namely,-

(1) any transaction referred to in section 80A i.e., inter-unit transfer of goods and services by an undertaking or unit or enterprise or eligible business to other business carried on by the assessee or *vice versa*, for consideration not corresponding to the market value on the date of transfer;

(2) any transfer of goods or services referred to in section 80-IA(8) i.e., inter-unit transfer of goods or services between eligible business and other business, where the consideration for transfer does not correspond with the market value of goods and services;

(3) any business transacted between the assessee carrying on eligible business and other person as referred to section 80-IA(10);

(4) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of section 80-IA(8) or section 80-IA(10) are applicable; or

(5) any business transacted between a company opting for section 115BAB and person with whom the company has close connection; or

(6) any business transacted between a co-operative society opting for section 115BAE and person with whom the co-operative society has close connection; or

(7) any other transaction as may be prescribed,

However, the above mentioned transactions shall not be treated as specified domestic transaction in case the aggregate of such transactions entered into by the assessee in the previous year does not exceed a sum of ₹ 20 crore.

(iii) **Arm's length price and income of a specified domestic transaction to be computed in the same manner as applicable to an international transaction [Sections 92 & 92C]:** In order to determine the arm's length price in respect of the specified domestic transaction, the provisions of section 92 and 92C shall apply to the specified domestic transaction as they apply to the international transaction. Accordingly, the methods of computation of

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arm's length price for an international transaction would be applicable to a specified domestic transaction also.

(iv) **Persons entering into a specified domestic transaction to maintain information and documents and furnish report of an accountant [Section 92D & 92E]:** With a view to create a legally enforceable obligation on assessees entering into a specified domestic transaction to maintain proper documentation and obtain and furnish report of a Chartered Accountant on or before the specified date, the provisions of section 92D and 92E have been made applicable to a specified domestic transaction as they apply to an international transaction.

(v) **Reference to Transfer Pricing Officer for computation of arm's length price of specified domestic transaction [Section 92CA]:** According to section 92CA, where any person has entered into an international transaction or a specified domestic transaction in any previous year, the Assessing Officer can with the previous approval of the Principal Commissioner or Commissioner, if he considers necessary or expedient to do so, refer the computation of the arm's length price of such transaction to the Transfer Pricing Officer (TPO).

When such reference is made, TPO can call upon the assessee to produce evidence in support of the computation of arm's length price made by him in respect of such transaction.

The TPO can also determine the ALP of other specified domestic transactions identified subsequently in the course of proceedings before him as if such transaction is a specified domestic transaction referred to the TPO by the Assessing Officer under section 92CA(1).

Where in respect of a specified domestic transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the TPO during the course of proceeding before him, the transfer pricing provisions shall apply as if such transaction is a specified domestic transaction referred to the TPO by the Assessing Officer under section 92CA(1).

The TPO has to pass an order determining the arm's length price in respect of the specified domestic transaction after considering the evidence, documents, etc. produced by the assessee and after considering the material gathered by him. He has to send a copy of his order to the Assessing Officer as well as the assessee.

Block Transfer pricing assessment scheme is also applicable on specified domestic transactions which allows to apply the ALP determined in relation to a specified

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domestic transaction for any previous year to the similar transaction for the two consecutive previous year immediately following such previous year.

(vi) Penalty provisions to apply to specified domestic transactions as they apply to an international transaction [Sections 271AA, 271BA & 271G]: The penalty provisions under sections 271AA, 271BA and 271G shall apply to the specified domestic transaction as they apply to an international transaction defined under section 92B.

Failure to furnish the report under section 92E from an accountant would attract penalty of ₹ 1,00,000 under section 271BA.

In addition,

(i) in case of failure to keep and maintain information, document as required under section 92D(1) or 92D(2); or

(ii) failure to report such specified domestic transaction which is required to be reported; or

(iii) maintain or furnishes incorrect information or document

penalty under section 271AA at 2% of the value of each transaction would be attracted.

Penalty@2% of value of specified domestic transaction would be attracted under section 271G for failure to furnish the prescribed information or document as required under section 92D(3) within the period of 10 days from the date of receipt of notice or the extended period not exceeding another 30 days, as the case may be.

(vii) Market value to be the arm's length price of goods or services in a specified domestic transaction [Section 80A & 80-IA(8)]: As per the provisions of section 80A(6), in a case where the goods or services held for the purpose of the undertaking or unit or enterprise or eligible business are transferred to any other business carried on by the assessee or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the undertaking or unit or enterprise or eligible business and the consideration for transfer as recorded in the accounts does not correspond to the market value of such goods or services as on the date of transfer, then, for the purpose of any deduction under Chapter VI-A, profits and gains of such undertaking or unit or enterprise or eligible business shall be determined at the market value of such goods or services as on the date of transfer.

Clause (iii) of *Explanation* to section 80A(6) clarifies that "market value" in relation to any goods or services sold, supplied or acquired, means the arm's length price as defined under section 92F of such goods or services, if it is a specified domestic transaction referred to in

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section 92BA i.e., the aggregate value of all such transaction specified in section 92BA exceeds ₹ 20 crore.

Therefore, in case the transfer of goods and services between undertaking or unit or enterprise or eligible business and any other business of the assessee takes place at the arm's length price, such arm's length price shall be the market value for the purpose of section 80A(6), and no further adjustment would be required in respect of the same, if the transaction is a specified domestic transaction.

(viii) Similarly, for the purpose of section 80-IA(8), the market value, in relation to any goods or services transferred between the eligible business and any other business carried on by the assessee, shall mean -

(1) the price that such goods or services would ordinarily fetch in the open market; or

(2) the arm's length price as defined under section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.

(ix) Profit from transactions between an assessee carrying on "eligible business" and other assessees to be determined as per arm's length price [Section 80-IA(10)]: Under section 80-IA(10), the Assessing Officer is empowered to make an adjustment while computing the profit and gains of the eligible business on the basis of the reasonable profit that can be derived from the transaction, in case the transaction between the assessee carrying on the eligible business under section 80-IA and any other person is so arranged that the transaction produces excessive profits to the eligible business.

It has been provided that if the aforesaid arrangement between the assessee carrying on the eligible business and any other person is a specified domestic transaction referred to in section 92BA, then, the amount of profit of such transaction shall be determined having regard to arm's length price as defined under section 92F and not as per the reasonable profit from such transaction.

(x) Transfer Pricing Rules made applicable to Specified Domestic Transactions

The transfer pricing provisions have been extended to Specified Domestic Transactions. Accordingly, the transfer pricing rules prescribed for international transactions have been suitably amended to make the same applicable for specified domestic transactions, as well.

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Rule No.	Particulars	Amendment
10A	**Meaning of expressions used in computation of Arm's length price**	**Definition of "associated enterprise" and "enterprise" included** **"Associated Enterprise"** shall - (i) have the same meaning as assigned to it in section 92A; and (ii) in relation to a specified domestic transaction entered into by an assessee, include - (A) other units or undertakings or businesses of such assessee in respect of a transaction referred to in section 80A or section 80-IA(8); (B) any other person referred to in section 80-IA(10) in respect of a transaction referred to therein; (C) other units, undertakings, enterprises or business of such assessee, or other person referred to in section 80-IA(10) or in respect of a transaction referred to in section 10AA or the transactions referred to in Chapter VI-A to which the provisions of section 80-IA(8) or section 80-IA(10) are applicable; **"Enterprise"** shall have the same meaning as assigned to it in clause (iii) of section 92F and shall, for the purposes of a specified domestic transaction, include a unit, or an enterprise, or an undertaking or a business of a person who undertakes such transaction.
10AB	**Other methods of determination of ALP**	This Rule provides that for the purpose of section 92C(1)(f), the other method for determination of the arm's length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts. This Rule has been made applicable to specified domestic transactions as well.

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10B	**Determination of ALP under section 92C**	The methods for determination of arm's length price specified in this Rule for the purpose of section 92C(2) in relation to an international transaction shall also be made applicable in respect of specified domestic transactions.
10C	**Most appropriate method**	Sub-rule (1) provides that, for the purposes of section 92C(1), the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to an international transaction. Sub-rule (2) specifies the factors to be taken into account in selecting the most appropriate method. This Rule is made applicable in respect of a specified domestic transaction as well.
10D	**Information and documents to be kept and maintained under section 92D**	Sub-rule (1) requires every person who has entered into an international transaction or specified domestic transaction to maintain the requisite information and documents as detailed thereunder. As per sub-rule (2), maintenance of information and documents shall not apply where the aggregate value of international transactions does not exceed ₹ 1 crore. However, sub-rule (1) shall be applicable for every specified domestic transaction irrespective of its value.
10E	**Report from an accountant to be furnished under section 92E**	This rule provides for submission of audit report from a chartered accountant by every person who has entered into an international transaction. This provision would also apply to a person entered into a specified domestic transaction as well.

(xi) Safe Harbour Rules notified for Specified Domestic Transactions [Rule 10TH to Rule 10THD]

Section 92CB provides that determination of

- income referred to in section 9(1)(i); or
- arm's length price under section 92C or Section 92CA

shall be subject to Safe Harbour rules. Section 92CB(2) empowers the CBDT to prescribe safe harbour rules.

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Safe Harbour means circumstances in which the income-tax authorities shall accept the transfer price or income, deemed to accrue or arise under section 9(1)(i), as the case may be, declared by the assessee.

Accordingly, the CBDT has, in exercise of the powers conferred by section 92CB and 92D, read with section 295, inserted Rules 10TH, 10THA, 10THB, 10THC & 10THD providing the safe harbour rules for specified domestic transactions.

Rule	Rule heading	Particulars
10TH	**Definitions:**	
	Appropriate Commission	Meaning assigned to it in section 2(4) of the Electricity Act, 2003. Appropriate Commission means the Central Regulatory Commission referred to in sub-section (1) of section 76 or the State Regulatory Commission referred to in section 82 or the Joint Commission referred to in section 83, as the case may be, of the Electricity Act, 2003.
	Government Company	Meaning assigned to it in section 2(45) of the Companies Act, 2013. Government company means any company in which not less than 51% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company. "Paid-up share capital" shall be construed as "total voting power", where shares with differential voting rights have been issued.
10THA	**Eligible assessee**	• A person who has exercised a valid option for application of safe harbour Rules in accordance with the provisions of Rule 10THC, **AND** • is a Government company engaged in the business of generation, supply, transmission or distribution of electricity; or • is a co-operative society engaged in the business of procuring and marketing milk and milk products.

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<table>
<tr><td>10THB</td><td>Eligible Specified Domestic Transaction</td><td>A specified domestic transaction undertaken by an eligible assessee and which comprises of:
(i) supply of electricity; or
(ii) transmission of electricity; or
(iii) wheeling of electricity; or
(iv) purchase of milk or milk products by a co-operative society from its members.</td></tr>
<tr><td>10THC</td><td>Safe harbour</td><td>(1) Where an eligible assessee has entered into an eligible specified domestic transaction in any previous year relevant to an assessment year and the option exercised by the said assessee is treated to be validly exercised under Rule 10THD, the transfer price declared by the assessee in respect of such transaction for that assessment year shall be accepted by the income-tax authorities, if it is in accordance with the circumstances specified in Rule 10THC(2).
(2) The following are the circumstances in respect of the eligible specified domestic transaction.
<table>
<tr><th>S. No.</th><th>Eligible specified domestic Transaction</th><th>Circumstances</th></tr>
<tr><td>1</td><td>Supply of electricity, transmission of electricity, wheeling of electricity</td><td>The tariff in respect of supply of electricity, transmission of electricity, wheeling of electricity, as the case may be, is determined or the methodology for determination of the tariff is approved by the Appropriate Commission in accordance with the provisions of the Electricity Act, 2003.</td></tr>
</table></td></tr>
</table>

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			2	Purchase of milk or milk products by a co-operative society from its members	The price of milk or milk products is determined at a rate which is fixed on the basis of the quality of milk, namely, fat content and Solid Not Fat (SNF) content of milk; and – (a) the said rate is irrespective of,- (i) the quantity of milk procured; (ii) the percentage of shares held by the members in the co-operative society; (iii) the voting power held by the members in the society; and (b) such prices are routinely declared by the co-operative society in a transparent manner and are available in public domain.
		(3) No comparability adjustment and allowance under the second proviso to section 92C(2) shall be made to the transfer price declared by the eligible assessee and accepted by the income-tax authority.			

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		(4) The provisions of sections 92D relating to maintenance and keeping of information and document and section 92E for submission of report from an accountant in respect of a specified domestic transaction shall apply irrespective of the fact that the assessee exercises his option for safe harbour in respect of such transaction.
10THD	**Procedure**	**Furnishing of Form 3CEFB** The assessee has to furnish Form 3CEFB, complete in all respects, to the Assessing Officer on or before the due date for furnishing the return of income for the relevant assessment year specified in *Explanation 2* to section 139(1), for exercising the option of safe harbour. The return of income should be furnished on or before the date of submitting the Form 3CEFB. **Verification by the Assessing Officer** Before treating the option for safe harbor by the assessee as validly exercised, the Assessing Officer has to verify whether the assessee exercising the option is an eligible assessee and the transaction in respect of which the option is exercised is an eligible specified domestic transaction. **Furnishing of documents or information required by the Assessing Officer** Assessing Officer may issue a notice to the assessee to furnish such information or documents or other evidence as he may consider necessary. The assessee has to furnish the same within the specified time in such notice. **Circumstances when option exercised can be declared Invalid** The Assessing Officer has to, by order in writing, declare the option exercised by the assessee as invalid and cause a copy of the order to be served on the assessee if – (i) the assessee does not furnish the information or documents or other evidence required by the Assessing Officer

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		(ii) the Assessing Officer finds that the assessee is not an eligible assessee (iii) the Assessing Officer finds that the specified domestic transaction in respect of which option has been exercised is not an eligible specified domestic transaction (iv) the tariff is not in accordance with the circumstances specified in Rule 10THC. **Order by Assessing Officer** The Assessing Officer has to pass the order declaring the option exercised by the assessee as invalid within a period of 3 months from the end of the month in which Form 3CEFB is received by him. No order can be passed declaring the option exercised by the assessee invalid unless an opportunity of being heard is given to him. **Filling of objections against the order of Assessing Officer by the assessee** If the assessee objects to the order of the Assessing Officer declaring the option to be invalid, he may file his objections with the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, to whom the Assessing Officer is subordinate, **within 15 days of receipt of the order of the Assessing Officer**. On receipt of objection, the Principal Commissioner or Commissioner or Principal Director or Director, as the case may be, shall, after providing an opportunity of being heard to the assessee, pass appropriate order, **within a period of 2 months from the end of the month** in which the objection filed by the assessee is received by him, in respect of the validity or otherwise of the option exercised by the assessee. A copy of the said order has to be served on the assessee and the Assessing Officer. If the Assessing Officer or the Principal Commissioner or the Commissioner or the Principal Director or the Director, as the case may be, does not pass an order within the specified time, then the option for safe harbour exercised by the assessee shall be treated as valid.

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(xii) Information and documents to be kept and maintained under section 92D in case of an eligible assessee referred to in Rule 10THA in respect of eligible specified domestic transaction [Rule 10D(2A)]:

Section 92D(1)(i) provides that every person who has entered into an international transaction or specified domestic transaction shall keep and maintain prescribed information and document.

Rule 10D(1) provides for information and documents to be maintained under section 92D. Sub-rule (2A) in Rule 10D provides that nothing contained in Rule 10D(1) in so far as it relates to specified domestic transaction referred to in Rule 10THB, shall apply in the case of an eligible assessee referred to in Rule 10THA.

The information and documents to be maintained by an eligible assessee referred to in Rule 10THA relating to an eligible specified domestic transaction referred to in Rule 10THB are given in Rule 10D(2A) as follows:

Rule	Eligible Assessee	Information and documents to be kept and maintained
10THA(i)	**A government company engaged in the business of generation, supply, transmission or distribution of electricity**	(i) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises; (ii) a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted; (iii) the nature and terms (including prices) of specified domestic transactions entered into with each associated enterprise and the quantum and value of each such transaction or class of such transaction; (iv) a record of proceedings, if any, before the regulatory commission and orders of such commission relating to the specified domestic transaction; (v) a record of the actual working carried out for determining the transfer price of the specified domestic transaction; (vi) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price; and

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		(vii) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the transfer price.
10THA(ii)	**A co-operative society engaged in the business of procuring and marketing milk and milk products**	(i) a description of the ownership structure of the assessee co-operative society with details of shares or other ownership interest held therein by the members; (ii) description of members including their addresses and period of membership; (iii) the nature and terms (including prices) of specified domestic transactions entered into with each member and the quantum and value of each such transaction or class of such transaction; (iv) a record of the actual working carried out for determining the transfer price of the specified domestic transaction; (v) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the transfer price; (vi) the documentation regarding price being routinely declared in transparent manner and being available in public domain; and (vii) any other information, data or document which may be relevant for determination of the transfer price.
The above information should be supported by authentic documents. Both the information and documents must be contemporaneous and should exist latest by the specified date [i.e., the date one month prior to the due date of filing return under section 139(1)] i.e., 31st October of the assessment year. Such information and documents have to be kept and maintained for a period of eight years from the end of the relevant assessment year.		

24.6 TRANSFER OF INCOME TO NON RESIDENTS [SECTION 93]

A resident and ordinarily resident is subject to tax in India in respect of his global income whereas in case of a non-resident, income accruing or arising outside India would not be taxable in his hands in India if it is not deemed to accrue or arise in India and is not received in India. Thus, in order to reduce his tax liability, a resident Indian may transfer the ownership in his foreign asset to a non-resident, while continuing to enjoy the benefits of income derived therefrom. Section 93 hits

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at such transactions which are effected with a view to avoiding income-tax liability. For the purpose of this section, the word "non-resident" also includes a person who is not-ordinarily resident.

In order to attract the provisions of this section, the following conditions must be satisfied:

(a) There should be a transfer of assets.

(b) The said transfer may be made either alone or in conjunction with associated operations.

(c) The transfer of assets is effected in such a manner that the income from transferred assets becomes payable to a non-resident.

(d) As a consequence of the transfer, the transferor, either alone or in conjunction with associated operations, has acquired any right, by virtue of which he gets the power to enjoy the income from transferred assets, whether immediately or in future.

(e) Such income of the non-resident transferee would have been chargeable to tax in India, had it been the income of the resident transferor.

(f) The Assessing Officer is satisfied that avoidance of liability to tax in India is the purpose of the transfer.

In such a case, the income from transferred asset would be deemed to be the income of the resident transferor and would, accordingly, be taxable in his hands. Therefore, where assets are transferred to a body corporate outside India, in consideration of shares allotted by it to the transferor, he (the transferor), will become assessable under this section in respect of the income of the company derived by it from those assets. This section will not, however, apply to cases where it is shown to the satisfaction of the Assessing Officer that (i) neither the transfer nor any associated operation had for its purpose or for one of its purposes the avoidance of liability to taxation or (ii) it is provided to the satisfaction of the Assessing Officer that the transfer was effected for *bona fide* commercial purpose and with no intent to avoid tax.

	Terms	Meaning
(i)	**Associated operation**	The expression 'associated operation," in relation to a transfer, means an operation of any kind effected by any person in relation to: (i) any of the assets transferred; (ii) any assets representing, whether directly or indirectly, any of the assets transferred; (iii) any income arising from such assets; (iv) any assets representing, whether directly or indirectly, the accumulation of income arising from such assets.

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(ii)	**Assets**	It includes property or rights of any kind.
(iii)	**Transfer**	In relation to rights, includes creation of those rights
(iv)	**Benefit**	It includes a payment of any kind.

For purposes of this section, a person is deemed to have the power to enjoy the income of a non-resident if:

(i) the income, in fact, so dealt with by any person as to be calculated at some point of time to enure for the benefit of the transferor, whether in the form of the income or otherwise;

(ii) the receipt or accrual of the income operates to increase value of any assets held by the transferor or for his direct or indirect benefit;

(iii) the transferor receives or is entitled to receive at any time any benefit out of the income or out of any money available for the purpose by reason of the effect or successive effects of the associated operations on that income and the assets which represent that income;

(iv) the transferor is in a position to obtain for himself the beneficial enjoyment of the income by exercising any power of appointment or power of revocation or otherwise, whether with or without the consent of any other person, or

(v) the transferor is able to control, directly or indirectly, the application of the income in any manner whatsoever.

However, in determining whether a person has the power to enjoy the income, due regard shall be had to the substantial result and effect of the transfer and any associated operations; all benefits which may at any time accrue to such person as a result of the transfer and any associated operations must be taken into consideration irrespective of the nature or form of the benefits.

It may be noted that where an assessee has been charged to tax in respect of a sum deemed to be his income under this section, the subsequent receipt of that sum by the assessee, whether as income or in any other form, shall not be liable to tax in his hands at the time of receipt.

24.7 INTRODUCTION OF SPECIFIC ANTI AVOIDANCE MEASURES IN RESPECT OF TRANSACTIONS WITH PERSONS LOCATED IN NOTIFIED JURISDICTIONAL AREA [SECTION 94A]

The objective of anti-avoidance measures is to discourage assessees from entering into transactions with persons located in countries or territories which do not have effective information exchange mechanism with India. The following are the anti-avoidance measures introduced -

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(i) The Central Government is empowered to notify any country or territory outside India as a NJA (Notified Jurisdictional Area), having regard to the lack of effective exchange of information with such country or territory.

Clarification on removal of Cyprus from the list of notified jurisdictional area under section 94A of the Income-tax Act, 1961 – [Circular No. 15/2017, dated 21-04-2017]

Cyprus was specified as a "notified jurisdictional area" (NJA) under section 94A of the Income-tax Act, 1961 vide Notification No. 86/2013 dated 01.11.2013. The said Notification No. 86/2013 was subsequently rescinded vide Notification No. 114 dated 14.12.2016 and Notification No. 119 dated 16.12.2016 with effect from the date of issue of the notification.

The CBDT has, vide this Circular, clarified that Notification No. 86/2013 has been rescinded with effect from the date of issue of the said notification, thereby, removing Cyprus as a notified jurisdictional area with retrospective effect from 01.11.2013.

(ii) A transaction where one of the parties thereto is a person located in a NJA would be deemed to be an international transaction then all parties to the transaction to be deemed as associated enterprises, and accordingly, all the provisions of transfer pricing to be attracted in case of such a transaction. However, the benefit of permissible variation between the ALP and the transfer price based on the rate notified by the Central Government would not be available in respect of such transaction.

(iii) Such transaction may be in the nature of –

(1) purchase, sale or lease of tangible or intangible property or

(2) provision of service or

(3) lending or borrowing money or

(4) any other transaction having a bearing on the profits, income, losses or assets of the assessee. It may include a mutual agreement or arrangement for allocation or apportionment of, or contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee.

(iv) Person located in a NJA shall include a person who is a resident of the NJA and a person, not being an individual, which is established in the NJA. It would also include a permanent establishment of any other person in the NJA.

(v) Payments made to any financial institution located in a NJA would not be allowed as deduction unless the assessee authorizes the CBDT or any other income-tax authority

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acting on its behalf to seek relevant information from the financial institution on behalf of the assessee.

(vi) No deduction in respect of any other expenditure or allowance, including depreciation, arising from the transaction with a person located in a NJA would be allowed unless the assessee maintains the relevant documents and furnishes the prescribed information.

(vii) Any sum credited or received from a person located in a NJA to be deemed to be the income of the recipient-assessee if he does not explain satisfactorily the source of such money in the hands of such person or in the hands of the beneficial owner, if such person is not the beneficial owner.

(viii) The rate of TDS in respect of any payment made to a person located in the NJA, on which tax is deductible at source, will be the higher of the following rates –

(1) rates specified in the relevant provision of the Income-tax Act, 1961; or

(2) rate or rates in force; or

(3) 30%.

ILLUSTRATION 7

A Ltd., an Indian company, provides technical services to a company, XYZ Inc., located in a NJA for a consideration of ₹ 40 lakhs in October, 2025. It charges ₹ 42 lakhs for similar services rendered to PQR Inc., which is not located in a NJA. PQR Inc. is not an associated enterprise of A Ltd.

Discuss the tax implications under section 94A read with section 92C in respect of the above transaction of provision of technical services by A Ltd. to XYZ Inc.

SOLUTION

Since XYZ Inc. is located in a NJA, the transaction of provision of technical services by the Indian company, A Ltd., would be deemed to be an international transaction and XYZ Inc. and A Ltd. would be deemed to be associated enterprises. Therefore, the provisions of transfer pricing would be attracted in this case.

The price of ₹ 42 lakhs charged for similar services from PQR Inc, being an independent entity located in a non-NJA country, can be taken into consideration for determining the arm's length price (ALP) under Comparable Uncontrolled Price (CUP) Method.

Since the ALP is more than the transfer price, the ALP of ₹ 42 lakhs would be considered as the income arising from the international transaction between A Ltd. and XYZ Inc.

It may be noted that the benefit of permissible variation between the ALP and transfer price is not available in respect of a transaction entered into with an entity in NJA.

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ILLUSTRATION 8

Mr. X, a non-resident individual, is due to receive interest of ₹ 5 lakhs during March 2026 from a notified infrastructure debt fund eligible for exemption under section 10(47). He incurred expenditure amounting to ₹ 10,000 for earning such income. Assuming that Mr. X is a resident of a NJA, discuss the tax implications under section 94A, read with sections 115A and 194LB.

SOLUTION

The interest income received by Mr. X, a non-resident, from a notified infrastructure debt fund would be subject to a concessional tax rate of 5% under section 115A on the gross amount of such interest income. Therefore, the tax liability of Mr. X in respect of such income would be ₹ 26,000 (being 5% of ₹ 5 lakhs *plus* health and education cess@4%).

Under section 194LB, tax is deductible @5% (*plus* health and education cess@4%) on interest paid by such fund to a non-resident. However, since X is a resident of a NJA, tax would be deductible@30% (*plus* health and education cess@4%) as per section 94A, and not @5% specified under section 194LB. This is on account of the provisions of section 94A(5), which provides that "**Notwithstanding anything contained in any other provision of this Act,** where a person located in a NJA is entitled to receive any sum or income or amount on which **tax is deductible under Chapter XVII-B,** the **tax shall be deducted at the highest of the following rates**, namely–

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provision of the Act;

(c) at the rate of thirty per cent."

Mr. X can, however, claim refund of excess tax deducted along with interest.

24.8 LIMITATION OF INTEREST DEDUCTION IN CERTAIN CASES [SECTION 94B]

(1) **Preference of debt over equity as a measure to finance businesses:** Debt and equity are the instruments through which a company is generally financed or capitalized. The manner in which a company is capitalized has a major impact on the amount of taxable profit as the tax laws of countries generally provide for a deduction in respect of interest paid or payable while arriving at the taxable profit. However, the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus, the amount of interest it pays, the lower will be its taxable income. Due to this reason, debt is considered a more tax efficient method of finance than equity. Multinational groups

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are often able to structure their financing arrangements to maximize tax benefits through intra-group financing. In this manner, the MNEs are able to claim the excessive deduction of interest in the high tax jurisdiction and shift the profits to the low tax jurisdiction resulting in base erosion and profit shifting.

(2) **Tax Rules to prevent shifting of profits through excessive interest payments**: In order to address this issue, tax rules are in place in many countries to fix a ceiling limit on the amount of interest deductible in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, with the objective of protecting a country's tax base.

(3) **Relevant Action Plan of BEPS**: Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in Action Plan 4 and recommended certain measures in its final report.

(4) **Insertion of provision in the Income-tax Act, 1961 in line with BEPS Action Plan 4**: Section 94B has, accordingly, been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest expenses claimed by an entity on loan borrowed from its associated enterprises shall not be deductible in computation of income under the "Profits and gains of business or profession" to the extent that it arises from excess interest.

Excess interest shall mean an amount of

- total interest paid or payable* in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) of the borrower in the previous year or
- interest paid or payable to associated enterprise for that previous year

whichever is less.

**"Total interest paid or payable" to be interpreted as interest paid or payable to non-resident associated enterprise as per the intent expressed in section 94B(1) and also the Explanatory Memorandum to the Finance Bill, 2017.*

(5) **Applicability**: The provision shall be applicable to an Indian company, or a permanent establishment of a foreign company in India, being the borrower who incurs expenditure by way of interest or similar nature in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower.

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However, the provision of this section would be applicable only where the expenditure by way of interest or of similar nature exceeds **₹ 1 crore,** in respect of any form of debt issued by a non-resident, being an 'associated enterprise' of such borrower.

(6) **Meaning of debt**: Any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under the head "Profits and gains of business or profession".

(7) **Provision of guarantee and deposit of matching amount deemed to be debt issued**: Where the debt is issued by a lender which is not associated but an associated enterprise either

- provides an implicit or explicit guarantee to such lender or
- deposits a corresponding and matching amount of funds with the lender,

such debt shall be deemed to have been issued by an associated enterprise.

(8) **Carry forward of excess interest**: The disallowed interest expense can be carried forward upto eight assessment years immediately succeeding the assessment year for which the disallowance was first made and claimed as deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

(9) **Businesses excluded from applicability of the provisions of section 94B**: The following has been excluded from the applicability of the provisions of this section -

- an Indian company or permanent establishment of a foreign company which is engaged in the business of banking and insurance or
- a Finance Company located in any IFSC
- such class of non-banking financial companies as may be notified by the Central Government or
- interest paid in respect of a debt issued by a lender which is a permanent establishment in India of a non-resident, being a person engaged in the business of banking.

(10) ***Meaning of Finance Company:*** *"Finance Company" as per Regulation 2(1)(e) of the IFSC Authority (Finance Company) Regulations, 2021 means a financial institution separately incorporated to deal in one or more of the permissible activities, provided*

(i) It does not accept public deposit from resident and non-resident, as defined in these regulations; and

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(ii) It is not registered with the Authority as a Banking Unit;

Accordingly, the CBDT vide notification no. 10/2025, dated 27.01.2025, inserted Rule 21ACA to provide that the Finance Company located in any IFSC shall only carry out one or more of the following activities –

(i) lending in the form of loans, commitments and guarantees, credit enhancement, securitisation, financial lease;

(ii) factoring and forfaiting of receivables; or

(iii) functions of Global or Regional Corporate Treasury Centre such as borrowings, lending, hedging of currency or commodity risk or investments, cash management, structured credit, intra group financing, financial budgeting and similar other such treasury services and activities.

The interest being paid by such Finance Company, being the borrower, in respect of any debt issued by a non-resident, shall be in foreign currency

(11) Meaning of non-banking financial company: A non-banking financial company" means -

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) such other non-banking institution or class of such institutions, as may be notified by the Bank with the previous approval of the Central Government.

Johnson Matthey Public Limited Company vs. CIT (International Taxation) (2024) 465 ITR 649 (Delhi)

Issue: *Whether the amount received as "Guarantee Fees" by a foreign company from its Indian subsidiaries fall within the definition of "interest"?*

Facts of the Case: *The assessee was a tax resident of the United Kingdom and engaged in manufacturing specialty chemicals. It entered into global corporate guarantee for the purpose of securing loans taken by its Indian subsidiaries from foreign banks. It received guarantee charges for extending such guarantee.*

Relevant Provision: *As per section 2(28A), "interest" means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right*

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or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized. Article 12(5) of India-UK DTAA defines "interest" to mean income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from Government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures but, subject to the provisions of paragraph 9 of this Article, shall not include any item which is treated as a distribution under the provisions of Article 11(Dividends) of this Convention.

Analysis and Decision: *The High Court concur with the views of the Tribunal that the word "interest" as defined in Article 12(5) of the Treaty and section 2(28A) of the Act, shall be understood contextually. Article 12(5) of the DTAA and section 2(28A) of the Act extend the scope of such payments. However, payment or re-payment pursuant to any loan to be qualified as "interest", necessarily have to be within the context of loan and shall relate to the parties to the privity of contract. In this context only, the expressions "claims of any kind", "service fee or other charge" have to be understood. The word "interest" does not take into its fold any payments made to stranger to the privity of loan transactions, though such payments have to be made incidentally in relation to such loan.*

Undoubtedly, assessee is a stranger to the privity of loan transactions in as much as the contract of loan is a different from the contract of guarantee, as such in our considered opinion, the expression of "debt claims of any kind" or "the service fee or other charge in respect of moneys borrowed or debt incurred" does not stand extended to the payment of guarantee commission received by the assessee in India.

The expression "interest" is defined to mean amounts payable in respect of any monies borrowed or debts incurred. Undisputedly the appellant had not borrowed any monies. The debt, if any, which could be said to have been incurred was clearly not one owed to the Indian subsidiaries. The income that it received from its Indian subsidiaries was solely in consideration of any liability that could possibly befall in case its Indian subsidiaries were to default in their repayment obligations.

Accordingly, the High Court held that the guarantee fee would neither fall within the ambit of Article 12 of India-UK DTAA nor section 2(28A) of the Act.

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Limitation of interest deduction (Section 94B): A Summary

**"Total interest paid or payable" may be interpreted as interest paid or payable to non-resident associated enterprise as per the intent expressed in section 94B(1) and also the Explanatory Memorandum to the Finance Bill, 2017.*

ILLUSTRATION 9

ND Ltd., an Indian Company, has borrowed ₹ 90 crores on 01-04-2025 from M/s. TM Inc, a company incorporated in London, at an interest rate of 10% p.a. The said loan is repayable over a period of 5 years. Further, this loan is guaranteed by M/s TY Inc. incorporated in UK. M/s. TD Inc, a non-resident, holds shares carrying 40% of voting power both in M/s ND Ltd. and M/s TY Inc.

Net profit of M/s. ND Ltd. for P.Y. 2025-26 was ₹ 11 crores after debiting the above interest, depreciation of ₹ 5 crores and income-tax of ₹ 4 crores.

Calculate the amount of interest to be allowed to be claimed under the head "Profits and gains of business or profession" in the computation of M/s ND Ltd. giving appropriate reasons. Also explain allowability of such disallowed interest, if any.

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SOLUTION

If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds ₹ 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall **not** be allowed as deduction as per section 94B.

Further, where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise and limitation of interest deduction would be applicable.

In the present case, since M/s TD Inc holds 40% of voting power i.e., more than 26% of voting power in both ND Ltd and M/s TY Inc, ND Ltd. and M/s TY Inc are deemed to be associated enterprises.

Since loan of ₹ 90 crores taken by ND Ltd., an Indian company from M/s TM Inc, is guaranteed by M/s TY Inc, an associated enterprise of ND Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s TM Inc shall be considered for the purpose of limitation of interest deduction u/s 94B.

Computation of interest to be allowed as per section 94B in the computation of income under the head profits and gains of business or profession of ND Ltd.

Particulars		₹ (in crores)
Net profit		11.00
Add: Interest already debited (₹ 90 crores x 10%)		9.00
Depreciation		5.00
Income-tax		4.00
EBITDA		**29.00**
Interest paid or payable by ND Ltd.		**9.00**
Lower of the following would be disallowed		
- Total interest paid or payable in excess of 30% of EBITDA (₹ 9,00,00,000 – ₹ 8,70,00,000) = ₹ 30 lakhs	0.30	
- Interest paid or payable to non-resident AE	9.00	
Interest to be disallowed as deduction		**0.30**
Interest allowable as deduction under the head "Profits and gains from business or profession (₹ 9,00,00,000 – ₹ 30,00,000)		**8.70**

Disallowed interest of ₹ 30 lakhs can be carried forward to the subsequent assessment year and it would be allowed as deduction against profits and gains, to the extent of allowable interest expenditure u/s 94B.

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TEST YOUR KNOWLEDGE

Questions

1. *Examine the consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?*

2. *Mr. Hari holds 30% of voting power in ABC Inc, a company incorporated under the laws of Country A. For the purpose of expansion of business, the said company enters into an agreement with XYZ Ltd., a company incorporated under the Indian laws. As per one of the clauses of the agreement, ABC Inc has the power to appoint 6 directors of XYZ Ltd., which has 12 directors on the board. Further, total purchases by XYZ Ltd. for the F.Y. 2025-26 is estimated to be ₹ 500 crores, out of which, purchases of ₹ 48 crores has been sourced locally and the balance shall be supplied by ABC Inc. The price for entire purchase has been fixed in the agreement and the conditions for supply are determined by ABC Inc.*

   Advise Mr. Hari as to whether ABC Inc and XYZ Ltd are Associated Enterprises, on the basis of the provisions of the Income-tax Act, 1961.

3. *I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2025-26. I. Limited also supplied the same product to another UK based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited.*

4. *X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of international transactions of ₹ 300 lakhs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of ₹ 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.*

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5. *Anush Motors Ltd., an Indian company declared income of ₹ 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2026:*

   (i) *10,000 cars sold to Rida Ltd., US company, which holds 30% shares in Anush Motors Ltd. at a price which is less by $ 200 for each car than the price charged from Shingto Ltd.*

   (ii) *Royalty of $ 1,20,00,000 was paid to Kyoto Ltd., a US company, for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000. Kyoto Ltd. is the sole owner of technology used by Anush Motors Ltd. in its manufacturing process and the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.*

   (iii) *Loan of Euro 1000 crores carrying interest @10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2026. The total book value of assets of Anush Motors Ltd. on the date was ₹ 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @9% p.a. Total interest paid for the year was EURO 100 crores.*

   Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2026-27 keeping in mind that the value of 1$ and of 1 EURO was ₹ 63 and ₹ 84, respectively, throughout the year.

6. *What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions? Examine.*

7. *XE Ltd. is an Indian Company in which Zilla Inc., a US company, has 28% shareholding and voting power. Following transactions were effected between these two companies during the financial year 2025-26.*

   (i) *XE Ltd. sold 1,00,000 pieces of T-shirts at $ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc., at $ 3 per T-Shirt.*

   (ii) *XE Ltd. borrowed $ 2,00,000 from a foreign lender based on the guarantee of Zilla Inc. For this, XE Ltd. paid $ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected $ 7000 as guarantee fee.*

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(iii) XE Ltd. paid $15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for $ 10,000.

Assume the rate of exchange as 1 $ = ₹ 64

XE Ltd. is located in a Special Economic (SEZ) and its income before transfer pricing adjustments for the year ended 31st March, 2026 was ₹ 1,200 lakhs.

Compute the adjustments to be made to the total income of XE Ltd. Assuming that such adjustments are made by the Assessing Officer, state whether it can claim deduction under section 10AA for the income enhanced by applying transfer pricing provisions.

8. Examine with reasons whether the two enterprises referred to in the independent situations given below can be deemed to be associated enterprises under the Indian transfer pricing regulations:

(i) PQR Inc, a US company having its place of effective management also in the USA, has advanced a loan equivalent to ₹ 170 crores to Mahanadi Ltd., an Indian company on 10-4-2025. The total book value of assets of Mahanadi Ltd. is ₹ 300 crores. The market value of the assets, however, is ₹ 320 crores. Mahanadi Ltd. repaid ₹ 30 crores before 31-3-2026.

(ii) Queenland plc., a French company having its place of effective management also in the France, has the power to appoint 3 of the directors of Godavari Ltd, an Indian company, whose total number of directors in the Board is 8.

(iii) Total value of raw materials and consumables of Saraswati Ltd., an Indian company, is ₹ 900 crores. Of this, supplies to the tune of ₹ 830 crores are by Zoel GmbH, a German company having its place of effective management in Germany, at prices and terms decided by the German company.

9. NP Ltd., an Indian Company, has borrowed ₹ 80 crores on 01-04-2025 from M/s. TL Inc, a company incorporated in London, at an interest rate of 10% p.a. The said loan is repayable over a period of 5 years. Further, loan is guaranteed by M/s ST Inc. incorporated in UK. M/s. Tweed Inc, a non-resident, holds shares carrying 40% of voting power both in M/s NP Ltd. and M/s ST Inc.

Net profit of M/s. NP Ltd. for P.Y. 2025-26 was ₹ 7 crores after debiting the above interest, depreciation of ₹ 6 crores and income-tax of ₹ 4 crores. Calculate the amount of interest to

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be disallowed under the head "Profits and gains of business or profession" in the computation of M/s NP Ltd., giving appropriate reasons.

10. *MNO Ltd., having its registered office in Mumbai, is engaged in multiple businesses. It has borrowed ₹ 200 crores from State Bank of India (SBI) for which 100% guarantee was given by the parent company, ABC Inc. of Country A. The total borrowings of MNO Ltd. is ₹ 1,000 crores.*

    MNO Ltd. buys mobile phones from ABC Inc. The mobile phones are branded for which royalty at ₹ 100 per mobile phone sold is paid to ABC Inc. Similar mobile phones are also sold to other customers in India by ABC Inc. but no royalty is charged from them. The credit period offered to MNO Ltd. is 2 months, whereas for other customers, the credit period is 1 month. During the year, 10 lakh mobile phones were bought for an aggregate sum of ₹ 2,600 crores from ABC Inc. The purchase could be assumed as uniform throughout the financial year 2025-26. The cost of capital may be adopted as 10% per annum. ABC Inc. would have billed ₹ 2,400 crores (excluding interest component for the delay beyond 1 month) for supply of identical quantity of similar mobile phones to other customers. It may be assumed that the entire purchase has been sold out by 31st March, 2026.

    Determine the arm's length price (ALP) of the transaction of purchase of mobile phones by MNO Ltd. from ABC Inc., Country A and its impact on the assessable income, if any, for the assessment year 2026-27.

11. *Beta Ltd., an Indian company, has two units in India, a manufacturing unit in Hyderabad and a trading unit in Surat. Beta Ltd. has entered into various international transactions with its associate enterprises from both the units. The assessment of Beta Ltd., an Indian company, for A.Y.2026-27 is pending before the Assessing Officer who referred the matter to Transfer Pricing Officer (TPO) for determination of arm's length price (ALP) in respect of its manufacturing unit at Hyderabad. The TPO, however, expanded the scope of his work by calling for details in respect of the trading unit of Beta Ltd. located at Surat.*

    Examine the procedure to be followed by the Assessing Officer before making reference to TPO. Can the TPO enlarge his scope of work by calling for details of trading activity at Surat, when the Assessing Officer has made reference only in respect of the manufacturing unit at Hyderabad? Examine.

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Answers

1. In case the Assessing Officer makes adjustment to arm's length price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:-

(1) No deduction under section 10AA or Chapter VI-A shall be allowed from the income so increased.

(2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

(1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days of the receipt of draft order by him to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.

(2) In any other case, he can file an appeal under section 246 to the Joint Commissioner (Appeals)/ under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.

(3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

2. Two enterprises shall be deemed to be associated enterprises if, at any time during the previous year, more than half of the board of directors or members of the governing board, or one or more of the executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise.

In the present case, the power to appoint is only for half the number and not more than half. Hence, ABC Inc. and XYZ Ltd. are not associated enterprises under this criteria.

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Two enterprises shall be deemed to be associated enterprises, if 90% or more of the raw materials and consumables required for the manufacture or processing of goods or article 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.

In this case, ABC Inc. supplies more than 90% of the requirements of purchases of XYZ Ltd. Further, the price is controlled by the former by way of written agreement. Also, the conditions for supply are determined by ABC Inc. Hence, the two entities would be deemed to be associated enterprises under this criterion.

3. In this case, I. Limited, the Indian company, supplied billets to its foreign holding company, U. Limited. Since the foreign company, U. Limited, is the holding company of I. Limited, I. Limited and U. Limited are the associated enterprises within the meaning of section 92A.

As I. Limited supplies similar product to an unrelated entity, V. Limited, UK, the transactions between I. Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between I. Limited and U. Limited Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with U. Limited are on FOB basis, whereas transactions with V. Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

	Amount (in Euro)
Price per MT of billets to V. Limited	700
Less: Cost of insurance and freight per M.T.	200
Adjusted Price per M.T.	500

Since the adjusted price for V. Limited, UK and the price fixed for U. Limited are the same, the arm's length price is Euro 500 per MT. Since the sale price to related party (i.e., U. Limited) and unrelated party (i.e., V. Limited) is the same, the transaction with related party U. Limited has also been carried out at arm's length price.

4. The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds 55% shares of X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of "international transaction" under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm's length price.

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The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

(i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X applies, would attract penalty @ 200% of the amount of tax payable since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

(ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.

(iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of ₹ 1 lakh.

The Assessing Officer shall give an opportunity of hearing to the assessee with a notice as to why the arm's length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

Note: *It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.*

5. Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that "Anush Motors Ltd." is associated with :-

(i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

(ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

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The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2026-27.

Particulars		₹ (in crores)
Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		300.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ $ 200 each for 10,000 cars ($ 200 x 10,000 x ₹ 63)	12.60
(ii)	Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 x ₹ 63) [See Note below]	18.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (₹ 84*1000*1/100)	840.00
Total Income		**1,171.50**

***Note**: It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.*

6. The presence of multinational enterprises in India and their ability to allocate profits in different jurisdictions by controlling prices in intra-group transactions prompted the Government to set up an Expert Group to examine the issues relating to transfer pricing.

There is a possibility that two or more entities belonging to the same multinational group can fix up their prices for goods and services and allocate profits among the enterprises within the group in such a way that there may be either no profit or negligible profit in the jurisdiction which taxes such profits and substantial profit in the jurisdiction which is tax haven or where the tax liability is minimum. This may adversely affect a country's share of due revenue. The increasing participation of multinational groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intra-group transactions, which may lead to erosion of tax revenue. Therefore, transfer pricing provisions have been brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises.

7. XE Ltd, the Indian company and Zilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Zilla Inc. holds shares carrying not less than 26% of the voting power in XE Ltd.

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As per *Explanation* to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price. In this case, from the information given, the arm's length price has to be determined taking the comparable uncontrolled price method to be the most appropriate method.

Particulars	₹ in lakhs
Amount by which total income of XE Ltd. is enhanced on account of adjustment in the value of international transactions:	
(i) Difference in price of T-Shirt @ $ 1 each for 1,00,000 pieces sold to Zilla Inc. ($ 1 x 1,00,000 x ₹ 64)	64.00
(ii) Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender ($ 3,000 x ₹ 64)	1.92
(iii) Difference for excess payment for services to Zilla Inc. ($ 5,000 x ₹ 64)	3.20
	69.12
XE Ltd. cannot claim deduction under section 10AA in respect of ₹ 69.12 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4)	

8. **(i)** PQR Inc, a foreign company, has advanced loan of ₹ 170 crores to Mahanadi Ltd., an Indian company, which amounts to 56.67% of book value of assets of Mahanadi Ltd. Since the loan advanced by PQR Inc. is 51% or more of the book value of assets of Mahanadi Ltd., PQR Inc. and Mahanadi Ltd. are deemed to be associated enterprises under the Indian transfer pricing regulations.

The deeming provisions would be attracted even if there is a repayment of loan during the same previous year which brings down the said percentage below 51%.

(ii) Queenland plc, a foreign company has the power to appoint 37.50% (3 out of 8) of the directors of an Indian company, Godavari Ltd.

Two enterprises would be deemed to be associated enterprises **if more than half of the board of directors** of one enterprise **are appointed by the other enterprise.**

In this case, since Queenland plc has the power to appoint only 37.50% (which is less than half) of the directors of an Indian company, Godavari Ltd., Queenland plc and Godavari Ltd. are **not** deemed to be associated enterprises.

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(iii) Since Zoel GmbH, a German company, supplies 92.22% of the raw materials and consumables required by Saraswati Ltd., an Indian company, which is more than the specified threshold of 90%; and the prices and terms of supply are decided by the German company, the two companies are deemed to be associated enterprises.

9. If an Indian company, being the borrower, incurs any expenditure by way of interest in respect of any debt issued by its non-resident associated enterprise (AE) and such interest exceeds ₹ 1 crore, then, the interest paid or payable by such Indian company in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is lower, shall not be allowed as deduction as per section 94B.

Further, where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise and limitation of interest deduction would be applicable.

In the present case, since M/s Tweed Inc holds 40% of voting power i.e., more than 26% of voting power in both NP Ltd and M/s ST Inc, NP Ltd. and M/s ST Inc are deemed to be associated enterprises.

Since loan of ₹ 80 crores taken by NP Ltd., an Indian company from M/s TL Inc, is guaranteed by M/s ST Inc, an associated enterprise of NP Ltd., such debt shall be deemed to have been issued by an associated enterprise and interest payable to M/s TL Inc shall be considered for the purpose of limitation of interest deduction under section 94B.

Computation of interest to be disallowed as per section 94B in the computation of income under the head profits and gains of business or profession of NP Ltd.

Particulars	₹
Net profit	7,00,00,000
Add: Interest already debited (₹ 80 crores x 10%)	8,00,00,000
Depreciation	6,00,00,000
Income tax	4,00,00,000
EBITDA	**25,00,00,000**
Interest paid or payable by NP Ltd.	8,00,00,000

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Lower of the following would be disallowed		
- Total interest paid or payable in excess of 30% of EBITDA (₹ 8,00,00,000 – ₹ 7,50,00,000)	₹ 50,00,000	
- Interest paid or payable to non-resident AE	₹ 8,00,00,000	
Interest to be disallowed as deduction		**50,00,000**

10. MNO Ltd., an Indian company, and ABC Inc., a Country A based company, are associated enterprises as per section 92A, since ABC Inc. is a parent company of MNO Ltd. Thus, the transaction of purchase of mobile handsets by MNO Ltd. from ABC Inc. would be an international transaction. The value of international transaction is to be worked out on the basis of Arm's Length Price (ALP).

ABC Inc. is selling mobile phones to unrelated customers, which would be the comparable uncontrolled transaction in this case. The purchase price for unrelated customers has to be adjusted by taking into consideration the functional differences existing between the transactions of ABC Inc. with associated enterprise (MNO Ltd.) and other unrelated parties.

Accordingly, the arm's length price for purchase of mobile phones has to be computed for working out the impact on assessable value as per CUP method.

Computation of Arm's Length Price

Particulars	₹ in crores
Purchase price of mobile phones by unrelated parties from ABC Inc.	2,400
Adjustments for functional differences	
Add: Royalty payable by MNO Ltd. [₹ 100 per mobile phone x 10,00,000]	10
Cost of capital for 1 month credit which is not given to unrelated party [10% x ₹ 2,400 crore x 1/12]	20
Arm's Length Price of 10,00,000 mobile phones (A)	**2430**
Purchase price of mobile phone by MNO Ltd. from ABC Inc., its parent company (associated enterprise) (B)	**2600**
Amount to be added to its total income (B) – (A)	**170**

Note *– In case it is assumed that ₹ 10 crores is not included in the price of ₹ 2600 crores, the adjustment of royalty of ₹ 10 crores paid/payable is not required. The ALP in such a case would be ₹ 2,420 crores. The amount to be added to the total income would be ₹ 180 crores.*

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11. As per section 92CA(1), where the Assessing Officer considers it necessary or expedient so to do, he may refer the computation of the arm's length price in relation to the international transaction or specified domestic transaction entered by any person, being an assessee, to the Transfer Pricing Officer (TPO).

However, the Assessing Officer has to take the prior approval of the Principal Commissioner of Income-tax (PCIT)/Commissioner of Income-tax (CIT) before making such a reference.

As per section 92CA(2A), the Transfer Pricing Officer (TPO) can also determine the ALP of other international transactions or specified domestic transaction which have not been referred to him, but which have come to his notice subsequently in the course of proceedings before him.

The Assessing Officer has made reference for determination of ALP in respect of the manufacturing unit at Hyderabad which shall be taken as the proceedings before him (TPO).

The TPO can enlarge his scope of work during the course of proceedings before him of Hyderabad unit by calling for details of trading activity at Surat, and the same is within the powers conferred by section 92CA(2A).

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CHAPTER 25

FUNDAMENTALS OF BEPS

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **gain** a broad understanding of the concept of Base Erosion and Profit Shifting (BEPS);
- **appreciate** the significance of action plans of BEPS;
- **comprehend and appreciate** the provisions incorporated in the Indian tax laws in line with the different Action Plans of BEPS.

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25.1 BACKGROUND

Impact of Globalisation

Globalisation has benefited our domestic economies, boosted trade and increased foreign direct investments in many countries. The unrestricted movement of capital and labour, the shift of manufacturing bases from high-cost to low-cost locations, the gradual removal of trade barriers, technological and telecommunication developments, and the ever-increasing importance of managing risks and of developing, protecting and exploiting intellectual property, have had an important impact on the way cross-border activities take place. In this way, it accelerated growth, created jobs and fostered innovation. Globalisation is not new, but the pace of integration of national economies and markets has increased substantially in recent years. It has a significant impact on a country's corporate income tax regimes.

Growth of Multi-national Enterprises and consequent tax abuse

Way back in 1920s, pursuant to the first world war, the League of Nations recognised that the interaction of domestic tax systems can lead to double taxation with adverse effects on growth and global prosperity. Globally, countries concur on the need to eliminate double taxation and the need to achieve this on the basis of accepted international laws that are clear and predictable, giving certainty to both governments and businesses. International tax law is, therefore, a pillar in facilitating the development of the global economy. With the economy, the enterprises also became more globally integrated. Multi-national enterprises (MNE) now represent a significant proportion of global GDP.

Also, the increasing significance of the service component of the economy, and of digital products which are deliverable over the Internet, has made it much easier for businesses to locate many productive activities in geographic locations that are distant from the physical location of their customers. These developments have been accompanied by the increasing sophistication of tax planners in identifying and exploiting the legal arbitrage opportunities and the boundaries of acceptable tax planning, thus, encouraging MNEs to minimise their tax burden by resorting to aggressive tax planning.

Adverse Effects of BEPS

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid. This has become a critical issue since governments have to cope with less revenue and a higher cost to ensure compliance. Moreover, BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. In developing countries, the lack of

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tax revenue leads to significant under-funding of public investment that could help foster economic growth. Further, when tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden. Also, enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Need for international collaboration to protect tax sovereignty of its countries

Taxation is at the core of countries' sovereignty, but the interaction of domestic tax laws with the tax laws of other countries in certain cases leads to gaps and frictions. While developing their domestic tax laws, sovereign states may not adequately take into consideration the effect of other countries' laws. The interaction of separate sets of domestic laws enforced by sovereign countries causes frictions, including potential double taxation for corporations operating in many countries. It also causes gaps, in cases where corporate income is untaxed, both in the country of source and in the country of residence, or is taxed only at nominal rates. In the domestic context, coherence is generally achieved through a principle of matching – a payment that is deductible by the payer is usually taxable in the hands of the recipient, unless explicitly exempted. There is no similar principle of coherence at the international level, which leaves considerable scope for arbitrage by taxpayers, though sovereign states have united to ensure coherence in a narrow field, namely, to prevent double taxation. BEPS relates primarily to instances where the interaction of different tax rules & tax systems leads to double non-taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. International standards have tried to reduce these frictions in a manner that respects tax sovereignty; however, gaps still remain. Therefore, there is a need for countries to collaborate on tax matters so that they are able to get their due share of taxes.

25.2 OVERVIEW OF BEPS

In the background of the above repercussions and the global financial crisis in 2009, the G-20 countries shifted their focus to strengthen the international financial system. The G-20 mandated the OECD to address the issue of tax avoidance, in light of which during February 2013, the OECD published a report on "Addressing Base Erosion and Profit Shifting" iterating the need for analyzing the issue of tax base erosion and profit shifting by global corporations. The OECD followed it up with publishing draft Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan) in July 2013

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which came to final fruition in October 2015. The BEPS action plan identifies fifteen actions to address BEPS in a comprehensive manner and sets a deadline to implement those actions.

The Action Plans were structured around three fundamental pillars viz.:

(i) Introducing **coherence** in the domestic rules that affect cross-border activities.

(ii) Reinforcing of **'substance'** requirements in existing international standards; Alignment of taxation with location of value creation and economic activity; and

(iii) Improving **transparency** and **tax certainty**.

A brief classification of the various action plans based on the fundamental pillars is as under:

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Coherence

Domestic tax systems are coherent – tax deductible payments by one person results in income inclusions by the recipient.

International coherence in corporate income taxation - A pre-requisite to complement the standards that prevent double taxation with a new set of standards designed to avoid double non-taxation

Substance

Present tax laws must be modified: To align tax with substance.

Domestic and international tax laws should ideally relate to both income and the economic activity that generates it. - since at times,tax treaty and transfer pricing facilitate the separation of taxable profits from value-creating activities, such as through shell companies that have little or no economic substance.

Concerns in the area of transfer pricing should be addressed within the prevalent system : These areas include returns related to over-capital-isation, risk and intangible assets. Specific rules, either within or beyond the arm's length principle, may be required for this purpose.

Transparency

Greater transparency and improved data: Pre-requisites to evaluate the impact and magnitude of BEPS.

Taxpayers to report their aggressive tax planning arrangements and rules about transfer pricing documentation, breaking down the information on a country-by-country basis: Assist governments identify risk areas and focus their audit strategies.

Making dispute resolution mechanisms more effective: To provide businesses with greater certainty and predictability

The BEPS measures range from new minimum standards to a revision of pre-existing international standards, and to common approaches which will facilitate the convergence of national rules and guidance drawing on best practices.

An unprecedented amount of interest and participation has been witnessed by OECD with more than sixty countries, both OECD members and G-20 countries, being directly involved as a part of technical groups in the development of congruent international tax standards. The Inclusive Framework on BEPS works to ensure that the international tax framework for MNEs remains relevant for today and the future, thereby promoting economic efficiency and global welfare. It will also ensure that governments continue to efficiently raise revenues not only from traditional but also from digital businesses, both for direct tax and indirect tax purposes.

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The summary explanatory statement indicates the level of political commitment by OECD, G20 and other States involved in the 2015 work to the various reports. The OECD has iterated the following terms to indicate the commitment by various participant countries:

New minimum standard - New minimum standard implies application of a new rule to be implemented by all states, since non-implementation may result in negative spill overs (including adverse impact of competitiveness) on other countries. Each of the four BEPS minimum standards [namely, Actions 5, 6, 13 and 14] is subject to peer review in order to ensure timely and accurate implementation and thus safeguard the level playing field. All members of the Inclusive Framework on BEPS commit to implementing the minimum standards and commit to participating in the peer review.

Revision of a standard which already exists – Existing standards have been updated and will be implemented but with the caveat that all BEPS participants have not endorsed the underlying standards on tax treaties or transfer pricing; and

Best practice – A best practice is not a standard but optional recommendation for states to follow. Guidance based on best practices will support those countries proposing to act in the areas of mandatory disclosure initiatives or controlled foreign company (CFC) legislation.

(1) ACTION PLAN 1 – ADDRESSING THE CHALLENGES OF THE DIGITAL ECONOMY

Digital economy: Dissolving link between income-producing activity and physical location

At present, in the digital domain, business may be conducted without regard to national boundaries and may dissolve the link between an income-producing activity and a specific location. Hence, business in digital domain doesn't actually occur in any physical location but instead takes place in "cyberspace." Persons carrying business in digital domain could be located anywhere in the world. Entrepreneurs across the world have been quick to evolve their business to take advantage of these changes. It has also made it possible for the businesses to conduct themselves in ways that did not exist earlier, and given rise to new business models that rely more on digital and telecommunication network, do not require physical presence, and derives substantial value from data collected and transmitted from such networks.

Given the rise of e-commerce, an entire digital economy has emerged in the last decade. Since there is a concept of 'intangibility' attached to the digital model of business, tax authorities often faced challenges rightly bringing to tax the profits earned from a digital business. To address the

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same, the first action plan of the BEPS project was developed by the OECD which outlines the methods and principles based on which physical and digital economies can be taxed at par. Before the same, physical locations of the servers of such digital businesses were considered to establish the tax jurisdiction in which the profits of digital businesses could be taxed. It was observed that servers were, therefore, placed in tax efficient jurisdictions, even though the main income generation and customers were from other jurisdictions.

Taxation issues in E-Commerce

These new business models under the industrial revolution 4.0 have created new tax challenges. Since the existing international tax system was designed during early 20th century, they remain archaic and are incompatible with the modern day business dynamics:

The typical taxation issues relating to digitalisation are:

(i) the difficulty in characterizing the nature of payment and establishing a nexus or link between a taxable transaction, activity and a taxing jurisdiction,

(ii) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

The digital business, thus, challenges physical presence-based permanent establishment rules. If permanent establishment (PE) principles are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e., place of business, location, and permanency must be reconciled with the new digital reality.

OECD Recommendations under Action Plan 1 of the BEPS project

The OECD has recommended several options to tackle the direct tax challenges which include:

Modifying the existing Permanent Establishment (PE) rule to provide whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website

Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or **imposition of a equalisation levy** on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having PE in other contracting state.

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Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

OECD - BEPS 2.0 – Consensus based solution for tax challenges arising out of digitalisation

The 2015 Action 1 report provided for options to safeguard against BEPS on account of digitalisation, however it did not provide for any recommendations and left it to the discretion of the countries to resort to these measures as part of their domestic law. The report also indicated that it was agreed between the members to continue to monitor developments in respect of the digital economy, with a further report to be delivered by October, 2021

After the delivery of the Interim Report in March 2018, the Inclusive Framework has released details of an agreement on 8th October 2021, titled "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy".

Pillar 1 - Re-allocation of profit and revised nexus rules: This pillar explores potential solutions for determining where tax should be paid for new business models and on what basis ("nexus"), as well as what portion of profits could or should be taxed in the jurisdictions where clients or users are located ("profit allocation").

Pillar 2 - Global anti-base erosion mechanism (Minimum Tax): This pillar explores the design of a system to ensure that multinational enterprises pay a minimum level of tax. This pillar is intended to address remaining issues identified by the OECD/G20 BEPS initiative by providing countries with new tools to protect their tax base from profit shifting to jurisdictions which tax these profits at below the minimum rate.

The Pillar Two Model Rules have been designed to make sure they accommodate a diverse range of tax systems, including different tax consolidation rules, income allocation, entity classification rules etc., as well rules for specific business structures such as joint ventures and minority interests. As such, many of the specific provisions of the Pillar Two Model Rules will not apply to all jurisdictions or each individual inscope MNE. Taxpayers that either have no foreign presence or that have less than EUR 750 million in consolidated revenues are not in scope of the Model Rules. In addition, the Pillar Two Model Rules do not apply to government entities, international organisations and non-profit organisations (preserving domestic tax exemptions for sovereign, non-profit and charitable entities), nor do they apply to entities that meet the definition of a pension, investment or

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real estate fund (preserving the widely shared tax policy of not wishing to add an additional layer of taxation between the investment and the investor). These entities are excluded even if the MNE group they control remains subject to the rules. Taxpayers in scope of the rules calculate their effective tax rate for each jurisdiction where they operate, and pay top-up tax for the difference between their effective tax rate per jurisdiction and the 15% minimum rate. Any resulting top-up tax is generally charged in the jurisdiction of the ultimate parent of the MNE. A de minimis exclusion applies where there is a relatively small amount of revenue and income in a jurisdiction. The Pillar Two Model Rules also contemplate the possibility that jurisdictions introduce their own domestic minimum top-up tax based on the GloBE mechanics, which eliminates (or is at least fully creditable against) any liability under GloBE, thereby preserving a jurisdiction's primary right of taxation over its own income.

Indian Taxation Regime

The concept of 'Significant Economic Presence' (SEP) which is similar to the virtual fixed place PE as recommended in the 2015 BEPS Action Plan 1 report has been introduced in the Income-tax Act, 1961 *vide Explanation 2A* to section 9(1)(i).

Significant economic presence of a non-resident in India shall also constitute business connection in India. Significant economic presence means-

	Nature of transaction	Condition
(a)	in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India	Aggregate of payments arising from such transaction or transactions during the previous year should exceed **₹ 2 crores.**
(b)	systematic and continuous soliciting of business activities or engaging in interaction with users in India	The number of users should be atleast **3 lakhs**.

Further, the above transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) the agreement for such transactions or activities is entered in India;

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

However, where a business connection is established by reason of significant economic presence in India, only so much of income as is attributable to the transactions or activities referred to in (a) or (b) above shall be deemed to accrue or arise in India.

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Chapter VIII in the Finance Act, 2016 on Equalisation Levy

In order to address the challenges of the digital economy, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provided for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India. This was provided for in section 165 of the Finance Act, 2016.

Meaning of "Specified Service"

(1) Online advertisement;

(2) Any provision for digital advertising space or any other facility or service for the purpose of online advertisement.

Specified Service also includes any other service as may be notified by the Central Government.

Further, in order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India or from a non-resident having a permanent establishment in India does not exceed ₹ 1 lakh in any previous year.

However, the consideration received or receivable for specified services would not include the consideration, which are taxable as royalty or fees for technical services in India under the Income-tax Act, 1961 read with the DTAA notified by the Central Government under section 90 or section 90A.

Chapter VIII of the Finance Act, 2016 related to equalisation levy was amended by Finance Act, 2020 to provide for imposition of equalization levy (EL) of 2% on the amount of consideration received/ receivable by an e-commerce operator from e-commerce supply or services.

To reduce the compliance burden, equalisation levy @2% has been withdrawn by the Finance (No. 2) Act, 2024 on consideration received or receivable for e-commerce supply or services, on or after the 1st August, 2024.

Further, equalisation levy @ 6% on specified services has also been withdrawn by the Finance Act, 2025 with effect from 1st April 2025.

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(2) ACTION PLAN 2 - NEUTRALISE THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS

Before understanding what Action Plan 2 recommends, we must understand what a hybrid mismatch is.

Hybrid Mismatch Arrangement: Meaning

A hybrid mismatch is an arrangement that:

Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -

Specific country laws that allow taxpayers to opt for the tax treatment of certain domestic and foreign entities may aid hybrid mismatches. It may not be easy to find out which country has in fact lost tax revenue, since the laws of each country involved have been complied with; however, there is a reduction of the overall tax paid by all parties involved as a whole, which ultimately has an adverse effect on competition, economic efficiency, transparency and fairness.

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Recommended general amendments are as follows:

- **A rule denying transparency to entities where the non-resident investors' resident country treats the entity as opaque;**

Example

Let us say, X Co., a parent company in country X indirectly holds Y Co., an operating company in country Y. Between X Co. and Y Co. is a hybrid entity that is treated as transparent or disregarded for country X tax purposes and as non-transparent for country Y tax purposes. X Co. holds all or almost all equity interest in the hybrid entity which in turn holds all or almost all equity interests in Y Co. The hybrid entity borrows money from a third party and the loan is used to invest equity into Y Co (or to buy the shares in Y Co from either another company of the same group or from an unrelated third party). The hybrid entity pays interest on the loan. Except for the interest, the hybrid entity does not claim any other significant deduction and does not have any significant income.

With respect to Country Y, for tax purposes, Hybrid Entity is subject to corporate income tax. Its interest expenses can be used to offset other country Y group companies' income under the country Y group tax relief regime. On the other hand, country X treats the hybrid entity as transparent or disregarded, with the result that its interest expenses are allocated to X Co, which deducts the interest expense to offset unrelated income. The net effect is that there are two deductions for the same contractual obligation in two different countries.

Therefore, by virtue of rule denying transparency to an entity which is treated as opaque in the subsidiary company's country, the double deduction can be avoided.

- **A rule denying an exemption or credit for foreign underlying tax for dividends that are deductible by the payer;**

Example

N Co, a company resident in country N is funded by M Co., a company resident in country M with an instrument that qualifies as equity in country M but as debt in country N. A payment made under the instrument would be deductible as interest expense for N Co under country N tax law. The corresponding receipts are treated as exempt dividends under the tax laws of country M. Consequently, deduction is available under the tax laws of country N without a corresponding income inclusion in country M.

Therefore, by virtue of rule denying an exemption or credit for foreign underlying tax for dividends that are deductible by the payer, exemption of such income in country M would not be possible.

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- **A rule denying a foreign tax credit for withholding tax where that tax is also credited to some other entity; and**
- **Amendments to CFC and similar regimes attributing local shareholders the income of foreign entities that are treated as transparent under their local law.**

Treaty changes - Action Plan 2 recommends a new provision in the case of income earned by a transparent entity. As per the new provision, treaty benefits will only be afforded to so much of the income of the entity as the income of a resident of that State. A specific or general saving rule is proposed so that a State can tax a resident entity generally unrestricted by treaty.

Anti-hybrid rules - The report further issued a series of dedicated domestic anti-hybrid rules which would work in two stages. The primary rules would deny deductions to payers in situations where either

(i) Those payments will not be included in the recipient's ordinary income, or

(ii) The same amount is being simultaneously deducted by another entity.

Treatment of Branch mismatches: 2017 Report

Branch mismatches arise where the ordinary rules for allocating income and expenditure between the branch and head office result in a portion of the net income of the taxpayer escaping the charge to taxation in both the branch and residence jurisdiction. Unlike hybrid mismatches, which result from conflicts in the legal treatment of entities or instruments, branch mismatches are the result of differences in the way the branch and head office account for a payment made by or to the branch. The 2017 report identifies five basic types of branch mismatch arrangements that give rise to one of three types of mismatches:

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The 2017 report includes specific recommendations for improvements to domestic law intended to reduce the frequency of branch mismatches as well as targeted branch mismatch rules which adjust the tax consequences in either the residence or branch jurisdiction in order to neutralise the hybrid mismatch without disturbing any of the other tax, commercial or regulatory outcomes.

(3) ACTION PLAN 3 - STRENGTHEN CONTROLLED FOREIGN COMPANY (CFC) RULES

Shifting investment income and passive income to subsidiaries in low tax or no tax jurisdictions: Deferral of home country taxation

Under the tax laws of several countries, a shareholder of a corporation is not taxed on the corporation's income until the income is distributed as a dividend. Therefore, it was common for publicly traded companies to form foreign subsidiaries in tax havens and shift "portable" income to those subsidiaries. Generally, income shifted were mainly investment income (interest and dividends) and passive income (rents and royalties), as well as sales and services income involving related parties. Tax in parent country on this income was avoided until the tax haven country paid a dividend to the shareholding company. This dividend could be avoided indefinitely by loaning the earnings to the shareholder without actually declaring a dividend.

Many countries (where global multi-nationals are based) have high tax rates as compared to certain other countries, which used their low tax rates as a means of attracting inward investment. As a result, when dividends were repatriated from these lower tax countries, the recipient generally suffered additional tax on those profits. Therefore, many companies have a tendency to leave the profits from these low-taxed subsidiaries offshore, with the objective of deferring home country taxation.

Obviously, Governments were disturbed that multinationals based in their countries kept large amounts of profits offshore. In order to address this issue, governments in various countries have introduced legislation aimed at eliminating the benefits of deferral, by currently taxing income in the parent country even when the income has not been repatriated or remitted to that country. These rules are generally referred to as Controlled Foreign Corporation (CFC) rules.

CFC Rules: Addressing BEPS

Controlled foreign company (CFC) rules respond to the risk that taxpayers with a controlling interest in a foreign subsidiary can strip the base of their country of residence and, in some cases, other

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countries by shifting income into a CFC. Without such rules, CFCs provide opportunities for profit shifting and long-term deferral of taxation.

The OECD Final Report does not propose a minimum standard for controlled foreign company (CFC) regimes. However, OECD regards CFC rules as being important in tackling BEPS and has made a series of **best practice recommendations** in relation to the 'building blocks' of an effective CFC regime. The major reason why the OECD was unable to provide more than best practice was fundamental disagreement over the policy of CFC regimes, in particular whether states should use the regime to protect other states' tax bases from earnings stripping.

(4) ACTION PLAN 4 – INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS

The OECD is concerned that multinational groups are able to erode their tax base (i.e., reduce their taxable profits) with interest expense, for example by:

- Locating third party debt in high tax countries;
- Using intra-group loans to achieve interest deductions in excess of the group's actual third party interest expense;
- Using related party or third party debt to finance the production of exempt or deferred income.

The use of third party and related party interest is perhaps one of the most simple of the profit-shifting techniques available in international tax planning. The fluidity and fungibility of money makes it a relatively simple exercise to adjust the mix of debt and equity in a controlled entity.

In particular, the deductibility of interest expense can give rise to double non-taxation in both inbound and outbound investment scenarios. The interest payments are deducted against the taxable profits of the operating companies while the interest income is taxed at comparatively low tax rates or not at all at the level of the recipient.

BEPS Action Plan 4 calls for the development of recommendations for the design of domestic rules to prevent tax base erosion through the use of interest expense and other financial payments that are economically equivalent to interest.

Common Approach: Linking an entity's net interest deduction to its level of economic activity

The mobility and fungibility of money enables multinational groups to achieve favourable tax results by adjusting the amount of debt in a group entity. The 2015 Report established a common approach

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which directly links an entity's net interest deductions to its level of economic activity, based on taxable earnings before interest income and expense, depreciation and amortisation (EBITDA). This approach includes three elements:

Indian Taxation Regime

Section 94B of the Income-tax Act, 1961: Addressing Thin Capitalization

Debt financing of cross-border transactions is often favorable than equity financing for taxpayer. In view of the above, in line with the recommendations of OECD BEPS Action Plan 4, section 94B of the Income-tax Act, 1961 provides a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible.

Applicability

The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

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Carry forward of disallowed interest expenditure

The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

Threshold limit

In order to target only large interest payments, it provides for a threshold of interest expenditure of ₹ 1 crore in respect of any debt issued by a non-resident associated enterprise exceeding which the provision would be applicable. Banks, Insurance business and such class of NBFCs notified by the Central Government are excluded from the ambit of the said provisions keeping in view of special nature of these businesses. A finance company, located in any IFSC, has also been excluded from the ambit of said provisions. Also, section 94B would not be attracted on interest paid in respect of debt issued by a lender which is a permanent establishment in India of a non-resident, being a person engaged in the business of banking.

(5) ACTION PLAN 5 – COUNTER HARMFUL TAX PRACTICES

The Action 5 Report is one of the four BEPS minimum standards. The minimum standard of the Action 5 Report consists of two parts. One part relates to preferential tax regimes, where a peer review is undertaken to identify features of such regimes that can facilitate base erosion and profit shifting, and therefore have the potential to unfairly impact the tax base of other jurisdictions. The second part includes a commitment to transparency through the compulsory spontaneous exchange of relevant information on taxpayer-specific rulings which, in the absence of such information exchange, could give rise to BEPS concerns. Thirdly, the review of substantial activities requirements in no or only nominal tax jurisdictions to ensure a level playing field.

Indian Taxation Regime

In India, the Finance Act, 2016 has introduced vide Section 115BBF of the Income-tax Act, a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

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Section 115BBF of the Income-tax Act, 1961: In line with nexus approach of BEPS Action 5

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, section 115BBF of the Income-tax Act, 1961 provides that where the total income of the eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, “developed” means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

(6) ACTION PLAN 6 – PREVENTING TREATY ABUSE

Protection against treaty shopping: Minimum Standard

Bilateral tax treaties concluded by jurisdictions in the world have served to prevent harmful double taxation and remove obstacles to cross-border trade in goods and services, and movements of capital, technology and persons. This extensive network of tax treaties has, however, also given rise to treaty abuse and "treaty-shopping" arrangements.

Treaty shopping typically involves the attempt by a person to indirectly access the benefits of a tax treaty between two jurisdictions without being a resident of one of those jurisdictions. There are a wide number of arrangements through which a person who is not a resident of a jurisdiction that is a party to a tax agreement may attempt to obtain benefits that a tax agreement grants to a resident of that jurisdiction.

Taxpayers engaged in treaty shopping and other treaty abuse strategies undermine tax sovereignty by claiming treaty benefits in situations where these benefits were not intended to be granted, thereby depriving jurisdictions of tax revenues.

Treaty abuse is one of the most important sources of BEPS concerns. It is undesirable for several reasons, including:

- Treaty benefits negotiated between the parties to a treaty are economically extended to residents of a third jurisdiction in a way the parties did not intend. The principle of reciprocity is therefore breached and the balance of concessions that the parties make is altered;

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- Income may escape taxation altogether or be subject to inadequate taxation in a way the parties did not intend; and
- The jurisdiction of residence of the ultimate income beneficiary has less incentive to enter into a tax treaty with the jurisdiction of source, because residents of the jurisdiction of residence can indirectly receive treaty benefits from the jurisdiction of source without the need for the jurisdiction of residence to provide reciprocal benefits.

Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping (the minimum standard). That commitment will require countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

Countries will implement this common intention by including in their treaties:

(i) the combined approach of Limitation of Benefits (LOB) and Principal Purpose Test (PPT) rule,

(ii) the PPT rule alone, or

(iii) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

Implementation of Action 6 Minimum Standard

The latest peer review on the implementation of the Action 6 minimum standard reveals that a large majority of Inclusive Framework members have modified, or are in the process of modifying, their treaty network to implement the minimum standard and other BEPS treaty-related measures.

As in previous editions, the latest peer review report continues to demonstrate the efficiency of the BEPS Multilateral Instrument (BEPS MLI) in implementing the minimum standard. It is by far the main tool of Inclusive Framework members for implementing the minimum standard. The majority of the jurisdictions that have signed the MLI have listed almost all their treaties under the MLI.

The provisions of the BEPS MLI have started to take effect with respect to treaties concluded by pairs of jurisdictions that have signed and ratified the BEPS MLI. For the treaties for which the MLI is effective, tax administrations can now use effective treaty provisions to put an end to treaty shopping.

Indian Tax Regime

LoB clause introduced in India-Mauritius Tax Treaty - On 10th May, 2016, India and Mauritius has signed a protocol amending the India-Mauritius tax treaty at Mauritius. In the said treaty, for the

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first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. The tax rate on such capital gains arising during the period from 1.4.2017-31.3.2019 should, however, not exceed 50% of the tax rate applicable on such capital gains in India. A Limitation of Benefit (LOB) Clause has been introduced which provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. Further, a shell or a conduit company claiming to be a resident of a Contracting State shall not be entitled to this benefit. A shell or conduit company has been defined as any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State. A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian rupee 15,00,000 or Indian ₹ 7,00,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

LoB clause in India-Singapore Tax Treaty - On similar lines, India and Singapore has signed a protocol amending the India-Singapore tax treaty. Capital gains on sale of shares of an Indian company by a resident of Singapore was taxable only in Singapore, if such shares were acquired before 1.4.2017. After amendment of the treaty, capital gains on alienation of shares would be taxable in a similar manner as laid out in India-Mauritius tax treaty, subject to LoB clause. The transition period benefit is also similar to that contained in India-Mauritius Tax Treaty. In respect of shares acquired after 1.4.2017 and sold before 1.4.2019, the expenditure test needs to be met for the 12 month period immediately preceding the date of transfer.

(7) ACTION PLAN 7 – PREVENT THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT (PE) STATUS

Tax treaties generally provide that the business profits of a foreign enterprise are taxable in a jurisdiction only to the extent that the enterprise has in that jurisdiction a permanent establishment to which the profits are attributable. The definition of permanent establishment included in tax treaties is therefore crucial in determining whether a non-resident enterprise must pay income tax in another jurisdiction.

Strategies used to avoid having a taxable presence in a jurisdiction under tax treaties may cause cross-border income to go untaxed or be taxed at low rates. The BEPS Action Plan called for a review of that definition to prevent the use of certain common tax avoidance strategies used to circumvent the former Model permanent establishment definition, such as arrangements through which taxpayers replace subsidiaries that traditionally acted as distributors by commissionnaire

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arrangements, with a resulting shift of profits out of the jurisdiction where the sales took place without a substantive change in the functions performed in that jurisdiction.

These changes will ensure that where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise will be considered to have a taxable presence in that country unless the intermediary is performing these activities in the course of an independent business. The changes will also restrict the application of a number of exceptions to the definition of permanent establishment to activities that are preparatory or auxiliary nature and will ensure that it is not possible to take advantage of these exceptions by the fragmentation of a cohesive operating business into several small operations; they will also address situations where the exception applicable to construction sites is circumvented through the splitting-up contracts between closely related enterprises.

Thus, the following steps have been advocated:

- ***Reworking exceptions to PE definition*** – An anti-fragmentation rule to be adopted to aggregate all activities carried by an enterprise in a state, along with activities undertaken by its closely related entities undertaking business operation that create tax mismatch and are cohesive in nature. The above test can also be applied to understand whether the activities undertaken by an enterprise in a state are 'preparatory or auxiliary'.
- ***Analyzing arrangements entered through contractual agreements*** –A Commissionnaire arrangement may be broadly defined as an arrangement through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a State without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that State on the profits derived from such sales. Since the person that concludes the sales does not own the products that it sells, that person cannot be taxed on the profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission). Commissionnaire arrangements have been a major cause of concern for tax administrations in many countries.

Progress in implementation of BEPS Action Plan 7

The changes to the PE definitions were integrated in the 2017 OECD Model Tax Convention and in Part IV of the MLI (Articles 12 to 15). The Multilateral Instrument (MLI) is a flexible instrument that allows jurisdictions to adopt BEPS treaty-related measures to counter BEPS and strengthen their

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treaty network. The MLI was signed by nearly 90 jurisdictions and about half of the MLI Signatories have so far adopted the MLI articles that implement the permanent establishment changes [For detailed understanding of MLI, refer to discussion under Action 15].

(8) ACTION PLAN 8-10 - TRANSFER PRICING OUTCOMES IN LINE WITH VALUE CREATION/INTANGIBLES/RISK AND CAPITAL AND OTHER HIGH-RISK TRANSACTIONS

Over the last decades and in step with the globalisation of the economy, worldwide intra-group trade has grown exponentially. Transfer pricing rules, which are used for tax purposes, are concerned with determining the conditions, including the price, for transactions within an MNE group resulting in the allocation of profits to companies within the group in different countries. In this regard, based on the arm's length principle, transactions between associated enterprises have to be priced as if the enterprises were independent, operating at arm's length and engaging in comparable transactions under similar conditions and economic circumstances.

The arm's length principle has proven useful as a practical and balanced standard for tax administrations and taxpayers to evaluate transfer prices between associated enterprises, and to prevent double taxation. However, with its perceived emphasis on contractual allocations of functions, assets and risks, the existing guidance on the application of the principle has also proven vulnerable to manipulation. This manipulation can lead to outcomes which do not correspond to the value created through the underlying economic activity carried out by the members of an MNE group. The aforesaid Action plans represent the OECD's work on transfer pricing which has been a core focus of the BEPS Action Plans. The specific Actions focus on Intangibles, Risks and capital and other high-risk transactions. These are the hard areas of transfer pricing and are summarized together in the Final Report 'Aligning Transfer Pricing Outcomes with Value Creation'.

Clarification and Strengthening of existing standards on transfer pricing

Transfer pricing rules, which are set out in Article 9 of tax treaties based on the OECD and UN Model Tax Conventions and the Transfer Pricing Guidelines, are used to determine on the basis of the ALP the conditions, including the price, for transactions within an MNE group. The existing standards in this area have been clarified and strengthened, including the guidance on the arm's length principle and an approach to ensure the appropriate pricing of hard-to-value-intangibles has been agreed upon within the arm's length principle. The work has focused on three key areas.

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Action Plan	Details
8	Addresses transfer pricing issues relating to controlled transactions involving intangibles, since intangibles are by definition mobile and they are generally difficult-to-value. Misallocation of the profits generated by valuable intangibles is a significant cause of BEPS.
9	Contractual allocations of risk are respected only when they are supported by actual decision-making and thus exercising control over these risks. Moreover, Action 9 addresses the level of returns to funding provided by a capital-rich MNE group member, where those returns do not correspond to the level of activity undertaken by the funding company.
10	This action focuses on other high-risk areas, which include: - the scope for addressing profit allocations resulting from controlled transactions which are not commercially rational, - the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and - the use of certain type of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with the value-creation.

Progress in Implementation

- Additional guidance on the attribution of profits to permanent establishments resulting from the changes in the Action 7 Final Report to Article 5 of the OECD Model Tax Convention was published in March 2018.
- Revised guidance on transactional profit split method (Action 10) was published in June 2018 and has been incorporated into the next edition of the OECD Transfer Pricing Guidelines.
- Additional guidance addressed to tax administrations on the application of the hard-to-value intangibles (HTVI) approach (Action 8) was finalised in June 2018 and has been incorporated in the next edition of the OECD Transfer Pricing Guidelines.
- New transfer pricing guidance on financial transactions (Actions 4 and 8-10) was published in February 2020 and has been incorporated in the next edition of the OECD Transfer Pricing Guidelines.

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(9) ACTION PLAN 11 – MEASURING AND MONITORING BEPS

The adverse fiscal and economic impacts of BEPS have been the focus of the OECD/G20 BEPS Project since its inception. While anecdotal evidence has shown that tax planning activities of some multinational enterprises (MNEs) take advantage of the mismatches and gaps in the international tax rules, separating taxable profits from the underlying value-creating activity, The Addressing Base Erosion and Profit Shifting report (OECD, 2013) recognised that the scale of the negative global impacts on economic activity and government revenues have been uncertain.

Although measuring the scale of BEPS proves challenging given the complexity of BEPS and the serious data limitations, the fiscal effects of BEPS are significant. BEPS causes other adverse economic effects, including tilting the playing field in favour of tax-aggressive MNEs, exacerbating the corporate debt bias, misdirecting foreign direct investment, and reducing the financing of needed public infrastructure.

Measuring the impact and scale of BEPS activities and the effect of the implementation of the BEPS measures are important components of the ongoing work of the OECD/G20 Inclusive Framework on BEPS. Such measurement and monitoring is necessary to inform both policymakers and taxpayers of the effectiveness of the BEPS measures and the extent to which BEPS issues continue to exist.

Indicators of BEPS activity

Six indicators of BEPS activity highlight BEPS behaviour using different sources of data, employing different metrics, and examining different BEPS channels. When combined and presented as a dashboard of indicators, they confirm the existence of BEPS, and its continued increase in scale in recent years.

(i) **The profit rates of MNE affiliates located in lower-tax countries are higher than their group's average worldwide profit rate.** For example, the profit rates reported by MNE affiliates located in lower-tax countries are twice as high as their group's worldwide profit rate on average.

(ii) **The effective tax rates paid by large MNE entities are estimated to be lower than similar enterprises with only domestic operations** - This tilts the playing-field against local businesses and non-tax aggressive MNEs, although some of this may be due to MNEs' greater utilisation of available country tax preferences.

(iii) **Foreign direct investment (FDI) is increasingly concentrated -** FDI in countries with net FDI to GDP ratios of more than 200% increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.

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(iv) **The separation of taxable profits from the location of the value creating activity is particularly clear with respect to intangible assets, and the phenomenon has grown rapidly** - For example, the ratio of the value of royalties received to spending on research and development in a group of low-tax countries was six times higher than the average ratio for all other countries, and has increased three-fold between 2009 and 2012.

(v) **Royalties received by entities located in these low-tax countries accounted for 3% of total royalties** - This provides evidence of the existence of BEPS, though not a direct measurement of the scale of BEPS.

(vi) **Debt from both related and third-parties is more concentrated in MNE affiliates in higher statutory tax-rate countries**. The interest-to-income ratio for affiliates of the largest global MNEs in higher-tax rate countries is almost three times higher than their MNE's worldwide third-party interest-to-income ratio.

(10) ACTION PLAN 12 – DISCLOSURE OF AGGRESSIVE TAX PLANNING ARRANGEMENTS

A significant challenge faced by tax authorities worldwide is the lack of timely, comprehensive and relevant information on aggressive tax planning strategies. Timely access to such information would facilitate quick response to tax risks through informed risk assessment, audits, or changes to legislation or regulations. Action 12 contains recommendations regarding the design of mandatory disclosure rules for aggressive tax planning schemes, taking into consideration the administrative and compliance costs for tax administrations and business and drawing on experiences of countries that have implemented such rules. It recognises the advantages of tools designed to facilitate the information flow on tax risks to tax administrations and tax policy makers. The Report provides a modular framework for guidance drawn from best practices for use by countries without mandatory disclosure rules to design a regime that suits their requirement to get early information on potentially aggressive or abusive tax planning schemes and their users. The Action 12 report also sets out specific recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations. The recommendations in this Report do not represent a minimum standard and countries can decide whether or not to introduce mandatory disclosure regimes. Where a country opts for mandatory disclosure rules, the recommendations provide the necessary flexibility to balance a country's need for better and more timely information with the compliance burdens for taxpayers. It also sets out specific best practice recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations.

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(11) ACTION PLAN 13 – RE-EXAMINE TRANSFER PRICING DOCUMENTATION

The lack of quality data on corporate taxation has been a major limitation to measuring the fiscal and economic effects of tax avoidance, making it difficult for authorities to carry out transfer pricing assessments on transactions between linked companies and even more difficult to carry out audits.

Under BEPS Action 13, all large multinational enterprises (MNEs) are required to prepare a country-by-country (CbC) report with aggregate data on the global allocation of income, profit, taxes paid and economic activity among tax jurisdictions in which it operates. This CbC report is shared with tax administrations in these jurisdictions, for use in high level transfer pricing and BEPS risk assessments. This report contains revised standards for transfer pricing documentation incorporating a master file, local file, and a template for country-by-country reporting of revenues, profits, taxes paid and certain measures of economic activity. The revised standardised approach requires taxpayers to articulate consistent transfer pricing positions and will provide tax administrations with useful information to assess transfer pricing and other BEPS risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries. Country-by-country reports will be disseminated through an automatic government-to-government exchange mechanism. The implementation package included in this report sets out guidance to ensure that the reports are provided in a timely manner, that confidentiality is preserved and that the information is used appropriately, by incorporating model legislation and model Competent Authority Agreements forming the basis for government-to-government exchanges of the reports.

Requirements as per OECD report on Action 13 of BEPS Action Plan

The OECD report provides for:

(a) revised standards for transfer pricing documentation; and

(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

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Three-tier structure mandated by BEPS

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure:-

	Document	Information
(1)	Master File	Standardised information relevant for all multinational enterprises (MNE) group members. Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.
(2)	Local file	Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.
(3)	Country-by-country report	The BEPS Action 13 report provides a template for multinational enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business the information set out therein. This report is called the Country-by-Country (CbC) Report. To facilitate the implementation of the CbC Reporting standard, the BEPS Action 13 report includes a CbC Reporting Implementation Package which consists of (i) model legislation which could be used by countries to require the ultimate parent entity of an MNE group to file the CbC Report in its jurisdiction of residence including backup filing requirements and (ii) three model Competent Authority Agreements that could be used to facilitate implementation of the exchange of CbC Reports, respectively based on the: a) Multilateral Convention on Administrative Assistance in Tax Matters; b) Bilateral tax conventions; and c) Tax Information Exchange Agreements (TIEAs). **Following information are required in the CbC report**: Information relating to the global allocation of the MNE's income and taxes paid; and Indicators of the location of economic activity within the MNE group.

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		CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

Advantages of the three-tier structure [As per BEPS Report]:

(a) Taxpayers will be required to articulate consistent transfer pricing positions;

(b) Tax administrations would get useful information to assess transfer pricing risks;

(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

Indian Taxation Regime

Transfer Pricing provisions under the Income-tax Act, 1961

Chapter X of the Income-tax Act, 1961 comprising sections 92 to 92F contain provisions relating to transfer pricing regime.

Section 92D requires maintenance of prescribed information and document relating to the international transaction and specified domestic transaction by every person who has entered into an international transaction. Also, a constituent entity of an international group is required to keep and maintain the prescribed information and document in respect of the international group.

Implementation of international consensus in India

India is one of the active members of BEPS initiative and part of international consensus. For the purpose of implementing the international consensus, a specific reporting regime in respect of CbC reporting and also the master file has been incorporated in the Income-tax Act, 1961. The essential elements have been incorporated in the Income-tax Act, 1961 while the remaining aspects would be dealt with in detail in the Income-tax Rules, 1962.

Note *– Refer to Chapter 24 Transfer Pricing, wherein the following have been discussed at length -*

(i) Elements relating to CbC reporting requirement and related matters which have been incorporated in section 286 of the Income-tax Act, 1961

(ii) Maintenance and furnishing of Master file: Consequent provisions incorporated in section 92D of the Income-tax Act, 1961.

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Threshold limit of consolidated group revenue for applicability of CbC reporting requirement

The CbC reporting requirement for a reporting year does not apply unless the consolidated revenues of the preceding accounting year of the group, based on consolidated financial statement, exceeds a threshold to be prescribed. This threshold for total consolidated group revenue of the international group prescribed under section 286 of the Income-tax Act, 1961 read with Rule 10DB of the Income-tax Rules, 1962 is ₹ 6,400 crores.

(12) ACTION PLAN 14 – MAKING DISPUTE RESOLUTION MORE EFFECTIVE

As novel challenges relating to international taxation surface, the necessity of having robust dispute resolution processes in place becomes increasingly apparent.

Recent statistics show that tax administrations are closing more cases than ever before. However, new MAP cases as from 2016 are increasing significantly, thus putting upward pressure on countries' MAP inventories. Therefore, the total inventory of MAP cases keeps increasing every year since the number of cases closed has not been able to keep up with the number of new cases.

The BEPS Action 14 Minimum Standard seeks to improve the resolution of tax-related disputes between jurisdictions. Inclusive Framework jurisdictions have committed to have their compliance with the minimum standard reviewed and monitored by its peers through a robust peer review process that seeks to increase efficiencies and improve the timeliness of the resolution of double taxation disputes.

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Eliminating opportunities for cross-border tax avoidance and evasion and the effective and efficient prevention of double taxation are significant to developing an international tax system that facilitates economic growth and a buoyant global economy. Countries concur that the measures introduced to address BEPS pursuant to the BEPS Action Plans should not result in unnecessary uncertainty for compliant taxpayers and in unintended double taxation. Improving dispute resolution mechanisms is, therefore, a critical component of the work on BEPS issues.

The Action 14 Minimum Standard consists of elements and best practices, which assess a jurisdiction's legal and administrative framework in the following four key areas:

- preventing disputes;
- availability and access to MAP;
- resolution of MAP cases;
- implementation of MAP agreements.

Peer review implications for India

- The BEPS Action Plan 14 had suggested a peer review mechanism to ensure adequate implementation of the suggested minimum standard. As a result, the peer review undertaken for India in 2019 highlighted India's progress on MAP Programme and suggested recommendations for more effective functioning of the MAP. According to the peer review and BEPS Action Plan 14, the Indian tax authorities have taken significant steps to reform the MAP framework and make it effective.
- The significant reforms include:
  - The CBDT substituted Rule 44G and omitted Rule 44H of the Income-tax Rules, 1962 vide *CBDT Notification No. 23/2020 dated 6th May, 2020*. The new rule 44G extensively deals with the implementation and the procedural framework for the MAP process.
  - In line with the BEPS Action Plan 14 recommendation, India had released a detailed guidance note on MAP dated 7th August, 2020, available at https://www.incometaxindia.gov.in/news/map_guidance_7_8_2020.pdf. The MAP guidance addresses many of the open issues on procedural aspects of MAP and, more importantly, clarifies key practical nuances absent in the pre-BEPS era regime for the taxpayers to resort.

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(13) ACTION PLAN 15 – DEVELOPING A MULTILATERAL INSTRUMENT

MLI's role in tackling BEPS

Abuse of tax treaties is an important source of BEPS. The MLI helps the fight against BEPS by implementing the tax treaty-related measures developed through the BEPS project in existing bilateral tax treaties in a synchronized and efficient manner. These measures will prevent treaty abuse, improve dispute resolution, prevent the artificial avoidance of permanent establishment status and neutralize the effects of hybrid mismatch arrangements.

Action 15 of the BEPS Action Plan provides for an analysis of the tax and public international law issues related to the development of a multilateral instrument to enable countries that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties.

Formation of ad hoc Group to develop MLI

Based on this analysis, a mandate for the formation of an ad hoc Group to develop a multilateral instrument on tax treaty measures to tackle BEPS, was approved by the OECD Committee on Fiscal Affairs and endorsed by the G20 Finance Ministers and Central Bank Governors in February 2015.

In line with Action 15 report, an ad-hoc group was formed with a pre-defined purpose of development of such Multilateral Instrument (MLI) and that adopted the text of the Convention and accompanying Explanatory Statement in November 2016. India was part of the Ad Hoc Group of more than 100 countries and jurisdictions from G20, OECD, BEPS associates and other interested countries, which worked on an equal footing on the finalization of the text of the Multilateral Convention, starting May 2015. The text of the Convention and the accompanying Explanatory Statement was adopted by the Ad hoc Group on 24th November 2016.

Features of MLI

The Multilateral Convention is, thus, an outcome of the OECD/ G20 Project to tackle Base Erosion and Profit Shifting (the "BEPS Project") i.e., tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

The MLI modifies tax treaties that are "Covered Tax Agreements". A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.

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The MLI is a flexible instrument which will modify tax treaties according to a jurisdiction's policy preferences with respect to the implementation of the tax treaty-related BEPS measures. The MLI provides for different types of flexibility:

(i) jurisdictions can choose amongst alternative provisions in certain MLI articles;

(ii) jurisdictions can choose to apply optional provisions (for instance, the provisions on mandatory binding arbitration);

(iii) jurisdictions may also choose to reserve the right not to apply MLI provisions (to opt out through a "reservation") with respect to all of their Covered Tax Agreements or with respect to a subset of their Covered Tax Agreements. Jurisdictions only have the possibility to opt out of provisions that do not reflect a BEPS minimum standard, with the possibility to withdraw their reservation (and opt in) later.

Coverage of the MLI

In the first signing ceremony of the MLI on 7th June, 2017, more than 65 countries have signed the MLI making it a historic moment in the international tax framework. India is an active participant in the BEPS programme and was one of the jurisdictions during the signing event. USA and Brazil have not signed the MLI and thereby not a party to this convention. The current status of signatories and parties to MLI is available at https://www.oecd.org/tax/beps/beps-mli-signatories-and-parties.pdf.

The MLI entered into for the avoidance of taxes is a new concept in International Taxation. The fundamentals of MLI can be decoded using the rhetoric 3W1H principles (Why, What, When and How).

Why the need for MLI under the BEPS? – The evolution from Bilateral to Multilateral

Before we embark into what is MLI, we must understand the need for an MLI under the international tax laws. The existing framework of international tax law is through tax treaties entered bilaterally between countries.

The MLI convention is synonymous to a treaty. Treaties are instruments which create international law, it is one of the most common and important sources of international law. They are agreements between sovereign states and are binding on every sovereign state signatory to such agreement. A treaty is defined by the Vienna Convention on the Law of Treaties (commonly referred to as 'VCLT') as 'an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and

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whatever its particular designation'. As much as treaties are instruments under international law, conventions, agreements, charters are all synonymously used along with treaty.

The tax treaty framework is through Countries which have entered into Double Tax Avoidance Agreements (generally referred to as 'DTAA') with several other countries on a bilateral basis i.e. agreement between two countries (e.g. Country A with Country B) to prevent double taxation of income. India has entered bilateral tax treaties with more than 90 countries. The bilateral tax treaties are, inter alia, entered with a view, majorly to prevent double taxation of income and give relief in respect of doubly taxed incomes.

The rapid growth of globalization led to the creation of Multinational Enterprises (MNEs) wherein the entities within a group were present all over the world and in many cases at jurisdictions which were set up with the main objective to obtain tax arbitrage using treaty shopping mechanism. Consequent to the 2008 global economic crisis, the international organizations and the fellow nations came up with the BEPS action plan to recognise and counter unfair tax planning strategies adopted by certain MNEs which had exploited the gaps in the global taxation system by artificially shifting profits to low or no-tax locations (where there is little or no economic activity which leads to little or no tax being paid). These tax planning strategies violated the 'Economic Allegiance' principle which means to compensate to a nation or a kingdom for the benefits that one derived from exploiting that nation or kingdom's resources. This resulted in the source taxation principle under the international tax principles.

As a result of the BEPS agenda, 15 Action Plans were brought out by the OECD under G20's mandate to tackle the unfair tax planning mechanisms adopted by MNEs. The action plan 15 can be considered as the machinery action, which is intended to put into play the anti-avoidance tax solutions proposed in the other BEPS action items. The need for such a machinery action item is because currently there are more than 3000 bilateral tax treaties that are active and to invoke the solutions proposed under the BEPS action plans, these bilateral tax treaties have to be amended. Amending the bilateral treaties and involves cumbersome legal process as each country have their own constitutional or other legal mechanisms to invoke international treaties into their domestic laws. Further, mere incorporation of these solutions in domestic law will not achieve the desired objective as the tax treaties will remain a tool for tax evaders. Therefore, to ensure the BEPS solutions are transposed into the tax treaty, action plan 15 objective was to bring all these amendments under one single umbrella and hence, the work on developing a multilateral agreement was undertaken.

Multilateral agreements are entered by three or more nations, thus, bringing many countries under one roof. Such agreements are considered effective and less time-consuming. The World Trade

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Organization (WTO) agreement, in which India is a party, is a classic example of multilateralism. Multilateral agreements, in the context of international taxation, is not new as there have been precedents from Scandinavian, Caribbean countries entering into such an agreement to avoid double taxation. India also has its experience through the SAARC Limited Multilateral Agreement for the avoidance of double taxation. But what distinguishes those agreements from the BEPS MLI is that the MLI is exclusively entered to ensure there are no double nontaxation and reduction of taxes, unlike the former whose objective was inter alia to avoid double taxation and to promote economic relations.

Therefore, the MLI modifies tax treaties not by directly amending the text of the tax treaty, but by being applied together with the relevant tax treaty. They do not make the existing DTAA otiose, they operate along with the existing DTAA and will modify the application of some clauses in the existing DTAA using the lex posterior (later in time) principle. Therefore, the BEPS MLI is an effective tool to implement the anti-avoidance measures in a synchronised manner without the need to bilaterally renegotiate each and every agreement. The BEPS MLI can act as a retaliatory tool for tax enforcers to use against the tax evaders, as it can disentitle a taxpayer from undertaking treaty shopping or availing unfair treaty benefits based on the anti-avoidance measures initiated under the BEPS action items. Having seen the need for an MLI on tax treaties, we will dwell further on the operational aspects of the same.

What is MLI? – Structure and key organs

The MLI under the BEPS action plan 15 is to implement the BEPS work into the existing treaty network. The MLI will enable to provide a standard language for modification of all the existing DTAAs. This enables elimination of disputes arising on account of different terms being used differently or distinctively in each of the DTAA between contracting states thereby acting as deterrence for tax abuse. It is reiterated that the BEPS MLI is an enabler to the existing tax treaties and does not replace the existing tax treaties. It operates along with the existing DTAA by modifying the application of a provision under the DTAA.

Structure of the MLI

Just as bilateral tax treaties are agreements, the MLI is also a similar instrument and its interpretation will be governed by the principles laid down by VCLT. There are 7 parts and 39 articles in the MLI. The coverage of MLI through its articles in light of the BEPS action plans is structured in the manner provided below. Articles 3 to 17 are recognised as substantive provisions under the MLI convention.

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Part	Particulars	Article
Part I	Scope and Interpretation of terms	Article 1-Article 2
Part II	Hybrid Mismatches	Article 3-Article 5
Part III	Treaty Abuse	Article 6-Article 11
Part IV	Avoidance of PE Status	Article 12-Article 15
Part V	Improving Dispute Resolution	Article 16-Article 17
Part VI	Arbitration	Article 18-Article 26
Part VII	Final Provisions	Article 27- Article 39

Key Organs of the MLI

Each country before becoming a signatory is required to adopt certain 'mandatory minimum standards', make 'notification' of MLI provisions, 'make a reservation' to certain provisions of MLI and also provides for 'compatibility clauses' to 'opt-in and opt-out' of MLI provisions. Here, we will discuss the key organs of the MLI which acts as a fulcrum for the operation of the instrument.

Key organs
Covered Tax Agreement
Compatibility Clause
Reservation Clauses
Minimum Standard

Covered Tax Agreements (CTA)

The entire scope and starting point of the MLI revolve around CTA. Article 2 of MLI defines a CTA as: 'an agreement for avoidance of double taxation with respect to taxes on income that is in force between two or more parties and/or jurisdictions with respect to which each party has notified to the Depository as a listed agreement under the MLI'.

It is, therefore, extremely relevant that to make the MLI operational between two parties (or) jurisdictions/ states, each country must notify each other's bilateral tax treaty while becoming a signatory to the MLI. Each country has to notify the DTAA with other jurisdiction under the MLI, upon which the said DTAA will be the CTA for the purposes of MLI operation.

India has notified 93 jurisdictions under the MLI at the time of ratifying the MLI convention. Similarly, it is also important that the countries which have signed a bilateral treaty with India must also notify

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DTAA with India while depositing their instrument with OECD. Therefore, 'the matching principle' is a key attribute and only when the other country also notifies the DTAA with India, the DTAA between India and that country will be considered as a CTA.

Examples

Exhibit 1: Whether the India & Australia DTAA is a CTA under the MLI?

Steps	Considerations	Comments
Step 1	Whether India and Australia already have a DTAA in existence?	Yes, move to step 2
Step 2	Whether India and Australia are signatories to MLI?	Yes, both the parties are signatories to the MLI.
Step 3	Whether India has notified DTAA with Australia as a CTA in its MLI deposit note to the OECD?	Yes, India has notified DTAA with Australia as a CTA.
Step 4	Whether Australia has notified DTAA with India as a CTA in its MLI deposit note to the OECD?	Yes, Australia has notified DTAA with India as a CTA.
Step 5 - Conclusion	Article 2 – Scope provisions matched and hence India -Australia DTAA is a CTA.	MLI provisions will apply.

Exhibit 2: Whether the India & Mauritius DTAA is a CTA under the MLI?

Steps	Considerations	Comments
Step 1	Whether India and Mauritius already have a DTAA in existence?	Yes, move to step 2
Step 2	Whether India and Mauritius are signatories to MLI?	Yes, both the parties are signatories to the MLI.
Step 3	Whether India has notified DTAA with Mauritius as a CTA in its MLI deposit note to the OECD?	Yes, India has notified DTAA with Mauritius as a CTA.
Step 4	Whether Mauritius has notified DTAA with India as a CTA in its MLI deposit note to the OECD?	No, Mauritius has not notified DTAA with India as a CTA.
Step 5 Conclusion	India – Mauritius DTAA matching provisions not satisfied. Therefore, the said DTAA is not a CTA.	MLI provisions will **NOT** apply. Will be governed only by existing DTAA provisions
Note: India-Mauritius DTAA was amended in the year 2016, *inter alia*, to incorporate certain BEPS provisions. This may be the possible reason for Mauritius not notifying DTAA with India as a CTA. This shows the flexibility that is available under the MLI for countries to choose.		

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Further, there are some countries like the USA and Brazil amongst others which have not signed the MLI Convention. Hence, in such a scenario, the India-USA DTAA or the India-Brazil DTAA will have no consideration towards the MLI and the existing DTAA provisions will only govern the tax treaty framework.

Therefore, once an existing tax treaty is recognised as a CTA in the MLI context, the tax treaty will have to take cognizance of the operational aspects of the MLI.

Compatibility Clauses – Bridge between the DTAA and the MLI

Once the existing DTAA becomes a CTA, we move to the next main organ of the MLI i.e. the compatibility clauses. One of the core objectives of the MLI is to ensure consistency amongst the nations to incorporate the BEPS solutions in their treaty network. Further, the objective of MLI is to only modify the application of certain provisions in the existing DTAA. Therefore, parties to the MLI are given the flexibility to choose the relevant provisions of the MLI that needs to be transposed to their existing DTAA. In a bilateral DTAA, two countries negotiate and have the flexibility to decide which provisions to be incorporated. Since tax policy of countries vary, flexibility is important to attract countries to sign the MLI. Therefore, the flexibility is provided in the form of compatibility clause and the reservation clause.

The compatibility clause is to ensure that there is no conflict between the two treaties i.e. the DTAA and the MLI. This is because of the uniqueness of the MLI, which is not a standalone treaty as it operates alongside the bilateral tax treaties. If there is a possible conflict that may arise between the two treaties i.e., the DTAA and the MLI, the compatibility clause would resolve this conflict. Further, the compatibility clause also gives options to parties to leave an existing provision of the DTAA undisturbed, if the existing provision serves the desired objective with which a particular provision of the MLI was placed to.

There are 4 different categories of compatibility clause(s) which are found under the MLI convention. They are depicted in the following table

Compatibility Clause	Meaning	Effect	Notification Criteria
"in place of"	Purpose of this clause is to replace an existing provision of the CTA, with that of mutually notified provisions of MLI between two countries.	The concerned provision of MLI shall replace the existing CTA provision.	Only when both the parties to the CTA notify, the CTA provision be replaced by the MLI provision.

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"in the absence of"	Purpose of this clause is to enforce a new provision into the CTA, where such provision is absent in the CTA.	The concerned MLI provision is added to the existing CTA which does not contain such a provision.	Only when both the parties to the CTA notify, the MLI provision gets added in the CTA.
"applies to" or "modifies"	Purpose of this clause is that the relevant CTA provision will be modified by MLI provision without replacing the CTA provision.	This existence of this compatibility clause is that there should be a mutually notified CTA provision on which this condition is made effective. Thereafter, the relevant MLI provision shall be made applicable to an existing CTA provision without replacing the provisions of CTA.	Only when both the parties to the CTA notify, the MLI provision would be made applicable to the existing CTA provision.
"in place of or in the absence of"	Purpose of this clause is to replace an existing provision in CTA with the MLI provision. Further, where there is no such provision in the CTA, the MLI provision will be added to the existing CTA. This is the most commonly used clause in many of the substantive provisions of the MLI.	**Use of "in place of":** Where existing provisions of CTA are notified by two countries, then, the MLI provisions are replaced with CTA provisions. **Use of "in the absence of":** Where no such provisions exist in a CTA, then the MLI provisions includes them and gets added into the CTA.	With regard to the notification, this is different from the earlier clauses, wherein even if both the parties to the CTA does not notify this clause, the MLI provision shall apply and supersede the provisions of the CTA to the extent of incompatibility. The same holds good even if only one party notifies this clause.

Reservation Clauses – 'Opt-Out' Mechanism

The reserved provisions of MLI shall not apply to a CTA if either of the parties makes a reservation. A reservation is defined in the VCLT as a "unilateral statement made by a State, when signing, ratifying, accepting, approving or acceding to a multilateral instrument, whereby it purports to exclude or to modify the legal effect of certain provisions of the Convention"

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Hence, reservations under treaties, introduce flexibility in treaty negotiations, so that States come forward to be a signatory to such multilateral conventions. The general rule of multilateral instrument is that its parties are bound by the entire instrument unless the parties make a reservation. The MLI enables states to opt-out of the provisions, either entirely or partially, by introducing a mechanism of reservations.

However, reservations concerning minimum standard provisions (discussed later) under the MLI can be made only on limited situations and subject to satisfying certain conditions.

Examples:

1) India has reserved its position on Article 3 of the MLI on transparent entities (BEPS Action 2), therefore Article 3 will not be added or modified in any of India's existing DTAA as India has opted-out.

2) France has reserved its position on Article 4 of the MLI on dual resident entities (BEPS Action 2), therefore when we apply India-France DTAA, Article 4 of the MLI will not affect the DTAA since France has opted-out/reserved its position on the said Article 4 of the MLI.

A party to the MLI may reserve the right for provisions of the MLI to not apply:

- to its covered tax treaties in their entirety; or
- a subset of its covered tax treaties

Further, the reservations made under the MLI by a party will apply symmetrically wherein it applies to the reserving party and other parties to the convention. In certain exceptional situation, the reservation provision also works asymmetrically, which is a unique feature of the MLI, unlike other multilateral agreements.

Mandatory Minimum Standards

The mandatory minimum standards form the genesis of MLI and without which the object of MLI may not be fulfilled. One of the core objectives of developing the MLI is to ensure consistency amongst the 3000 odd tax treaties that are currently in existence. As we have seen earlier, the MLI also gives flexibility to the parties through compatibility and reservation clause, however, to ensure there is some consistency, the parties have to adhere to incorporating mandatory minimum standard provisions in the MLI.

The objective of the minimum standard provisions is to ensure that these anti-abuse provisions will help eliminating the treaty shopping mechanism and consequentially the elimination of double non-taxation scenarios by tax-evaders. The minimum standards under the MLI, therefore, achieve certain consistency amongst the existing tax treaties. These minimum standard provisions, which have to be incorporated in the tax treaties, help in combating tax avoidance.

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Out of the four minimum standards prescribed under the BEPS action plan i.e.

Action 5 - Countering Harmful Tax Practices

Action 6 - Treaty abuse prevention mechanism

Action 13 - Country by Country Reporting

Action 14 - Effective Dispute Resolution Mechanism

Action 6 and Action 14 solutions are specifically provided as a minimum standard provision under the BEPS MLI. With regards to Action 5 and Action 13, the solutions are to be incorporated under domestic laws.

However, in a case where the Contracting States together agree to reflect the minimum standard provisions specified under the MLI into their existing DTAA, then, such treaty partner may opt-out of the minimum standards under the MLI.

When – Entry into Force and Effective Date

The historic MLI was signed on 07 June 2017 by more than 65 countries at Paris, France during the initial signing ceremony. The Entry into Force and the Effective Date is specified under Articles 34 - 36 of the MLI. Since the MLI is a new instrument for the signatory countries, many countries which were not part of the initial signing ceremony have been signing the MLI on an ongoing basis. It is, therefore, important to understand when the MLI enters into force and the effective date.

The MLI will apply only to those countries which have:

- Signed the MLI;
- Ratified, accepted or approved the MLI under the domestic law and deposited such instrument of ratification with the OECD depositary.

Upon deposit of the instrument of ratification, the MLI enters into force on the first day of the month following the expiry of 3 calendar months beginning on the date of such subsequent deposit.

Effective date

Once the MLI is entered into force by both the Contracting States, the effective date of the MLI shall be:

For withholding taxes – 1st day of next calendar year that begins on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the CTA.

For other taxes – Taxable period that begins on or after the expiration of a period of 6 calendar months from the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the CTA.

India's journey and effective date on the applicability of the MLI

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Date	Event
7th June, 2017	The signing of the MLI
25th June 2019	Deposit of ratification instrument with the OECD depository.
1st October 2019	Entry into Force of India's MLI

The provisions of the said Convention would have effect in India with respect to a Covered Tax Agreement in accordance with the provisions of Article 35 of the said Convention. Accordingly, in exercise of the powers conferred by section 90(1) of the Income-tax Act, 1961, the Central Government has, vide Notification No.57/2019 dated 9.8.2019 (available at https://www.incometaxindia.gov.in/communications/notification/notification57_2019.pdf), notified that the provisions of the said Convention shall be given effect to in the Union of India, in accordance with India's Position under the said Convention, as set out in the Annexure thereto.

If a country has signed and notified DTAA with India, however, the MLI has not entered into force, then in such a case, the MLI provisions will not be applicable. For e.g., Italy has notified DTAA with India as a CTA; however, Italy has not ratified its MLI under its domestic laws and hence the provisions of MLI cannot be applied until Italy's MLI is entered into force. Therefore, the MLI does not apply in respect for India-Italy DTAA.

ILLUSTRATION 1

An Indian company intends to withhold taxes on a payment to be made to an Italian Company on 10th April 2025. In this regard, the Indian company wants to understand whether the provisions of MLI are applicable to read it along with the India-Italy DTAA.

SOLUTION

With effect from 1st April 2020, India's MLI has entered into effect. However, Italy has not yet ratified the MLI as on 10th April 2025, therefore, the MLI provisions of Italy has not entered into force yet and therefore, the MLI provisions are not applicable. The Indian company will rely only on the existing India-Italy DTAA.

How does the MLI Operates - Mechanics

The MLI is only an addition to the existing DTAA and does not replace the DTAA. It only intends to modify/amend the existing DTAA subject to the discretion of the parties and hence has to be read along with the DTAA between the parties. Due to the unique feature of MLI not being a standalone agreement, the operation of the MLI is critical and needs proper application.

The mechanics for applying the MLI is on the satisfaction of the conditions as follows:

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ILLUSTRATION 2

Whether MLI provisions will apply in the following scenarios?

(a) Country A and Country B are signatories to the MLI. Both countries have ratified the MLI agreement as per their domestic legislative process. Country A has notified DTAA with Country B as a CTA, however, Country B has not notified DTAA with Country A.

(b) Country A - Country B DTAA is a CTA under Article 2 of the MLI as both the countries have notified the concerned DTAA. Country A has ratified the MLI under their domestic laws and has deposited the ratification instrument. Country B has not ratified the MLI owing to political instability in their country. In this regard, Country A wishes to invoke the MLI provisions while accessing the Country A – Country B DTAA. Is the action of Country A valid?

SOLUTION

(a) Since Country B has not notified DTAA with Country A as CTA, the MLI provisions will not apply with regard to the Country A - Country B DTAA, as per Article 2 of the MLI.

(b) Under Article 34 - Entry into Force of the MLI, only when a Country deposits its instrument of ratification, the MLI will enter into force according to the timelines stipulated in the mentioned Article. In the given scenario, since Country B has not ratified the MLI, consequently, the MLI with regards to Country B has not entered into force yet. Hence, Country A - Country B CTA under MLI is not in force yet and, therefore, provisions of the MLI are not applicable. The action of Country A is, therefore, invalid.

Resources: The discussion on BEPS Action Plans contained in this chapter is essentially based on the Action Plans developed in the context of the OECD/G20 BEPS Project and available at the website https://www.oecd.org/en/topics/policy-issues/base-erosion-and-profit-shifting-beps.html#beps-actions

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SUMMARY

BEPS Action Plan 1 : Addressing the challenges of the digital economy

OECD Recommendation		Provision incorporated in Indian Tax Laws
i	Modifying existing Permanent Establishment (PE) rule to provide whether an enterprise engaged in fully de-materialized digital activities would constitute a PE if it maintained significant digital presence in another country's economy	**Significant economic presence** Significant economic presence of a non-resident in India shall also constitute business connection in India. Significant economic presence means-
ii	A virtual fixed place of business PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction & carries on business through that website.	

	Nature of transaction	Condition
(a)	in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India	Aggregate of payments arising from such transaction or transactions during the previous year should exceed **₹ 2 crores.**
(b)	systematic and continuous soliciting of business activities or engaging in interaction with users in India	The number of users should be atleast **3 lakhs**.

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iii	Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider.	Section 194-O provides that where sale of goods or provision of services of an e-commerce participant is facilitated by an e-commerce operator through its digital or electronic facility or platform, such e-commerce operator is liable to deduct tax at source @0.1% of the gross amount of such sales or services or both.
iv	Imposition of an Equalisation Levy on consideration for certain digital transactions received by a Non-resident from a resident or Non-resident having PE in the other contracting state.	***Equalisation Levy @6% on specified services has been withdrawn by the Finance Act, 2025 with effect from 1st April 2025.***

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BEPS Action Plan 6: Preventing treaty abuse	
OECD Minimum Standard	**LoB clause incorporated in Indian Tax Treaties**
Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping by including in their treaties: (i) the combined approach of **Limitation of Benefits (LOB)** and **Principal Purpose Test (PPT)** rule, (ii) the **PPT rule** alone, or (iii) the **LOB rule** supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.	**LoB clause in India-Mauritius Tax Treaty** • On 10.5.2016, the India-Mauritius tax treaty was amended and for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. • The tax rate on such capital gains arising from 1.4.2017-31.3.2019 should, however, not exceed 50% of the applicable tax rate on capital gains in India. • LOB Clause provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. • A shell or a conduit Co. claiming to be a resident of a Contracting State shall not be entitled to this benefit. • A shell or conduit Co. is any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State. **LoB clause in India-Singapore Tax Treaty** • Capital gains on sale of shares of an Indian company by a resident of Singapore was taxable only in Singapore, if such shares were acquired before 1.4.2017. • The India-Singapore tax treaty has been amended to provide that capital gains on alienation of shares acquired on or after 1.4.2017 would be taxable in a similar manner as laid out in India-Mauritius tax treaty, subject to LoB clause. • The transition period benefit is also similar to that contained in India-Mauritius Tax Treaty.

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BEPS Action Plan 15 Developing a Multilateral Instrument (MLI)	
BEPS Report	**Entry into Force of MLI**
The MLI helps fight against BEPS by implementing tax treaty-related measures developed through the BEPS Project in existing bilateral treaties in a synchronized and efficient manner to – • **prevent treaty abuse,** • **improve dispute resolution** • **prevent the artificial avoidance of PE status** • **neutralize the effects of hybrid mismatch arrangements**. The MLI is flexible instrument which modifies tax treaties that are "**Covered Tax Agreements**". A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.	➢ The Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS) was signed by India at Paris, France on 7th June, 2017. ➢ India had ratified the said Convention and had deposited the instrument of ratification along-with the list of Covered Tax Agreements, reservations and notifications (India's Position under the said Convention) to the Depositary on 25th June, 2019. ➢ The date of entry into force of the said Convention for India is 1st October, 2019, being the first day of the month following the expiry of a period of three calendar months beginning on 25th June, 2019, being the date of deposit by India of the instrument of ratification. ➢ The earliest date when the provisions of this Convention can take effect in India is 1st April, 2020 (six months from 1st October, 2019, the date of entry into force for India)

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TEST YOUR KNOWLEDGE

Questions

1. *What do you understand by base erosion and profit shifting? Describe briefly its adverse effects.*

2. *What are the significant OECD Recommendations under Action Plan 1 of BEPS? Which recommendation has been adopted in Indian tax laws?*

3. *Discuss the provision incorporated in the Income-tax Act, 1961 in line with the OECD recommendations under Action Plan 4 of BEPS.*

4. *Describe the three tier structure for transfer pricing documentation mandated by BEPS Action Plan 13.*

5. *Explain the nexus approach recommended by OECD in BEPS Action Plan 5 which has been adopted in the Income-tax Act, 1961.*

6. *What are the ways in which hybrid mismatch arrangements are used to achieve unintended double non-taxation or long-term tax deferral?*

Answers

1. Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.

Adverse Effects of BEPS:

(1) Governments have to cope with less revenue and a higher cost to ensure compliance.

(2) In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth.

(3) BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. When tax laws permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden.

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(4) Enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

2. The OECD has recommended several options to tackle the direct tax challenges which include:

(1) Modifying the existing Permanent Establishment (PE) rule to provide that whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country's economy.

(2) A virtual fixed place of business PE in the concept of PE i.e., creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.

(3) Imposition of a final withholding tax on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.

The concept of 'Significant Economic Presence' (SEP) which is similar to the virtual fixed place PE as recommended in the 2015 BEPS Action Plan 1 report has been introduced in the Income-tax Act, 1961 *vide Explanation 2A* to section 9(1)(i).

Significant economic presence of a non-resident in India shall also constitute business connection in India. Significant economic presence means-

	Nature of transaction	Condition
(a)	in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India	Aggregate of payments arising from such transaction or transactions during the previous year should exceed **₹ 2 crores.**
(b)	systematic and continuous soliciting of business activities or engaging in interaction with users in India	The number of users should be atleast **3 lakhs**.

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Further, the above transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) the agreement for such transactions or activities is entered in India;

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

However, where a business connection is established by reason of significant economic presence in India, only so much of income as is attributable to the transactions or activities referred to in (a) or (b) above shall be deemed to accrue or arise in India.

In order to address the challenges of the digital economy, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provided for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India. This was provided for in section 165 of the Finance Act, 2016.

However, the equalisation levy @ 6% on specified services has been withdrawn by the Finance Act, 2025 with effect from 1st April 2025.

3. In line with the recommendations of OECD BEPS Action Plan 4, section 94B has been inserted in the Income-tax Act, 1961 by the Finance Act, 2017 to provide a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible.

The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

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In order to target only large interest payments, it provides for a threshold of interest expenditure of ₹ 1 crore in respect of any debt issued by a non-resident associated enterprise exceeding which the provision would be applicable. Banks, Insurance business and class of NBFCs notified by the Government are excluded from the ambit of the said provisions keeping in view of special nature of these businesses. A finance company, located in any IFSC, has also been excluded from the ambit of said provisions w.e.f. A.Y. 2025-26. Also, section 94B would not be attracted on interest paid in respect of debt issued by a lender which is a permanent establishment in India of a non-resident, being a person engaged in the business of banking.

4. Action 13 contains a three-tiered standardized approach to transfer pricing documentation which consists of:

(a) **Master file**: Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.

(b) **Local file**: Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.

(c) **Country-by-country (CBC) report**: CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism.

5. In India, the Finance Act, 2016 has introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.

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The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, section 115BBF has been inserted in the Income-tax Act, 1961 to provide that where the total income of the eligible assessee (being a person resident in India who is the true and first inventor of the invention and whose name is entered in the patent register as the patentee in accordance with the Patents Act, 1970 and includes every such person, being the true and the first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent.) includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

6. Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -

(1) Creation of two deductions for a single borrowal;

(2) Generation of deductions without corresponding income inclusions;

(3) Misuse of foreign tax credit; and

(4) Participation exemption regimes.

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CHAPTER 26

APPLICATION AND INTERPRETATION OF TAX TREATIES

LEARNING OUTCOMES

After studying this chapter, you would be able to

- **identify** the connecting factors of double taxation;
- **appreciate** the meaning of, and need for, tax treaties;
- **appreciate** the basic principles of interpretation of tax treaties;
- **identify** the extrinsic aids to interpretation of a tax treaty;
- **appreciate** the importance of commentaries in interpretation of tax treaties;
- **appreciate** the role of Vienna Convention in application and interpretation of tax treaties.

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26.1 INTRODUCTION

Article 38(1) of the International Court of Justice (ICJ)[1] provides that the court shall apply the following in deciding on a particular matter –

International Convention(s) [general or particular]

- establishing rules expressly recognised by the contesting states

International Customs

- serving as evidence of general practice accepted as law

General principles

- recognised by civilised nations

Judicial decisions and teachings of highly qualified publicists of various nations

- serving as subsidiary means for determination of rules of law

Success of any law depends upon the manner in which it is interpreted and administered. In order to interpret any law or agreement, one needs to understand the philosophy of law which has been kept in mind at the time of passing such law in a country or at the time of forming an agreement between the two countries on a particular aspect. This gives rise to the principles of public international law (example – U.N principles on business and human rights).

The interpretation of DTAAs require a different approach than the interpretation of domestic tax laws as the latter is based on interpretative principles set out by the national courts, whereas, the DTAAs are an international agreement between the government of two countries. The treaties are interpreted in light of the customary principles set out under the Vienna Convention of the Law of treaties.

Source(s) of International Tax Law

S. No.	Source	Particulars relating to the source/origin
(i)	Double Taxation Avoidance Agreement (DTAA)	DTAAs may be comprehensive or limited. It is to be noted that along with the DTAA, it is the protocols, memorandum of understanding, and exchange of

[1] https://www.icj-cij.org/en/statute#CHAPTER_II. The International Court of Justice acts as a world court. The Court's jurisdiction is twofold: it decides, in accordance with international law, disputes of a legal nature that are submitted to it by States (jurisdiction in contentious cases); and it gives advisory opinions on legal questions at the request of the organs of the United Nations or specialized agencies.

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		information, etc. forming part of the DTAA which enables interpretation of a DTAA.
(ii)	Customary international law and general principles of law	Customary international law is the aspect of international law that derives from customs and conventions. Along with general principles of law and treaties, custom is also considered by the International Court of Justice, jurists, the United Nations, and its member states to be among the primary sources of international law. The vast majority of the world's governments accept, in principle, the existence of customary international law, although there are many differing opinions as to what rules are contained therein.
(iii)	Vienna Convention on Law of Treaties (VCLT)	VCLT is a multilateral treaty signed and ratified by several countries, which codifies the customary international law for interpretation of tax treaties.

26.2 DOUBLE TAXATION AND CONNECTING FACTORS

The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business **with that country** or **in that country**. Internationally, the term used to determine the jurisdiction for taxation is "connecting factors". There are two types of connecting factors, namely, "Residence" and "Source". It means a company can be subject to tax either on its residence link or its source link with a country.

If a company is doing business **in a** host/source country, then, besides being taxed in the home country on the basis of its residence link, it will also be taxed in the host country on the basis of its source link as the company would be heavily engaged in doing business in the territory of other country, for example, through its branch in that country.

However, if a company is doing business **with** another country (i.e., host/source country), then, it would generally be subject to tax in its home country alone, based on its residence link, since the company is not engaged in carrying on the business in the territory of source country (for example, export of goods to another country). In this regard, it may, however, be noted that significant economic presence in another country may result in tax liability in the other country. For example, as per the Income-tax Act, 1961, transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India if aggregate of payments arising from such transaction or transactions during the previous year exceeds ₹ 2 crores, would be deemed as significant economic presence of such non-resident in

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India. Significant economic presence of a non-resident in India would constitute business connection in India and consequently, income would be deemed to accrue or arise in India and hence, be taxable in India (the Source country).

- **Juridical double taxation**

  When source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as "juridical double taxation".

  In order to avoid such double taxation, a company can invoke provisions of Double Taxation Avoidance Agreements (DTAAs) (also known as **Tax Treaty** or Double Taxation Convention–DTC) with the host/source country, or in the absence of such an agreement, an Indian company can invoke provisions of section 91, providing unilateral relief in the event of double taxation.

  Example 1

  Company ICO is a resident of India. It has set up a branch in UK. Here, India would be the country of residence for ICO, whereas UK would be the country of source. UK would tax the profits earned by the branch of ICO located in UK, whereas ICO would be taxed on worldwide basis in India, including profits of its UK branch. However, ICO can claim relief in respect of taxes paid in UK while filing its tax return in India under the Indo-UK Double Taxation Avoidance Agreement.

  If, instead of UK, ICO has a branch in a state with which India does not have tax treaty, then it can claim unilateral relief under section 91 of the Income-tax Act, 1961 in respect of taxes paid by its branch in that state.

- **Economic double taxation**

  'Economic double taxation' happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different persons (because of lack of subject identity)

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Example 2

When one State attributes an income/capital to its legal owner whereas the tax law of other State attributes it in the hands of the person in possession or having economic control over the income, it leads to economic double taxation. For example, if one State (say, Country X) levies dividend distribution tax on the company resident in that State (say, ABC Ltd.) and the other State (say, Country Y) levies tax on dividend received by the shareholder who is resident of Country Y, receiving dividend income from shares held in ABC Ltd., the company resident in Country X, then, economic double taxation arises.

26.3 TAX TREATIES: AN OVERVIEW

(1) Definition of "Treaty"

Treaty is a generic term embracing all instruments binding under international law, regardless of their formal designation, concluded between two or more international juridical persons.

The application of the term treaty signifies that the parties intend to create rights and obligations enforceable under international law.

Article 2 of Vienna Convention on Law of Treaties, 1969 defines a "treaty" as an international **agreement** concluded between States **in written form** and **governed by international law**, whether embodied in a **single instrument or in two or more related instruments** and whatever its particular designation.

(2) Role of Tax Treaties

"Treaty" represents various compromises agreed upon by the respective Contracting States depending upon the economic expediency of a particular country.

Tax, in the country of source is considered as a cost, whereas the same is an obligation in the country of residence. Therefore, there is need to achieve tax efficiency. Double Tax Avoidance Agreements come into play to mitigate hardship caused by subjecting the same income to double taxation.

Tax Treaties attempt to eliminate double taxation and try to achieve balance and equity. They aim at sharing of tax revenues by the concerned States on a rational basis. Tax treaties do not always succeed in eliminating Double Taxation, but contain the incidence to a tolerable level.

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(3) Types of DTAAs

Limited DTAAs are those which are limited to certain types of incomes only. e.g., DTAA between India and Pakistan is limited to income from international air transport only.

Comprehensive DTAAs are those which cover almost all types of incomes covered by any model convention. Many a time, a treaty also covers wealth tax, gift tax, surtax, etc.

(4) Directive Principles set out in the Indian Constitution

In the Indian context, Article 51 of the Indian Constitution has, *inter alia*, set out some directive principles which must be followed by the State in the context of International agreements and relationships. It has been provided that-

"The State shall endeavor to -

(a) Promote international peace and security;

(b) Maintain just and honourable relations amongst nations;

(c) Foster respect for international law and treaty obligations in the dealings of organised people with one another; and

(d) Encourage settlement of international disputes by arbitration.

Article 253 of the Indian Constitution provides that Parliament has power to make any law for the whole or any part of the territory of India for implementing any treaty, agreement or convention with any other country or countries or any decision made at any international conference, association or other body.

It is pertinent to note that entries 10 and 14 of List I of the Seventh Schedule to the Constitution of India confer the power on Parliament to legislate treaties with foreign countries. Further, this power of Parliament has been delegated to the Central Government vide sections 90 and 90A of the Income-tax Act, 1961.

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(5) Need for tax treaties

The concept of source and residence prevailing in a majority of the countries is the root cause of double taxation. Hence, there is a need to have tax treaties in force. Generally, the residence state has the primary right to tax the global income of its residents unless it exempts that income under its domestic tax law. The right of the source state gets curtailed under the DTAA as it is always a secondary state and has limited connection with the taxpayer. The rights of the source state are sometimes limited (e.g. in case of royalties, interest) or are unconditional or are conditional (e.g. business profits only taxable if PE exists). Even in some cases, no rights are granted to the source state and the entire income is taxable in the residence state. The allocation or distribution of the taxing rights depends upon the negotiation or bargaining power between the two countries and flow of investment and trade between them.

Tax treaties only distribute or assign taxing jurisdiction. It does not impose tax. Having assigned the jurisdiction of tax between the State of Residence and State of Source, the domestic tax laws of the respective State determine taxing rules. Taxing experts in early 1920 appointed by the League of Nations describe the method of classification as Contracting States dividing tax sources and tax objects amongst themselves by mutually binding themselves not to levy taxes or to tax only to a limited extent.

English lawyers called it "Classification and Assignment Rule", whereas German jurists called it the **"Distributive Rule".** According to this principle, "to the extent that an exemption is agreed to, its effect is, in principle, independent of whether the Contracting States imposes a tax, in the situation to which the exemption applies, and irrespective of whether the State actually levies the tax". The point here is that having agreed to give the right of tax to the other state, that state may or may not levy tax and if the state in whose favour right to tax is devolved, chooses not to tax such income, then, it may result in double non-taxation. The argument in favour of double non-taxation is that income would be subject to tax in the exempt state as and when the exemption is withdrawn or tax is levied. Thus, this rule ensures that double taxation does not arise in future also, if the source state decides to levy tax.

In addition to allocating the taxing rights and eliminating double taxation, there are various other important considerations as mentioned below:

- Ensuring non-discrimination between residents and non-residents
- Resolution of disputes arising on account of different interpretation of tax treaty by the treaty partner.
- Providing assistance in the collection of the fair and legitimate share of tax.

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Section 90 also provides that the Central Government may enter into an agreement with the Government of any country outside India for

(a) granting of relief in respect of Income-tax; or

(b) avoidance of double taxation without creating any opportunities for double non-taxation or reduced taxation through tax evasion or avoidance (including treaty shopping arrangements); or

(c) exchange of information for the prevention of evasion or avoidance of income-tax or for investigation of cases of such evasion or avoidance; or

(d) recovery of income-tax.

Further, in addition to above, there are some other principles which must be considered by countries in tax treaties –

(i) Equity and fairness: Same income earned by different taxpayers must be taxed at the same rate regardless of the source of income.

(ii) Neutrality and efficiency: Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.

(a) Capital export neutrality and

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(b) Capital import neutrality (CIN).

Capital export neutrality (CEN) provides that business decision must not be affected by tax factors between the country of residence and the target country; whereas CIN provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) Promotion of mutual economic relation, trade and investment: In some cases, it is observed that avoidance of double taxation is not the only objective. The other objective may be to give impetus to a country's overall economic growth and development.'

26.4 INTERPRETATION OF TAX TREATIES

(1) Introduction

Tax treaties are signed between two sovereign nations by competent authorities under delegated powers from the respective Governments. Thus, an international agreement has to be respected and interpreted in accordance with the rules of international law as laid down in the Vienna Convention on Law of Treaties (VCLT). These rules of interpretation are not restricted to tax treaties but also apply to any treaty between two countries. Therefore, any dispute between two nations in respect of Article 25 relating to Mutual Agreement Procedure of the OECD/UN Model Conventions has to be solved in the light of the VCLT.

However, when it comes to application of a tax treaty in the domestic forum, the appellate authorities and the courts are primarily governed by the laws of the respective countries for interpretation.

In India, even before insertion of Section 90(2) by the Finance (No.2) Act, 1991, with retrospective effect from 1-4-1972, CBDT had clarified *vide Circular No. 333 dated 2-4-1982* that where a specific provision is made in the DTAA, the provisions of the DTAA will prevail over the general provisions contained in the Act and where there is no specific provision in the DTAA, it is the basic law i.e. the provisions of the Act, that will govern the taxation of such income.

Section 90(2) of the Income-tax Act, 1961 provides that where the Indian Government has entered into DTAAs which are applicable to the taxpayers, then, the provisions of the Act shall apply to the extent they are more beneficial to the taxpayer.

Interpretation of any statute, more so international tax treaties, requires that we follow some rules of interpretation. In subsequent paragraphs, we shall deal with rules of interpretation of tax treaties.

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(2) Role of Vienna Convention in Application and Interpretation of Tax Treaties

The International Law Commission initiated the work on the Vienna Convention on Law of Treaties in the year 1949 which was completed in the year 1969. It came into force in the year 1980. As of 2.8.2023, it was ratified by 116 Countries. It is an open treaty whereby any country can become signatory of the Convention at any time.

Since tax treaty is a part of international law, its interpretation should be based on certain set of principles and rules of interpretation. The Vienna Convention on Law of Treaties provides the basic rules of interpretation of any international agreement (including a tax treaty). It represents the customary international law. The VCLT codifies the principles of interpretation laid down by usage, custom and courts over centuries.

The principles engraved in Vienna Convention on Law of Treaties have been acknowledged and embraced by the Indian courts of law while pronouncing their ruling. Para 60 of the Supreme Court ruling in *Ram Jethmalani & Ors. v. Union of India & Ors* Writ Petition (Civil) No. 176/2009 reads as follows –

"Article 31, "General Rule of Interpretation", of the Vienna Convention of the Law of Treaties, 1969 provides that a "treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." While India is not a party to the Vienna Convention, it contains many principles of customary international law, and the principle of interpretation, of Article 31 of the Vienna Convention, provides a broad guideline as to what could be an appropriate manner of interpreting a treaty in the Indian context also".

The Delhi High Court ruling in *AWAS Ireland v. Directorate General of Civil Aviation (W.P.(C) 671/2005 delivered on 19th March 2015*, applied the principles enshrined in the Vienna Convention of Law of Treaties, 1969. The said ruling invited reference to Article 51(c) of the Constitution of India which enjoins that the State shall endeavour to "foster respect for international law". The Court observed that the provisions of Article 51(c) of the Constitution of India when read with Articles 26, 27 and 31 of the Vienna Convention of Law of Treaties clearly cast an obligation on the Contracting States to not only remain bound by the terms of a treaty entered into by it but also obliges the State not to cite internal law as a justification for failure to perform its obligations under a treaty. An international convention, i.e., a treaty, is required to be interpreted in good faith, in accordance with the ordinary meaning given to the terms of the treaty, in their context and in light of its stated object and purpose.

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Therefore, it would be worthy to understand some of the Articles of the Vienna Convention of Law of Treaties which would help appreciate the manner of application and interpretation of tax treaties.

Principles enunciated in the Vienna Convention on Law of Treaties[2]

Article No.	Article Heading	Principle enunciated
26	***Pacta Sunt Servanda (in good faith)***	Every treaty in force is binding upon the parties and must be followed by them in good faith.
27	**Internal law and observance of treaties**	A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. For instance, the parties to the treaty should not dishonour their international commitments with each other by retrospectively amending their domestic tax laws or by not abiding by the treaty terms.
28	**Non-retroactivity of treaties**	Unless a different intention appears from the treaty or is otherwise established, treaty provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party. In other words, unless otherwise provided, treaties cannot have retrospective application
29	**Territorial Scope of Treaties**	Unless a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.
31	**General Rule of Interpretation**	• A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose. This is a basic principle. It states that treaties should be interpreted by first giving the ordinary meaning to the language. It is only if the ordinary meaning is ambiguous, or leads to illogical results, that the purpose may be considered. • The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

[2] https://treaties.un.org/doc/Publication/UNTS/Volume%201155/volume-1155-I-18232-English.pdf

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		(b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto. • The following shall be taken into account, together with the context in that: (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; (c) Any relevant rules of international law applicable to relation between the parties. • A special meaning shall be given to a term if it is established that the parties so intended.
32	**Supplementary means of interpretation**	Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable.
33	**Interpretation of Treaties Authenticated in two or more languages**	• When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail. • A version of the treaty in a language other than the one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree. • The terms of the treaty are presumed to have the same meaning in each authentic text. • Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference in meaning which the application of Articles 31 and 32 does not remove, the meaning which best

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		reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.
34	**General Rule regarding third states**	A treaty does not create either obligations or rights for a third State without its consent.
42	**Validity and Continuance in force of treaties**	• The validity of a treaty or of the consent of a State to be bound by a treaty may be impeached only through the application of the Convention. • The termination of a treaty, its denunciation or the withdrawal of a party, may take place only as a result of the application of the provisions of the treaty or of the Convention. The same rule applies to suspension of the operation of a treaty
60	**Termination or Suspension of the operation of a treaty as a consequence of its breach**	• A material breach of a bilateral treaty by one of the parties entitles the other to invoke the breach as a ground for terminating the treaty or suspending its operation in whole or in part. • A material breach of a multilateral treaty by one of the parties entitles: (a) the other parties by unanimous agreement to suspend the operation of the treaty in whole or in part or to terminate it either: (i) in the relations amongst themselves and the defaulting State, or (ii) as between all the parties; (b) a party specially affected by the breach to invoke it as a ground for suspending the operation of the treaty in whole or in part in the relations between itself and the defaulting State; (c) any party other than the defaulting State to invoke the breach as a ground for suspending the operation of the treaty in whole or in part with respect to itself if the treaty is of such a character that a material breach of its provisions by one party radically changes the position of every other party with respect to further performance of its obligations under the treaty. • A material breach of a treaty, for the purposes of this Article, consists in: (a) a repudiation of the treaty not sanctioned by the Convention; or

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		(b) the violation of a provision essential to the accomplishment of the object or purpose of the treaty. • The foregoing paragraphs are without prejudice to any provision in the treaty applicable in the event of a breach.
61	**Supervening impossibility of performance**	• A party may invoke the impossibility of performing provision of a treaty as a ground for terminating or withdrawing from it, if the impossibility results from the permanent disappearance or destruction of an object indispensable for the execution of the treaty. If the impossibility is temporary, it may be invoked only as a ground for suspending its operation. • Impossibility of performance may not be invoked by a party as a ground for terminating, withdrawing from or suspending the operation of a treaty if the impossibility is the result of a breach by that party either of an obligation under the treaty or of any other international obligation owed to any other party thereto.
62	**Fundamental change of circumstances**	• A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless – (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty. • A fundamental change of circumstances may not be invoked as a ground for terminating or withdrawing from a treaty – (a) if the treaty establishes a boundary; or (b) if the fundamental change is the result of a breach by the party invoking it either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty.

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		• If, under the foregoing paragraphs, a party may invoke a fundamental change of circumstances as a ground for terminating or withdrawing from a treaty it may also invoke the change as a ground for suspending its operation.
64	**Emergence of new peremptory norm of general international law**	If a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and stands terminated.

(3) Basic Principles of Interpretation of law for interpreting a Treaty

Principles or rules of interpretation of a tax treaty would be relevant only where terms or words used in treaties are ambiguous, vague or are such that different meanings are possible. If words are clear or unambiguous, then there is no need to resort to different rules for interpretation.

Prior to the Vienna Convention, treaties were interpreted according to the customary international law. Just as each country's legal system has its own canons of statutory construction and interpretation, likewise, several principles exist for the interpretation of treaties in customary international law.

Some of the important principles of Customary International law in interpretation of tax treaties are as follows:

(i) **Golden Rule – Objective Interpretation:** Ideally, any term or word should be interpreted keeping its objective or ordinary or literal meaning in mind. The term has to be interpreted contextually.

Words and phrases are in the first instance to be construed according to their plain and natural meaning. However, if the grammatical interpretation would result in an absurdity, or in marked inconsistency with other portions of the treaty, or would clearly go beyond the intention of the parties, it should not be adopted[3].

(ii) **Subjective Interpretation:** Under this approach, the terms of a treaty are to be interpreted according to the common intention of the contracting parties at the time the treaty was concluded. The intention must be ascertained from the words used in the treaty and the context thereof.

[3] Prof. J. G. Starke in Introduction to International Law 10th Edition

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In *Abdul Razak A. Meman's case [2005] 276 ITR 306,* the Authority for Advance Rulings [the AAR] relied on the speeches delivered by the Finance Ministers of India as well as UAE to arrive at the intention of parties in signing the India-UAE Tax Treaty.

(iii) **Purposive Interpretation:** In this approach the treaty is to be interpreted so as to facilitate the attainment of the aims and objectives of the treaty. This approach is also known as the 'objects and purpose' method. For identifying the intention of the parties entering into treaty, reference can be made to the preamble of the treaty, its protocol and the technical memorandum.

In case of *Union of India v. Azadi Bachao Andolan 263 ITR 706,* the Supreme Court of India observed that "the principles adopted for interpretation of treaties are not the same as those in interpretation of statutory legislation. The interpretation of provisions of an international treaty, including one for double taxation relief, is that the treaties are entered into at a political level and have several considerations as their bases."

The Supreme Court also made the reference to the preamble of the treaty to ascertain the purpose of India-Mauritius Treaty. The Apex Court agreed with the contention of the Appellant that "the preamble to the Indo-Mauritius DTAA recites that it is for 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty".

(iv) **The Principle of Effectiveness:** According to this principle, a treaty should be interpreted in a manner as to have effect rather than make it void.

This principle, particularly stressed by the Permanent Court of International Justice, requires that the treaty should be given an interpretation which 'on the whole' will render the treaty 'most effective and useful', in other words, which will enable the provisions of the treaty to work and to have their appropriate effects[4].

(v) **Principle of *Contemporanea Expositio:*** A treaty's terms are normally to be interpreted on the basis of their meaning at the time the treaty was concluded. However, this is not a universal principle.

In *Abdul Razak A. Meman's* case *[2005] 276 ITR 306*, the AAR observed that "there can be little doubt that while interpreting treaties, regard should be had to material *contemporanea expositio,* which means that a statute is best explained by following the construction put upon

[4] Prof. J. G. Starke in Introduction to International Law 10th Edition

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it by judges at the time it was made, or soon after. This proposition is embodied in Article 32 of the Vienna Convention, and is also referred to in the decision of the Hon'ble Supreme Court in *K. P. Varghese v. ITO [1981] 131 ITR 597*."

(vi) **Liberal Construction:** It is a general principle of construction with respect to treaties that they shall be liberally construed so as to carry out the apparent intention of the parties.

In *John N. Gladden v. Her Majesty the Queen*[5], the principle of liberal interpretation of tax treaties was reiterated by the Federal Court, which observed that "contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated in so far as the particular item under consideration is concerned."

The Court further recognised that "we cannot expect to find the same nicety or strict definition as in modern documents, such as deeds, or Acts of Parliament, it has never been the habit of those engaged in diplomacy to use legal accuracy but rather to adopt more liberal terms."

(vii) **Treaty as a Whole – Integrated Approach:** A treaty should be construed as a whole and effect should be given to each word which would be construed in the same manner wherever it occurs. Any provision should not be interpreted in isolation; rather the entire treaty should be read as a whole to arrive at its object and purpose.

(viii) **Reasonableness and consistency[6] :** Treaties should be given an interpretation in which the reasonable meaning of words and phrases is preferred, and in which a consistent meaning is given to different portions of the instrument. In accordance with the principles of consistency, treaties should be interpreted in the light of existing international law.

An important aspect to be noted regarding the rules of interpretation is that they are not rules of law and are not to be applied like the rules enacted by the legislature in an Interpretation Act.

(4) Extrinsic Aids to Interpretation of a Tax Treaty

A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention, the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke, one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:

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[5] 85 D.T.C. 5188 at 5190, Source: UOI v. Azadi Bachao Andolan 263 ITR 706 (SC)
[6] Prof. J. G. Starke in Introduction to International Law 10th Edition

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(i) Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;

(ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];

(iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;

(iv) Other treaties, in *pari materia* (i.e., relating to the same subject matter), in case of doubt.

Provisions in Parallel Tax Treaties

If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y? Though the interpretation or explanations in treaty X would not be binding while interpreting the treaty Y, however, if the language is similar between the two treaties, one can make a reference to treaty X for understanding the intention of the Contracting parties.

The views of the Indian Judiciary are, however, not consistent in this respect. There are contradictory judgments by Indian courts/Tribunal in this regard.

International Articles/Essays/Reports

Like in the direct tax cases, Courts many a times refer to the Commentaries of Kanga Palkhiwala and Sampath Iyengar for interpretation as they are considered authoritative source. Also under the International taxation, various authors like Phillip Baker and Klaus Vogel's commentary are considered as classic sources of interpretation for understanding the tax treaties. International Article/Essays/Reports are referred as extrinsic aid for interpretation of tax treaties. Like, in case of *CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP)*, the High Court obtained "useful material" through international articles.

Protocol

Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.

Protocol to India France treaty contains the Most Favoured Nation (MFN) Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

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MFN clause is usually found in Protocols and Exchange of Notes to DTCs. Under this clause a country agrees to extend the benefits to the residents of the other country, which it had (first country) promised to the residents of third country. It tries to avoid discrimination between residents of different countries.

Normally, the benefit under this clause is restricted to a specific group like OECD countries or developing countries. The nature of benefits under MFN clause could either be application of lower rate of tax or narrowing the scope of the income liable to tax or allowing higher deduction in respect of executive and general administrative expenses of head office.

CLARIFICATION REGARDING THE MOST-FAVOURED-NATION (MFN) CLAUSE IN THE PROTOCOL TO INDIA'S DTAAS WITH CERTAIN COUNTRIES [CIRCULAR NO.3/2022 DATED 3.2.2022]

The Protocol to India's DTAAs with some of the countries, especially European States and OECD members (The Netherlands, France, the Swiss Confederation, Sweden, Spain and Hungary) contains a provision, referred to as the Most-Favoured-Nation (MFN) clause. Though each MFN clause in these DTAAs has a different formulation, the general underlying provision is that if after the signature/ entry into force (depending upon the language of the MFN clause) of the DTAA with the first State, India enters into a DTAA with another OECD Member State, wherein India limits its source taxation rights in relation to certain items of income (such as dividends, interest income, royalties, Fees for Technical Services, etc.) to a rate lower or a scope more restricted than the scope provided for those items of income in the DTAA with the first State, such beneficial treatment should also be extended to the first State.

Through this circular, the CBDT clarifies that the applicability of the MFN clause and benefit of the lower rate or restricted scope of source taxation rights in relation to certain items of income (such as dividends, interest income, royalties, Fees for Technical Services, etc.) provided in India's DTAAs with the third States will be available to the first (OECD) State only when all the following conditions are met:

(i) The second treaty (with the third State) is entered into after the signature/ Entry into Force (depending upon the language of the MFN clause) of the treaty between India and the first State;

(ii) The second treaty is entered into between India and a State which is a member of the OECD at the time of signing the treaty with it;

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(iii) India limits its taxing rights in the second treaty in relation to rate or scope of taxation in respect of the relevant items of income; and

(iv) A separate notification has been issued by India, importing the benefits of the second treaty into the treaty with the first State, as required by the provisions of section 90(1) of the Income-tax Act, 1961.

If all the conditions enumerated in (i) to (iv) are satisfied, then, the lower rate or restricted scope in the treaty with the third State is imported into the treaty with an OECD State having MFN clause from the date as per the provisions of the MFN clause in the DTAA, after following the due procedure under the Indian tax law.

The Apex Court, in the case of *AO v Nestle SA [2023] 458 ITR 756*, held that the above (iv) condition of issuance of notification under section 90 of the Income-tax Act, 1961 is necessary and a mandatory condition to give effect to a tax treaty or any protocol which has the effect of altering the existing provisions of the law.

Preamble

Preamble to a tax treaty could guide in interpretation of a tax treaty. As mentioned above, in case of *Azadi Bachao Andolan*, the Apex Court observed that 'the preamble to the Indo-Mauritius Double Tax Avoidance Treaty recites that it is for the 'encouragement of mutual trade and investment' and this aspect of the matter cannot be lost sight of while interpreting the treaty'. These observations are very significant whereby the Apex Court has upheld 'economic considerations' as one of the objectives of a Tax Treaty. Further, now after the BEPS Action Plan 6 recommendation and Multi-lateral Instrument (MLI), the new text has been added to the Preamble to reflect that the treaties are not intended for creating opportunities for double-non taxation and treaty shopping arrangements. This will play a key-role in interpreting the treaties post MLI.

Mutual Agreement Procedure [MAP]

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.

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(5) Commentaries on OECD/UN Models and their importance

There are two model conventions – OECD Model Convention and the UN Model Convention. The OECD Model was framed by the members from the developed countries. It gives importance to residence based taxation. UN Model Convention represents a compromise between the developing and developed countries. UN Model focusses on source based taxation. The OECD or UN Model Convention provides template to the tax administrations for negotiating the tax treaties. There are commentaries annexed to the Model Convention which helps in interpreting the model conventions. The OECD Model Commentaries represent the views of the Members of OECD from different countries. The UN Model Commentaries represent the views of the Group of Experts from different countries who represent in their individual capacity. Therefore, commentaries are one of the important rules of interpretation of tax treaties.

Views expressed in the commentaries carry great authority. However, the same are not binding on the countries even where the countries are signatories to the Model Convention. This is due to the fact that the actual treaties may be different from the model convention. Where Contracting States adopt the text of the Article as per OECD Model convention or UN Model Convention without any change, reliance can be placed on the Model Commentaries for interpreting the tax treaties. In the *Azadi Bachao Andolan* case, the Supreme Court has made reference to the OECD convention while interpreting terms used in DTAA.

(6) Foreign Courts' Decisions

Tax treaties may be interpreted differently by the different countries. A treaty signed between country A and B, may be interpreted by courts of Country A and B differently. Therefore, there may be no harmonization in the interpretation of tax treaties. A same income may be classified as royalty by one country and business income by another country. Therefore, reliance on foreign court rulings may result in harmonious interpretation.

In many of the rulings Indian courts have referred to the foreign court cases for interpretation of treaty provisions. In *CIT v. Vishakhapatnam Port Trust's* case *[1983] 144 ITR 146*, the Andhra Pradesh High Court observed that, "in view of the standard OECD Models which are being used in various countries, a new area of genuine 'international tax law' is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adoption is just as important as the initial removal of divergences. Therefore, the judgments rendered by courts in other countries or rulings given by other tax authorities would be relevant."

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In the under-noted cases, foreign court cases have extensively been quoted for interpretation of treaty provisions:

Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

CIT v. Vishakhapatnam Port Trust [1983] 144 ITR 146

Abdul Razak A. Meman's case [2005] 276 ITR 306(AAR)

(7) Ambulatory v. Static Approach

International tax law gets updated from time to time to keep up with the developments in the society and the technology. Over the years, the OECD and UN have come up with different version of commentaries. Similarly, even the domestic tax laws also amended from time to time. The tax treaties make a reference to the domestic tax laws for the terms not defined under the treaty. Therefore, whenever a reference is made in a treaty to the provisions of domestic tax laws or to the Model Commentary for assigning meaning to a particular term, a question often arises what meaning to be assigned to the said term – the one which prevailed on the date of signing a tax treaty or the one prevailing on the date of application of a tax treaty. There are two views on the subject, namely, Static and Ambulatory.

All Model Commentaries including the Technical Explanation on US Model Tax Convention favors ambulatory approach, however with one caution and that is ambulatory approach cannot be applied when there is a radical amendment in the domestic law thereby changing the sum and substance of the term. Therefore, the current position under the domestic law or the latest version of the commentary should be resorted to if that interpretation provides a suitable meaning of the term and clarifies the term in a better way. This is due to the fact that such an interpretation has been introduced under the Model Commentary because of lack of clarity at the earlier point in time. Therefore, even if the treaty would be based on OECD Model 1977, still the meaning under the 2017 can be resorted to if that meaning provides a better clarity and the amendment is of clarificatory nature. However, if the meaning of the term changes altogether, then the meaning at the time when the treaty was signed should be resorted to.

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TEST YOUR KNOWLEDGE

Questions

1. *What do you mean by double taxation? Discuss the connecting factors which lead to double taxation.*

2. *"In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into tax treaty". Elucidate.*

3. *What is the General Rule of Interpretation under Vienna Convention of Law of Treaties?*

4. *What are the Extrinsic Aids to interpretation of a tax treaty?*

5. *Matrix Inc. incorporated in Country X, holds 26% controlling interest in Pilu Ltd., an Indian Company. Pilu Ltd. declared dividend of ₹ 50,00,000 during the P.Y. 2025-26. The DTAA between India and Country X, which came into force on 1.1.2018, provides for taxation of dividend @15%. Thereafter, India entered into a DTAA with Country Y, which came into force from 15.5.2018. The India-Country Y DTAA, inter alia, provides for concessional tax rate of 10% in respect of dividend. Country X is an OECD member since 2015 and Country Y is also an OECD member since 2017.*

   Mr. Jack, CFO of Matrix Inc. seeks your opinion on whether the concessional tax rate provided in the DTAA between India and Country Y can be availed by a resident of Country X and if so, are there any further conditions to be satisfied in this regard. You may assume that the protocol annexed to India's DTAAs with all OECD member countries contain the relevant tax parity clause.

   Would your answer change, if Country Y had become an OECD member only in the year 2020?

Answers

1. The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business **with that country** or **in that country**. Internationally, the term used to determine the jurisdiction for taxation is "connecting factors". There are two types of connecting factors, namely, "Residence" and "Source". It means a company can be subject to tax either on its residence link or its source link with a country. If a company is doing business in a host/source country, then, besides being taxed in the home country on the basis of its residence link, it will also be taxed in the host country on the basis of its source link as

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the company would be heavily engaged in doing business in the territory of other country, for example, through its branch in that country.

However, if a company is doing business with another country (i.e., host/source country), then, it would generally be subject to tax in its home country alone, based on its residence link, since the company is not engaged in carrying on the business in the territory of source country (for example, export of goods to another country). In this regard, it may, however, be noted that significant economic presence in another country may result in tax liability in the other country. For example, as per the Income-tax Act, 1961, transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India if aggregate of payments arising from such transaction or transactions during the previous year exceeds ₹ 2 crores, would be deemed as significant economic presence of such non-resident in India. Significant economic presence of a non-resident in India would constitute business connection in India and consequently, income would be deemed to accrue or arise in India and hence, be taxable in India (the Source country).

- **Juridical double taxation:** When source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as "juridical double taxation".

  In order to avoid such double taxation, a company can invoke provisions of Double Taxation Avoidance Agreements (DTAAs) (also known as **Tax Treaty** or Double Taxation Convention–DTC) with the host/source country, or in the absence of such an agreement, an Indian company can invoke provisions of section 91, providing unilateral relief in the event of double taxation.

- **Economic double taxation:** 'Economic double taxation' happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different persons (because of lack of subject identity)

2. In addition to allocating the taxing rights and elimination of double taxation, there are various other important considerations while entering into a tax treaty, as mentioned below:

- Ensuring non-discrimination between residents and non-residents
- Resolution of disputes arising on account of different interpretation of tax treaty by the treaty partner.
- Providing assistance in the collection of the fair and legitimate share of tax.

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Further, in addition to above, there are some other principles which must be considered by countries in their tax system –

(i) **Equity and fairness:** Same income earned by different taxpayers must be taxed at the same rate regardless of the source of income.

(ii) **Neutrality and efficiency:** Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.

(a) Capital export neutrality and

(b) Capital import neutrality (CIN).

Capital export neutrality (CEN) provides that business decision must not be affected by tax factors between the country of residence and the target country; whereas CIN provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) **Promotion of mutual economic relation, trade and investment:** In some cases, it is observed that avoidance of double taxation is not the only objective. The other objective may be to give impetus to a country's overall economic growth and development.

3. Article 31 of Vienna Convention of Law of Treaties contains the General Rule of Interpretation. It lays down that following general rule of interpretation:

- A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose.
- The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure

  (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

  (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto.
- The following shall be taken into account, together with the context in that:

  (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

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(b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) Any relevant rules of international law applicable to relation between the parties.

- A special meaning shall be given to a term if it is established that the parties so intended.

4. A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention, the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke, one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:

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(ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];

(iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;

(iv) Other treaties, in *pari materia* (i.e., relating to the same subject matter), in case of doubt.

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If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y? Though the interpretation or explanations in treaty X would not be binding while interpreting the treaty Y, however, if the language is similar between the two treaties, one can make a reference to treaty X for understanding the intention of the Contracting parties.

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Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.

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Mutual Agreement Procedure [MAP]

MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.

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5. The CBDT has, vide *Circular No. 3/2022 dated 3.2.2022*, clarified that the applicability of the Most Favoured Nation (MFN) clause and benefit of the lower rate or restricted scope of source taxation rights in relation to certain items of income including dividends provided in India's DTAAs with the third State (Country Y, in this case) will be available to the first (OECD) State (Country X, in this case) **only when all the following conditions are met:**

Condition		Satisfaction of condition in the case on hand
(i)	The second treaty (with the third State) is entered into after the signature/ Entry into Force of the treaty between India and the first state	This condition is satisfied as India has entered into a DTAA with Country Y on 15.5.2018, after it has entered into a DTAA with Country X on 1.1.2018.
(ii)	The second treaty is entered into between India and a State which is a member of the OECD at the time of signing the treaty with it;	This condition is satisfied as India has entered into a DTAA on 15.5.2018 with Country Y, which is a member of OECD since 2017. Hence, on 15.5.2018, Country Y was an OECD member.
(iii)	India limits its taxing rights in the second treaty in relation to rate or scope of taxation in respect of relevant items of income	This condition is satisfied since in DTAA between India and Country Y, dividend is taxable@10%.
(iv)	A separate notification has been issued by India, importing the benefits of the second treaty into the treaty with the first State as required by the provisions of section 90(1) of the Income-tax Act, 1961.	In this case, conditions (i), (ii) and (iii) mentioned above have been satisfied. The concessional rate of 10% can be applied for taxing the dividend received by Matrix Inc. from Pilu Ltd., an Indian company, only if India has issued a separate notification importing the benefits of India-Country Y tax treaty into India-Country X tax treaty, as required by the provisions of sections 90(1). If such notification has been issued, then, the concessional rate of 10% can be applied for taxing the dividend received by Matrix Inc. from Pilu Ltd., an Indian company; otherwise it cannot be applied, even if other conditions are satisfied.

In case if Country Y became an OECD member only in the year 2020, then, the concessional rate of 10% cannot be applied for taxing dividend received by Matrix Inc. from Pilu Ltd., since Country Y was not an OECD member on 15.5.2018, at the time when India signed the DTAA with it. Consequently, condition (ii) mentioned above would not be satisfied in such a case. Hence, dividend received by Matrix Inc. from Pilu Ltd. would be subject to tax@15%.

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CHAPTER 27

OVERVIEW OF MODEL TAX CONVENTIONS

LEARNING OUTCOMES

After studying this chapter, you would be able to:

- **appreciate** the need for Model Tax Convention;
- **appreciate** the key features of the OECD and UN Model Tax Conventions;
- **identify** the subject of the various articles of the OECD and UN Model Tax Conventions;
- **appreciate** the broad similarities and differences between the principles enshrined in certain articles of the OECD Model Tax Convention *vis-à-vis* the corresponding articles of the UN Model Tax Convention.

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27.1 INTRODUCTION

In order to enable various countries to enter into treaties, which are standardized to some extent, Organization for Economic Cooperation and Development (OECD) and the United Nations (UN) have developed certain Model Tax Treaties. These treaties can be used by various countries as a starting point in their negotiations with other countries. While these Models are not legally binding, they have been extensively used by various countries as a reference point while entering into Tax Treaties. In some cases, they have been incorporated verbatim or with minor changes. However, in other cases, countries have made suitable changes in the draft model according to their economic environment and commercial and tax considerations.

The significant model conventions have been briefly discussed hereunder:

OECD Model - The emergence of present form of OECD Model Convention can be traced back to 1927, when the Fiscal Committee of the League of Nations prepared the first draft of Model Form applicable to all countries. In 1946 the model convention was published in Geneva by the Fiscal Committee of U.N. Social & Economic Council and later by the Organisation for European Economic Co-operation (OEEC) in 1963. However, in 1961, the Organisation for Economic Co-operation and Development (OECD) was established, with developed countries as its members, to succeed the OEEC, and OECD approved the draft presented to the OEEC. In 1977, the final draft was prepared in the present form which has been revised several times; the latest being in the year 2017.

OECD Model Convention (OECD MC) is essentially a model treaty **between two developed nations.** This model advocates residence based taxation, i.e., it lays emphasis on the right of state of residence to tax the income.

UN Model – In 1968, the United Nations set up an Adhoc Group of Experts from various developed and developing countries to prepare a **draft model convention between developed and developing countries**. In 1980, this Group finalised the UN Model Convention (UN MC) in its present form. Since its first publication in 1980, the Model has been updated previously in 2001, 2011 and 2017. The latest updation was in the year 2021.

The UN MC is a compromise between the source principle and the residence principle. However, it gives more weight to the source principle as against the residence principle of the OECD MC. UN MC is designed to encourage flow of investments from the developed countries to developing countries. It takes into account sharing of tax-revenue with the country providing capital.

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The United Nations MC seeks to be balanced in its approach. As a corollary to the principle of taxation at source, the Articles of the Convention are based on a recognition by the source country that

(a) taxation of income from foreign capital should take into account expenses allocable to the earnings of the income so that such income is taxed on a net basis,

(b) taxation should not be so high as to discourage investment and

(c) it should take into account the appropriateness of the sharing of revenue with the country providing the capital.

In addition, the United Nations MC embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either a foreign tax credit or an exemption, as is also the case with the OECD Model Convention.

US Model – This Model Convention is used by the United States while entering into tax treaties with various countries. The US Model Convention was last revised in 2016.

These Models have a significant influence on international treaty practice, and have important common provisions. The similarities between these Models highlight the areas of consistency. The areas of divergence indicate some critical differences in approach or emphasis which need special focus. These differences are mainly in relation to the taxing rights which would be available to a country under domestic law and the extent to which any country should forego, under a bilateral tax treaty, in order to avoid double taxation and encourage investment.

The above model conventions have been illustrated in the following diagram:

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OECD Model contains VII chapters comprising of 32 articles and UN Model also contains VII chapters but comprising of 31 articles. List of articles of OECD MC and UN MC is given below:

Article	OECD Model, 2017	UN Model, 2021
	Chapter I : Scope of the Convention	
1	Persons covered	Persons covered
2	Taxes covered	Taxes covered
	Chapter II : Definitions	
3	General definitions	General definitions
4	Resident	Resident
5	Permanent establishment	Permanent establishment
	Chapter III : Taxation of Income	
6	Income from immovable property	Income from immovable property
7	Business profits	Business profits
8	International shipping and air transport	International shipping and air transport (Alternatives A & B)
9	Associated enterprises	Associated enterprises
10	Dividends	Dividends
11	Interest	Interest
12	Royalties	Royalties
12A		Fees for technical services
12B		Income from automated digital services
13	Capital gains	Capital gains
14		Independent personal services
15	Income from employment	Dependent personal services
16	Directors' fees	Directors' fees and remuneration of top-level managerial officials
17	Entertainers and sportspersons	Artistes and sportspersons
18	Pensions	Pensions and social security payments (Alternatives A & B)
19	Government service	Government service
20	Students	Students
21	Other income	Other income
	Chapter IV : Taxation of Capital	
22	Capital	Capital

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	Chapter V : Methods for the Elimination of Double Taxation	
23A	Exemption method	Exemption method
23B	Credit method	Credit method
	Chapter VI : Special Provisions	
24	Non-discrimination	Non-discrimination
25	Mutual agreement procedure	Mutual agreement procedure (Alternatives A & B)
26	Exchange of information	Exchange of information
27	Assistance in the collection of taxes	Assistance in the collection of taxes
28	Members of diplomatic missions and consular posts	Members of diplomatic missions and consular posts
29	Entitlement to benefits	Entitlement to benefits
30	Territorial extension	
	Chapter VII : Final Provisions	
31/30	Entry into force	Entry into force
32/31	Termination	Termination

Now, let us discuss the comparative analysis of some of the significant Articles in the Model Tax conventions.

27.2 COMPARATIVE ANALYSIS OF SOME OF THE SIGNIFICANT ARTICLES OF OECD AND UN MODEL CONVENTIONS

Title and Preamble to the Model Conventions

The title of the UN Model Convention reads as follows:

"Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and capital and the prevention of tax avoidance and evasion"

There is a specific reference to "the prevention of tax avoidance and evasion" in the title to emphasize its significance in the Model Convention.

The Preamble to the UN Model Convention reads as follows:

"(State A) and (State B),

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Desiring to further develop their economic relationship and to enhance their cooperation in tax matters,

Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax avoidance or evasion (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)"

The Title and Preamble to the OECD Model Convention is almost identical to that of the UN Model Convention. The only minor difference is the reference to "tax evasion and avoidance" in the place of "tax avoidance and evasion" in the Title and Preamble.

The Preamble clearly indicates that the UN and OECD Model Conventions do not intend to create opportunities for non-taxation or reduced taxation through tax avoidance or evasion including through treaty shopping arrangements.

This language of the Preamble would help ensuring that the provisions of the Conventions are interpreted and applied to prevent abusive treaty shopping arrangements.

Significant Articles in the Model Conventions

Over the years, both Model Conventions have seen a lot of convergence and the language is identical in quite a few Articles. However, there are key differences in approach and language in some Articles which will be the focus of our discussion, in the section below.

The jurisdiction or country of residence of the taxpayer is referred to as the Residence State and the jurisdiction or country where the source of income is located is referred to as the Source State.

Article 1: Persons Covered

The OECD and UN Model Convention would apply to persons who are residents of one or both of the Contracting States.

For the purposes of these Conventions, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State. However, the same would be treated as income only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

Example

State A and State B have concluded a treaty identical to the Model Tax Convention. State A considers that an entity established in State B is a company, and taxes that entity on interest that it

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receives from a debtor resident in State A. Under the domestic law of State B, however, the entity is treated as a partnership, and the two members in that entity, who share equally all its income, are each taxed on half of the interest. One of the members is a resident of State B and the other one is a resident of a country with which States A and B do not have a treaty. The paragraph provides that in such case, half of the interest shall be considered, for the purposes of Article 11, to be income of a resident of State B.

***Note** – The above example forms part of the Commentary to the UN Model Tax Convention.*

With the exception of benefits granted under certain Articles of these conventions, these Conventions would not affect the taxation, by a Contracting State, of its resident.

Article 1 of UN Model Convention covers provision dealing with the application of the Convention to "Collective investment vehicles". Funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established are referred to as "collective investment vehicles" (CIVs) like REITs.

These funds adopt different legal structures and may be set up, for instance, as companies, partnerships, trusts or contractual arrangements that create a joint ownership. It is to ensure that investing through a domestic CIV should result in a tax burden that is equal to the one that applies in the case of a direct investment, i.e. an investment where the CIV would not exist and where the investor in the CIV would have acquired directly its share of the assets held by the CIV.

Article 2: Taxes Covered

The OECD and UN Conventions would apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

Taxes on income and on capital cover all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

The existing taxes to which the Conventions would apply in case of each Contracting State are specifically to be mentioned.

The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of significant changes made to their tax law.

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Article 4: Residence

A taxpayer has to demonstrate that he is a resident of one or both Contracting States to be able to gain access to a tax treaty and avail the benefits thereunder.

The concept of 'resident of a Contracting State' has various functions and assumes significance in the following three scenarios:

- In determining a convention's scope of application;
- In solving cases where double taxation arises as a consequence of double residence;
- In solving cases where double taxation arises as a consequence of taxation in the state of residence and also in the state of source of income.

As per paragraph 1 of the UN Model 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 ***that person's*** domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof ***as well as a recognized pension fund of that State.*** 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.

Paragraph 1 of the OECD Model Convention is worded on similar lines. However, it does not contain reference to place of incorporation ***and does not include recognized pension fund***.

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.

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As per paragraph 3 of this Article, where by reason of the provisions of paragraph 1, a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement, the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention. They shall do so having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such mutual agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

The situation of dual residence may arise in case of companies in case where one Contracting State attaches importance to the place of incorporation and the other State to the place of effective management. The tie-breaker rule traditionally has been 'place of effective management'. Even India has used place of effective management in some of its treaties. In the latest update by OECD and UN, this has changed to a case by case approach considering the number of tax avoidance cases involving dual resident companies. Determination under the case by case approach will be requested by the concerned taxpayer through Article 25 (Mutual Agreement Procedure). Competent authorities will then rely on a range of factors to resolve the question of dual residency.

The last sentence of paragraph 3 of this Article provides that in the absence of determination by the competent authorities, the dual resident person would not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States. This will not, however, prevent the taxpayer from being considered a resident of each Contracting State for purposes other than granting treaty reliefs or exemptions to that person.

Article 5: Permanent Establishment

The concept of "Permanent Establishment" (PE), defined in Article 5, has considerable importance as business profits (Article 7) of an enterprise cannot be taxed by a Source State unless it proves the existence of a PE.

The comparable term to PE under the Indian tax law is "business connection" [Section 9(1)(i)]. Generally speaking, the concept of "business connection" is wider than PE and hence, a business connection may exist even without a PE, but the absence of a "business connection" may indicate absence of a PE.

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As the PE concept gives the Source State the right to tax, it is an important Article for developing countries. Hence, the UN Model Convention varies from the OECD Model Convention in the following respects:

- As per Article 5(3)(a) of the OECD Model Convention, a building site or construction or installation project constitutes a PE if it lasts more than twelve months. The UN Model Convention is wider as it covers "assembly or installation project" or "supervisory" activities in connection thereto and requires the activity in question to continue only for six months for constituting a PE.

- Article 5(3)(b) of the UN Model makes a specific reference to Service PE which is absent in the OECD Model. Article 5(3)(b) of the UN Model reads as follows –

  "The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12 month period commencing or ending in the fiscal year concerned".

  In the absence of a Service PE reference in OECD Model, the presence has to be ascertained through general principles under Article 5(1).

- Article 5(1) states the "basic rule" for a PE and expresses the primary meaning of PE. The definition of PE in Article 5 does not use the qualifying words "unless the context otherwise requires". As such, the definition needs to be followed in all cases unless specifically excluded.

  Paraphrasing Article 5(1), a PE exists if the following conditions are satisfied cumulatively:

  - There is an "enterprise".
  - Such enterprise is carrying on a "business";
  - There is a "place of business";
  - Such place of business is at the disposal of the enterprise (may be owned/rented but must be one which the enterprise has the effective power to use);
  - The place of business is "fixed", that is, it must be established at a distinct place with a certain degree of permanence

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The business of the enterprise is carried on wholly or partially through this fixed place of business.

A PE does not exist unless all the aforesaid conditions are satisfied.

- As per Article 5(2), the term "permanent establishment" includes especially:

  a) a place of management;

  b) a branch;

  c) an office;

  d) a factory;

  e) a workshop, and

  f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

- Agency PE under OECD and UN Models targets activities done by a dependent agent of the enterprise in the Source State. The definition of dependent agent PE includes instances when an agent habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts routinely concluded without material modification by the enterprise.

  In UN Model Convention, PE is constituted even if the person does not habitually conclude contracts nor plays the principal role leading to the conclusion of such contracts, but habitually maintains in that State, a stock of goods or merchandise from which that person regularly deliver goods or merchandise on behalf of that enterprise.

- The UN Model Convention has an additional Article 5(6) relating to insurance which is absent in OECD Model.

  As per this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.

  In the absence of similar Article in the OECD Model, a PE of an insurance enterprise has to be determined in accordance with provisions of Article 5(1) or 5(2) of the OECD model.

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Article 7: Business Profits

Business profits of an enterprise can only be taxed by the Residence State. Right of Source State to tax business profits of an enterprise only exists if a PE exists in its jurisdiction.

As per the approach under the OECD Model Convention, once a PE is proven, the Source State can tax only such profits as are attributable to the PE. The UN Model Convention amplifies this attribution principle by a **limited** Force of Attraction rule (FOA).

The FOA rule implies that when a foreign enterprise sets up a PE in State of Source, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that profits that the enterprise derives from State of Source, whether through the PE or not, can be taxed by it (State of Source).

As per Article 7 of the UN Model Convention, if the enterprise carries on business in the other Contracting State through a PE, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:

(a) that PE;

(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that PE; or

(c) other business activities carried on in that other State of the same or similar kind as those effected through that PE.

Article 11: Interest

Paragraph 1 of this Article provides the right to Residence State to tax interest. Paragraph 2, however, also confers right to the Source State to tax interest. Generally, the interest is taxed in the Source State at a given rate on gross basis. However, if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged cannot exceed a specified percentage of the gross amount of the interest. The OECD Model specifies the percentage as 10%, but the UN Model leaves this percentage to be established through bilateral negotiations.

It may be noted that the definition of interest in both the models viz. OECD and UN Model is similar in that it essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

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Article 12: Royalties

This Article provides the right of Contracting States to tax income from royalty.

Key differences between the two Models are as follows:

- As per the OECD Model, royalties arising in the Source State and beneficially owned by a resident of the Residence State are taxable only in the Residence State. However, the UN Model provides that royalties may be taxed in the Residence State. Hence, the UN Model departs from the principle of exclusive right to tax provided to Residence State in the OECD Model. Thus, under the UN Model, the Source State may also tax royalties. However, if the beneficial owner is a resident of the Residence State, the tax charged by the Source State cannot exceed the specified percentage of the gross amount of royalties. This specified percentage is to be established through bilateral negotiations.
- The term "royalties" as per UN Model Convention means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.
- The definition of 'royalties' under the OECD Model does not include the following: (a) rentals for films or tapes used for radio or television broadcasting and (b) equipment rentals like rentals for industrial, commercial or scientific equipment.

Article 12A: Fees for Technical Services

India is the pioneer of the FTS concept which was added to the Income-tax Act, 1961 since 1976. Some of our tax treaties do contain a specific provision for FTS.

The UN Model has a specific article pertaining to Fees for Technical Services (FTS). There is no specific reference to FTS in the OECD Model.

Paragraph 1 of Article 12A provides that the FTS may be taxed in the Residence State but does not provide that the FTS is exclusively taxable in the Residence State.

Paragraph 2 establishes the right of the country in which FTS arises to tax in accordance with its domestic law, subject to the limitation on the maximum rate of tax on gross amount of the fees, if the beneficial owner is a resident of the other Contracting State. The maximum rate of tax is to be established through bilateral negotiations.

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FTS is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use. Management involves application of knowledge, skill or expertise in the control or administration of the conduct of a commercial enterprise or organization. Payments made to a consultant for advice related to the management of an enterprise (or of the business of an enterprise) would be FTS. Technical involves the application of specialized knowledge, skill or expertise with respect to a particular art, science, profession or occupation. Fees received for services provided by regulated professions such as law, accounting, architecture, medicine, engineering would constitute FTS. Services performed by other professionals, such as pharmacists, and scientists, etc. may constitute technical services if those services involve provision of specialized knowledge, skill and expertise. The ordinary meaning of "consultancy" involves the provision of advice or services of a specialized nature.

An example of FTS can be seen from the following facts: R Company is a financial institution resident in State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, guarantees, foreign exchange, negotiable instruments. R Company's business is conducted primarily in State R, but it also has clients in other countries, including State S. State R and State S have a tax treaty which contains an article akin to Article 12A. Payments received for services provided by a financial institution would constitute FTS if the services involve use of knowledge, skill and expertise to provide research, analysis or advice to a specific client related to particular circumstances. This has to be distinguished from provision of non-specialized services such as payment and transmission services, debit and credit card services, etc., which do not involve the application of any specialized knowledge, skill and expertise on behalf of a particular client.

Article 12B: Income from Automated Digital Services

With the advent of modern means of telecommunications and the spread of digitalization, enterprises have the ability to effectively engage in substantial business activities in the market country (source jurisdiction) without a fixed place of business there, or to conclude contracts remotely through technological means with no involvement of individual employees or dependent agents.

Article 12B was added to the United Nations Model Tax Convention in its 2021 update to preserve the domestic law taxing rights for States from which payments for automated digital services are made. There is no article in the OECD Model corresponding to Article 12B.

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Paragraph 1 of Article 12B provides that the income from automated digital services arising in a Contracting State, underlying payments for which made to a resident of other Contracting State, may be taxed in the Residence State. It does not, however, provide that the income from automated digital services is exclusively taxable in the Residence State.

Paragraph 2 establishes the right of the country in which income from automated digital services arises to tax in accordance with its domestic law. However, if the beneficial owner of the income is a resident of the Residence State, the tax charged by the Source State cannot exceed the specified percentage of the gross amount of payments underlying the income from automated digital services. This specified percentage is to be established through bilateral negotiations.

"Automated digital services" is defined in paragraph 5 to mean any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider.

An important indicator of the concept of automated services is whether there is ability to scale up and provide the same type of services to new users with minimal human involvement. Once the service offering an automated digital service business is developed (such as a music catalogue or a social media platform), then, the business can provide that service to one user, or many more, on an automated basis with the same basic business processes. On the other hand, a non-automated digital service business would see a proportionate increase in the costs per unit in connection with providing the services to new customers.

Paragraph 6 lists examples of services that may constitute automated digital services. However, the provision is not self-standing; the requirements of paragraph 5 must also be met. Paragraph 6 simply provides an indication that an activity may constitute an automated digital service; it does not provide that an activity listed therein necessarily is an automated digital service. The following services are expressly mentioned in paragraph 6:

(a) online advertising services;

(b) supply of user data;

(c) online search engines;

(d) online intermediation platform services;

(e) social media platforms;

(f) digital content services;

(g) online gaming;

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(h) cloud computing services; and

(i) standardized online teaching services.

The categories are not mutually exclusive; for example, a digital content service could be funded in whole or in part by online advertising.

Paragraph 7 provides that the provisions of Article 12B shall not apply if the payments underlying the income from automated digital services qualify as "royalty" or "fees for technical services" under Article 12 or Article 12A.

Article 13: Capital Gains

This is the most commonly used Article and it provides for the taxation of income arising from transfer of a capital asset, including transfer of shares. The right to tax income from capital gains may be exclusively with the Residence State, or shared between the Residence and Source States.

The Article does not specify what is a capital gain and how is to be computed, this being left to the applicable domestic law. The Article contains rules for taxation of gains made from alienation of different assets such as immovable property, immovable property forming part of a PE, ships and aircrafts, etc.

In respect of shares, both Models are identical. Rights are conferred to the Source State if more than 50 percent of the value of shares during the preceding 365 days is derived directly or indirectly from immovable property in such Source State. Otherwise, the Residence State would have the exclusive right to tax.

UN Model Convention allows a State to tax gains from the alienation of rights granted under the law of that State as long as these rights allow the use of resources that are naturally present in that State and that are under the jurisdiction of that State. This would cover, for example, the alienation of rights such as fishing quotas granted by the State; the right to fell timber in a forest; the right to extract water; the right to explore part of a territory of the State for oil, gas or minerals; the right to install wind or tidal stream turbines in part of the territory of the State as well as the right to use all or part of the radiofrequency spectrum in the State, including for cell phone purposes.

This provision does not cover rights granted contractually between private parties even if these rights are protected under the law of the State. Thus, the alienation of exclusive right to use know how in a given State would not be covered by the provision as that right granted by the owner of the know-how is not granted under the law of the State.

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Both UN and OECD Model convention gives exclusive right to Residence State in case of gains from the alienation of any property other than covered in the other paragraphs of this Article.

Article 14: Independent Personal Services

Article 14 is only present in the UN Model. It was deleted from the OECD Model on 29-4-2000 on the basis of OECD Report (2000) on "Issues Related to Article 14 of the OECD Model Tax Convention". The Effect of deletion of Article 14 is that income derived from Professional Services etc., is now dealt with as 'Business Profits' (Article 7) under the OECD MC.

This Article deals with the taxation of income derived by a person for professional or specified services which are offered in the Source State through some presence. This article on Independent personal services in the UN Model reads as under:

(1) Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

(a) If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or

(b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

(2) The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Thus, the Article covers independent activities involving professional skills rendered by individuals on a principal to principal basis. The meaning of the term "professional services" is illustrated by some examples of typical liberal professions. The enumeration has an explanatory character only and is not exhaustive. It excludes industrial and commercial activities that are covered under the Article on Business Profits. Likewise, it also excludes professional services while in employment which are covered under the Article on Dependent Personal Services, e.g. a physician serving as a medical officer in a factory. Income of Artists, Athletes and Sportsmen, etc. is not covered by this Article. Also, income from Fees from Technical Services is also not covered.

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Article 21: Other Income

This Article deals with taxation of items of income which are not specifically taxable under any other specific Article. Key differences are as under:

- OECD approach envisages that the exclusive right to tax is with the Residence State. UN Model contains an additional paragraph, Article 21(3), which provides that Source State may also tax other income.
- Article 21(2) of both OECD and UN Model provides that for income effectively connected with a PE maintained in a Contracting State by a resident of the other Contracting State, taxation is governed by the provisions of Article 7 (Business Profits). Additionally, UN Model provides that if the aforesaid income is effectively connected with a fixed base situated in a Contracting State by a resident of the other Contracting State, taxation would be governed by the provisions of Article 14 (Independent personal services).

Articles 23A & 23B : Elimination of Double Taxation

In many cases, the application of tax treaty may result into double taxation for tax payers. In such a case, in order to provide relief to such tax payers, Articles 23A and 23B which contains provisions relating to elimination of double taxation have to be applied. Articles 23A and 23B provide for the mechanism through which tax credit/exemption may be available in the Residence State for taxes deducted in the Source State.

The OECD and UN Model Conventions specify two approaches - Exemption method (Article 23A) and Credit method (Article 23B). Under the exemption method, tax exemption may be available in the Residence State. Under the credit method, tax credit may be available in the Residence State for taxes deducted in the Source State. These methods are not mutually exclusive and there may be cases where a treaty may adopt exemption method for certain types of income and credit method for other incomes.

The double taxation referred to here, is juridical double taxation, meaning the same income or capital is taxable in the hands of the same person by more than one State. It does not thus, encompass situations of economic double taxation, i.e. where two different persons are taxable in respect of the same income or capital. If two States wish to solve problems of economic double taxation, they must do so in bilateral negotiations.

Article 25: Mutual Agreement Procedure

There may be a situation wherein a tax payer may believe that the treatment accorded by either or both Contracting States is not in accordance with the provisions of the tax treaty. In such a case, there is a need for dispute resolution which is addressed by this Article. This Article requires

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competent authorities of both countries to endeavor to resolve the conflict by engaging in bilateral negotiations.

The UN Model Convention provides two alternatives - Alternative A and Alternative B, for the article on Mutual Agreement Procedure which were introduced in 2011. Under OECD Model the taxpayer may make a request to either Contracting State while UN Model (Alternative A) contemplates taxpayer going to Residence State or the country of his nationality. Alternative B of UN Model Article 25 contemplates reference to an arbitration process as part of the Mutual Agreement Procedure. The decision arrived at, through the process is binding unless a person directly affected does not accept it.

Key differences between the OECD Model Convention (Article 25) and UN Model Convention (Article 25B - Alternative B) are as follows:

- Article 25B(5) of the UN Model provides that an arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case. However, Article 25(5) of the OECD Model provides a time limit of two years from the date when all the information required by the competent authorities in order to address the case need to be provided to both competent authorities.
- Article 25B(5) of the UN Model provides that arbitration must be requested by the competent authority of one of the Contracting States. Once such a request is made, the taxpayer will be notified. However, as per Article 25(5) of the OECD Model, arbitration must be requested in writing by the person who initiated the case.
- Article 25B(5) of the UN Model allows the competent authorities to depart from the arbitration decision if they agree to do so within six months after the decision has been communicated to them.

Article 26: Exchange of Information

In order to complete tax cases, a country may require certain information which may be available with the treaty partner. Article 26 provides for the information which may be exchanged and the manner in which such a request has to be made. The purpose of Article 26 is to facilitate effective exchange of information between Contracting States. From the perspective of many developing countries, Article 26 is particularly important not only for curtailing cross-border tax evasion and avoidance, but also to curtail the capital flight that is often accomplished through such evasion and avoidance.

The OECD and UN Model Conventions are similar with respect to this Article. A Contracting State cannot be expected to provide confidential financial information to another Contracting State

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unless it has confidence that the information will not be disclosed to unauthorized persons. A Contracting State can avoid the exchange of information obligations by showing that the information pertains to communication between an attorney and his client which is protected from disclosure under domestic law. However, lack of interest or use in such information cannot form the basis for a Contracting State to not co-operate with the exchange of information obligations.

Resources: The discussion on Model Tax Conventions in the above chapter is essentially based on the text and commentaries of the OECD Model Tax Convention, 2017 and UN Model Tax Convention, 2021 available at the websites http://www.oecd.org/tax/treaties/ and http://www.un.org, respectively.

SUMMARY

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<tr><th colspan="2">Article</th><th>OECD MC vis-à-vis UN MC
Common paras & Significant differences</th></tr>
<tr><td colspan="3">Chapter I : Scope of the Convention</td></tr>
<tr><td>1</td><td>Persons covered</td><td>
<ul>
<li>Resident of CS - For application of treaty, a person has to be a resident of one or both of the Contracting States (CSs).</li>
<li>Fiscally transparent entity - Income derived by or through a fiscally transparent entity under the tax law of either CS to be considered to be income of a resident of a CS, to the extent such income is treated, for purposes of taxation by that State, as the income of a resident of that State.</li>
<li>Collective investment vehicles - Provision dealing with the application of the UN Model Convention to “Collective investment vehicles.</li>
</ul>
</td></tr>
<tr><td>2</td><td>Taxes covered</td><td>
<ul>
<li>Taxes on income and capital - The MCs apply to taxes on income and on capital imposed on behalf of a CS or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.</li>
<li>Coverage of taxes - Taxes on income and on capital covers:
<table>
<tr><th>Taxes imposed</th><th>Taxes included</th></tr>
<tr><td rowspan="3">• On total income
• on total capital
• on elements of income or of capital</td><td>• taxes on gains from alienation of movable or immovable property</td></tr>
<tr><td>• taxes on total amounts of wages or salaries paid by enterprises</td></tr>
<tr><td>• taxes on capital appreciation</td></tr>
</table>
</li>
</ul>
</td></tr>
</table>

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Chapter II : Definitions		
4	**Resident**	**Resident of either CS** - A taxpayer has to demonstrate that he is a resident of one or both CSs to be able to gain access to a tax treaty and avail benefits thereunder. **Meaning of "Resident of a Contracting State"**- Any person who, under the laws of that State, is liable to tax therein by reason of that person's: 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. ***Note*** *- OECD MC does not contain reference to place of incorporation.* **Tie-breaker Rule** **<u>In case of individuals</u>** Where an individual is a resident of both CSs as per domestic tax laws of that CS, then, his residential status shall be determined by applying the tie-breaker rule in the following sequence:

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		 <u>In case of companies</u> • Dual residence arises where one CS attaches importance to POI and the other CS to the POEM. • The tie-breaker test involves a case by case approach considering the no. of tax avoidance cases involving dual resident Cos. • Request has to be made by the tax payer through Article 25 (MAP). • Competent Authorities will rely on range of factors to resolve the question of dual residency.
5	**Permanent establishment (PE)**	**Meaning of PE [Article 5(1)]** • There should be an "**enterprise**" (Entr). • Such Entr should be carrying on a "**business**"; • There should be a "**place of business** (POB)"; • Such place of business (POB) should be at the **disposal of the Entr** (may be owned / rented but must be one which the Entr has the effective power to use); • The POB should be "fixed", i.e., it must be established at a distinct place with a certain **degree of permanence** • The business of the enterprise is carried on wholly or partially through this fixed POB. A PE does not exist unless all the aforesaid conditions are satisfied.

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Specific inclusions in the meaning of PE [Article 5(2)]

Expansion of scope of Agency PE

- Agency PE targets activities done by a dependent agent (DA) of the Entr in the Source State (SS).
- DAPE now includes instances when an agent habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts routinely concluded without material modification by the enterprise.
- In UN Model Convention, PE is constituted even if the person does not habitually conclude contracts nor plays the principal role leading to the conclusion of such contracts, but habitually maintains in that State, a stock of goods or merchandise from which that person regularly deliver goods or merchandise on behalf of that enterprise.

PE of an Insurance Enterprise

UN MC	OECD MC
UN MC has an additional Article 5(6) relating to insurance. An insurance Entr of a CS is deemed to have a PE in the other CS if it collects premiums in the territory of that other CS or insures risks situated therein through a person.	In the absence of similar Article in the OECD MC, a PE of an insurance Entr is to be determined in accord with Article 5(1) or 5(2).

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<table>
<tr><th colspan="4">Chapter III : Taxation of Income</th></tr>
<tr><td>7</td><td>Business profits</td><td colspan="2">
Right of CS to tax business profits (BPs)
<table>
<tr><th>OECD MC</th><th>UN MC</th></tr>
<tr><td colspan="2">BPs of an Entr can only be taxed by the Residence State (RS). Right of Source State (SS) to tax BPs of an enterprise only exists if a PE exists in its jurisdiction.</td></tr>
<tr><td rowspan="2">Once a PE is proven, the SS can tax only such profits as are attributable to the PE</td><td>
<ul><li>The attribution principle is amplified by a <u>limited</u> Force of Attraction rule (FOA).</li><li>The FOA rule implies that when a foreign enterprise sets up a PE in SS, it brings itself within the fiscal jurisdiction of that State to such a degree that profits that the Entr derives therefrom, whether through the PE or not, can be taxed by it (i.e., the SS).</li></ul>
</td></tr>
<tr><td>
<ul><li>Accordingly, if the Entr carries on business in the other CS through a PE, the profits of the Entr may be taxed in the other CS but only so much of them as is attributable to:
(a) that PE;
(b) sales in that other CS of goods or merchandise of the same or similar kind as those sold through that PE; or
(c) other business activities carried on in that other State of the same or similar kind as those effected through that PE.</li></ul>
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<tr><td>11</td><td>Interest</td><td colspan="2">
Right of CSs to tax interest
<table>
<tr><th>Para of Article</th><th>Right of CS to tax interest</th></tr>
<tr><td>1</td><td>Confers the right to RS to tax interest</td></tr>
<tr><td>2</td><td>Confers right to the SS to tax interest.
Generally, interest is taxed in the SS at a given rate on gross basis.
However, if the beneficial owner of the interest is a resident of the other CS, the tax so charged ≤ specified % of the gross interest.</td></tr>
</table>
</td></tr>
</table>

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		The specified % as per OECD MC is 10%, but the UN MC leaves this % to be established through bilateral negotiations.

- **Definition of interest in OECD & UN MCs -** Interest means income from debt claims of every kind,
  - whether or not secured by mortgage and
  - whether or not carrying a right to participate in the debtor's profits.
- **Specific inclusions in the definition of interest as per OECD & UN MCs**
  - income from govt securities
  - income from bonds or debentures
  - premiums and prizes attaching to such securities, bonds or debentures.

  Note *- Interest does not include penalty charges for late payment*.

12	**Royalties** (Roy)		OECD MC	UN MC
		Right of CS to tax Roy. income	Roy. arising in SS and beneficially owned by resident of the RS is taxable only in RS. Thus, **RS has exclusive right to tax royalty income**.	Roy **may also be taxed in the SS**. However, if the beneficial owner is a resident of the RS, the tax charged by SS ≤ the specified %, (to be established through bilateral negotiations) of gross royalty.
		Definition of Roy	Definition of Royalty does not include: (a) rentals for films/tapes used for radio/ TV broadcasting; and (b) rentals for industrial, commercial or scientific equipment.	Royalty includes: (a) rentals for films or tapes used for radio or TV broadcasting and (b) equipment rentals like rentals for industrial, commercial or scientific equipment.
12A	**FTS**	The UN MC has a specific article pertaining to Fees for Technical Services (FTS). There is no specific reference to FTS in OECD MC.		

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Right of CS to tax FTS [UN Model]

Para of Article	Right of CS to tax FTS
1	Confers right to the RS to tax FTS. However, does not state that FTS is exclusively taxable in the RS.
2	Establishes the right of the SS to tax FTS in accordance with its domestic law, subject to limitation on the max. rate of tax on gross amount of fees, to be established through bilateral negotiations, if the beneficial owner is a resident of the other CS.

Meaning of FTS [UN Model]

FTS means payments for managerial, technical or consultancy services	
Exclusions from the meaning of FTS:	
i	payment to an employee
ii	payment for teaching in an or by an educational institution
iii	payment by an individual for services for personal use

12B Income from Automated Digital Services

Article 12B was added to the United Nations Model Tax Convention in its 2021 update to preserve the domestic law taxing rights for States from which payments for automated digital services are made. There is no article in the OECD MC corresponding to Article 12B.

Right of CS to tax income from automated digital [UN Model]

Para of Article	Right of CS to tax income from automated digital services
1	Confers right to the RS to tax income from automated digital services arising in a CS. However, does not state that FTS is exclusively taxable in the RS.
2	Establishes the right of the SS to tax income from automated digital services in accordance with its domestic law, subject to the specified percentage of the gross amount of payments underlying the income from automated digital services, to be established through bilateral negotiations, if the beneficial owner is a resident of the other CS.

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		Meaning of Automated digital services [UN Model] **Automated digital services any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider.** **Specific inclusions**: **i** online advertising services **ii** supply of user data **iii** online search engines **iv** online intermediation platform services **v** social media platforms **vi** digital content services **vii** online gaming **viii** cloud computing services **ix** standardized online teaching services
13	**Capital gains**	This Article provides for the taxation of income arising from transfer of a capital asset, including transfer of shares. **Right of CS to tax income from Capital Gains** • The right to tax capital gains may be exclusively with the RS, or shared between the RS and SS. • The Article does not specify what is a capital gain and how is to be computed, this being left to the applicable domestic law. • The Article contains rules for taxation of gains from alienation of different assets such as immovable property, immovable property forming part of a PE, ships & aircrafts, etc. • In respect of shares, OECD and UN MCs are identical. Rights are conferred to the SS if more than 50% of the value of shares during the preceding 365 days is derived directly or indirectly from immovable property in such SS. Otherwise, the Residence State would have the exclusive right to tax. • UN MC allows a State to tax gains from the alienation of rights granted under the law of that State as long as these rights allow the

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		use of resources that are naturally present in that State and that are under the jurisdiction of that State. • Both UN and OECD Model convention gives exclusive right to Residence State in case of gains from the alienation of any property other than covered in the other paragraphs of this Article.
14	**Indepen-dent personal services**	This Article present only in the UN MC deals with the taxation of income derived by a person for professional or specified services which are offered in the SS through some presence. **Right of CS to tax income from professional services (IPS) [UN MC]**

Right of RS	Income derived by a resident of a CS in respect of professional services or other activities of an independent character is taxable only in the RS.
Right of SS	In the following circumstances, however, IPS may also be taxed in the other CS (i.e., the SS):

Circumstance	Extent of income taxable in SS
If he has a fixed base regularly available to him in the SS for the purpose of performing his activities	Only so much of the income as is attributable to that fixed base may be taxed in the SS.
If his stay in the SS is for a period > 183 days in any 12 month period commencing or ending in the fiscal year concerned	Only so much of the income as is derived from his activities performed in the SS may be taxed in that State

Definition of "Professional Services" [UN MC]

The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

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		Note *– OECD MC does not contain a separate article on IPS. The same is dealt with as "Business Profits (Article 7)" under the OECD MC.*
21	**Other income (OI)**	This Article deals with taxation of items of income which are not specifically taxable under any other specific Article [i.e., upto Article 20].

	OECD MC	UN MC
Right to tax OI	Exclusive right to tax is with the RS.	Contains an additional para, Article 21(3), which provides that SS may also tax other income.
Right to tax income [other than income from immovable property] effectively connected with PE	Article 21(2) of both OECD and UN MC provides that for income effectively connected with a PE maintained in a CS by a resident of the other CS, taxation is governed by the provisions of Article 7 (Business Profits).	
		Additionally, UN Model provides that if the aforesaid income is effectively connected with a fixed base situated in a CS by a resident of the other CS, taxation would be governed by the provisions of Article 14 (IPS).

Chapter V : Methods for the Elimination of Double Taxation

23A/ 23B	**Exemption method/ Credit Method**	In many cases, the application of tax treaty may result into double taxation (DT) for tax payers. In such a case, Articles 23A and 23B provide for the mechanism through which tax credit/exemption may be available in the RS for taxes deducted in the SS.

- **Two approaches for elimination of DT under MCs**:

Exemption method (Article 23A)	Credit method (Article 23B)
Tax exemption may be available in the RS for taxes deducted in the SS.	Tax credit may be available in the RS for taxes deducted in the SS.

These methods are not mutually exclusive and there may be cases where a treaty may adopt exemption method for certain types of income and credit method for other incomes.

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Juridical DT and Economic DT:

	Juridical DT	Economic DT
Meaning	The same income or capital is taxable in the hands of the same person by more than one State	Two different persons are taxable in respect of the same income or capital
Example	FTS may be taxable in the hands of the recipient both in the RS as well as in SS, based on the domestic laws of the CSs.	In respect of dividend distributed by a Co., DDT may be payable by the Co. in SS, whereas the dividend may be taxable in the hands of the shareholder of the other CS, on the basis of his residence.
Type of DT addressed by Article 23A & 23B	Articles 23A & 23B address Juridical DT.	The Articles do not address Economic DT. If two States wish to solve problems of economic DT, they must do so in bilateral negotiations.

Chapter VI : Special Provisions

25 **Mutual agreement procedure (MAP)**

Where a tax payer believes that the treatment accorded by either or both CSs is not in accordance with the provisions of the tax treaty, this Article provides for dispute resolution through bilateral negotiations between competent authorities (CAS) of both CSs.

	OECD MC	UN MC
Request for MAP	The taxpayer may make a request to either CS	**Alternative A** - Taxpayer has to approach RS or the country of his nationality. **Alternative B** - Reference to an arbitration process as part of MAP. The decision arrived at through the process is binding unless a person directly affected does not accept it.
Time limit	Stipulates a time limit of 2 years from the date when all the information required	An arbitration may be initiated if the competent authorities (CAS) are unable to reach an agreement on a case within 3

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			by the CAS in order to address the case need to be provided to both CAS.	years from presentation of that case [Alternative B]
		Who can request for Arbitration?	Arbitration must be requested in writing by the person who initiated the case	Arbitration must be requested by the CAS of one of the CS. Once such a request is made, the taxpayer will be notified [Alternative B]
		Departure from arbitration by CAS	No specific provision for departure from arbitration.	The CAS may depart from the arbitration decision if they agree to do so within 6 months after the decision has been communicated to them [Alternative B]
26	**Exchange of information (EOI)**	**Purpose of Article 26** In order to complete tax cases, a country may require certain info which may be available with the treaty partner. Article 26 provides for: • the info which may be exchanged • the manner in which such a request has to be made. **Importance of Article 26**: • facilitates effective exchange of information between CSs. • curtails cross-border tax evasion and avoidance, • curtails the capital flight that is often accomplished through tax evasion & avoidance. This is particularly relevant in the perspective of developing countries. **Similar provisions contained in OECD and UN MCs** • A CS cannot be expected to provide confidential financial info to another CS unless it has confidence that the info will not be disclosed to unauthorized persons. • A CS can avoid the EOI obligations by showing that the info pertains to communication between an attorney and his client which is protected from disclosure under domestic law. • Lack of interest or use in such info cannot, however, form the basis for a CS to not co-operate with the EOI obligations.			

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TEST YOUR KNOWLEDGE

Questions

1. *Explain briefly the significant difference between the UN and OECD Model Tax Convention.*
2. *When does it become necessary to apply the tie-breaker rule? Discuss the manner of application of the tie-breaker rule.*
3. *Explain the meaning of "interest" and "fees for technical services" under the UN Model Convention.*
4. *What is the meaning of Automated Digital Services? Elucidate.*
5. *What are the payments covered within the scope of "Royalties" under the UN Model Convention and OECD Model Convention. Elucidate.*

Answers

1. OECD Model is essentially a model treaty between two developed nations whereas UN Model is a model convention between a developed country and a developing country.

Further, OECD Model advocates the residence principle, i.e., it lays emphasis on the right of state of residence to tax the income, whereas the UN Model is a compromise between the source principle and residence principle, giving more weight to the source principle as against the residence principle.

2. Every jurisdiction, in its domestic tax law, prescribes the mechanism to determine residential status of a person. If a person is considered to be resident of both the Contracting States, relief should be sought from Article 4 of the Tax Treaty. A series of tie-breaker rules are provided in Paragraph 2 Article 4 of Model Convention to determine single state of residence for an individual.

The tie-breaker rule would be applied in the following manner:

(i) The first test is based on where the individual has a **permanent home**. Permanent home would mean a dwelling place available to him at all times continuously and not occasionally and includes place taken on rent for a prolonged period of time.

(ii) If that test is inconclusive for the reason that the individual has permanent home available to him in both Contracting States, he will be considered a resident of the Contracting State where his personal and economic relations are closer, in other

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words, the place where lies **his centre of vital interests**. Thus, preference is given to family and social relations, occupation, place of business, place of administration of his properties, political, cultural and other activities of the individual.

(iii) Paragraph (ii) establishes a secondary criterion for two quite distinct and different situations:

- The case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests;
- The case where the individual has a permanent home available to him in neither Contracting State.

In the aforesaid scenarios, preference is given to the Contracting State where the individual has an **habitual abode**.

(iv) If the individual has habitual abode in both Contracting States or in neither of them, he shall be treated as a resident of the Contracting State of which he is **a national**.

(v) If the individual is a national of both or neither of the Contracting States, the matter is left to be **considered by the competent authorities** of the respective Contracting States.

3. As per Article 11 of the UN Model Convention, "Interest" essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

As per Article 12A of the UN Model Convention, "Fees for technical services" is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use.

4. As per Article 12B of UN Model Convention, "Automated digital services" means any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider.

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The term "Automated digital services" includes specially:

(a) online advertising services;

(b) supply of user data;

(c) online search engines;

(d) online intermediation platform services;

(e) social media platforms;

(f) digital content services;

(g) online gaming;

(h) cloud computing services; and

(i) standardized online teaching services.

5. The term "royalties" as per UN Model Convention means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.

The definition of 'royalties' under the OECD Model Convention does not include the following: (a) rentals for films or tapes used for radio or television broadcasting and (b) equipment rentals like rentals for industrial, commercial or scientific equipment.

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CHAPTER 28

LATEST DEVELOPMENTS IN INTERNATIONAL TAXATION

LEARNING OUTCOMES

After studying this chapter, you would be aware of the -

- latest developments in OECD/G20 BEPS Project
- two Pillar approach to address tax challenges out of digitalization
- key highlights of Pillar One and Pillar Two of BEPS 2.0

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28.1 BRIEF BACKGROUND OF BEPS

What is BEPS?

Base erosion and profit shifting (BEPS) refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax. Developing countries' higher reliance on corporate income tax means they suffer from BEPS disproportionately.

The report Addressing Base Erosion and Profit Shifting (OECD[1], 2013) concluded that no single tax rule on its own enables BEPS, it is rather the interplay among different issues that makes it possible. Domestic laws and rules that are not coordinated across borders, international tax standards that have not always kept pace with the changing global business environment and a pervasive lack of relevant information at the level of tax administrations and policymakers combine to provide opportunities for taxpayers to undertake BEPS strategies. The availability of harmful tax practices was also identified as a key pressure area.

Out of a shared desire to address BEPS concerns, there is agreement on a comprehensive package of measures which are designed to be implemented domestically and through treaty provisions in a coordinated manner, supported by targeted monitoring and strengthened transparency. The goal is to tackle BEPS structures by comprehensively addressing their root causes rather than merely the symptoms.

Thus, in 2015, under the OECD/G20 BEPS Project, 15 Actions Plans were delivered to tackle tax avoidance, improve the coherence of international tax rules, and ensure a more transparent tax environment (BEPS package).

[1] Organisation for Economic Co-operation and Development (OECD)

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Recognising all the progress made, including establishing a new OECD-G20 framework for more inclusive deliberations, it appears necessary to further deepen cooperation and focus on monitoring the implementation and effectiveness of the measures adopted in the context of the BEPS Project as well as the impact on both compliance by taxpayers and proper implementation by tax administrations.

OECD and G20 countries agree to keep working on an equal footing to monitor the implementation of the BEPS measures. The monitoring will consist of an assessment of compliance in particular with the minimum standards in the form of reports on what countries have done to implement the BEPS recommendations.

28.2 ESTABLISHMENT OF INCLUSIVE FRAMEWORK (IF)

Globalisation requires that global solutions and a global dialogue be established which go beyond OECD and G20 countries. The strong interest expressed by developing countries through their participation in the BEPS Project should be sustained by the establishment of an even more inclusive framework, which will continue to include other international organisations and regional tax organisations.

Drawing on the successful experience of the Global Forum on Transparency and Exchange of Information for Tax Purposes, in early 2016 OECD and G20 countries decided to work together to design and propose a more inclusive framework to support and monitor the implementation of the BEPS package, with countries and jurisdictions participating on an equal footing.

The idea was to include consideration of the manner in which non-OECD non-G20 countries and jurisdictions can commit to the agreed standards and their implementation. Thus, it was proposed to call on the OECD to prepare a framework by early 2016 with the involvement of interested non-G20 countries and jurisdictions, particularly developing economies, on an equal footing.

Resultantly, in June 2016, at the request of the G20, **the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework)** was established in Kyoto, Japan with an initial membership of 89 countries and jurisdictions.

As of 28th May 2024, the Inclusive Framework includes 147 members, who, on an equal footing, monitor the implementation and contribute to the development of measures to combat BEPS, while reviewing and monitoring the implementation of the OECD/G20 BEPS Project.

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28.3 INTRODUCTION OF TWO-PILLAR SOLUTION (BEPS 2.0)

In July 2021, 134 members of the Inclusive Framework, representing more than 90% of worldwide GDP, reached a historic agreement on a two-pillar solution to address the tax challenges of digitalisation and introduce a global minimum tax on the profits of large multinational enterprises (MNEs).

The agreement provides for fundamental tax reforms updating key elements of the century-old international tax system and will help countries protect their tax bases.

139 countries and jurisdictions[2] have joined the landmark agreement reached on the 8th of October 2021 Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (Two-Pillar Solution or 2021 October Statement).

It represented a major step forward in the reform of the international tax system and the outcome of intensive work carried out under BEPS Action 1 "Addressing the tax challenges arising from the digital economy," which has been the top priority of the OECD/G20 Inclusive Framework.

Since the agreement on the 2021 October Statement, the OECD/G20 Inclusive Framework has moved to its implementation, with significant progress achieved.

[2] as of 9 June 2023

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There are two parts to Pillar One: Amount A, the international framework for reallocation of taxing rights over profits of large and highly profitable MNEs; and Amount B, the simplified transfer pricing approach for baseline distribution activity.

Pillar Two is similarly structured around two complementary components: the Global Anti-Base Erosion (GloBE) Rules, which establish a minimum tax framework in each jurisdiction where large MNEs operate, and Subject-To-Tax-Rule (STTR), which allows a source jurisdiction to "tax back" where taxing rights have been ceded under a tax treaty and a payment is subject to a low nominal rate in the residence jurisdiction.

The following discussions provide an overview of Pillar One and Pillar Two.

28.3.1 Overview

Digital transformation spurs innovation, generates efficiencies, and improves services while boosting more inclusive and sustainable growth and enhancing well-being. At the same time, the breadth and speed of this change introduce challenges in many policy areas, including taxation.

Reforming the international tax system to address the tax challenges arising from the digitalisation of the economy, restore stability to the international tax framework and prevent further uncoordinated unilateral tax measures has therefore been a priority of the international community for several years, with commitments to deliver a consensus-based solution.

These tax challenges were first identified as one of the main areas of focus of the OECD/G20 BEPS Project, leading to the 2015 BEPS Action 1 Report (the Action 1 Report) (OECD, 2015). The Action 1 Report found that the whole economy was digitalising and, as a result, it would be difficult, if not impossible, to ring-fence the digital economy.

The 2015 Action 1 report provided the options to safeguard against BEPS on account of digitalisation, however, it did not provide any recommendations and left it to the discretion of the countries to resort to these measures as part of their domestic law. The report also indicated that it was agreed between the members to continue to monitor developments in respect of the digital economy.

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Pursuant to this, the OECD Inclusive Framework on BEPS came up with a consensus-based solution for tax challenges arising out of digitalisation (commonly known as BEPS 2.0), framed within two complementary pillars, namely, **Pillar One and Pillar Two**.

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As already discussed above, 2021 October Statement has been agreed upon and joined by 139 countries and jurisdictions[3]. The agreement demonstrates that developing countries can indeed play an active and influential role in international standard setting through their participation in the Inclusive Framework. This is not to say that the agreement reflects developing country preferences in all respects since all participants have recognised the need for compromise.

28.3.2 Pillar One

(1) Introduction

Pillar One is designed to deliver a sustainable taxation framework reflective of today's digitalising economy, with the potential to achieve a fairer and more efficient allocation of taxing rights.

It aims to ensure a fairer distribution of taxing rights among countries with respect to the largest and most profitable MNEs. It will reallocate taxing rights over a portion of the residual profits of MNEs to the market countries and jurisdictions where they have business activities, regardless of whether they have a physical presence there.

Under Pillar 1, an MNE is treated as a consolidated entity, and taxing rights are allocated on some predetermined formulas and assumptions which are briefly discussed in this chapter. These are primarily classified into two parts, Amount A and Amount B.

(2) Amount 'A' and Amount 'B'

Overview

Pillar 1 modifies nexus and profit allocation rules, redistributing super-profits to market jurisdictions of the MNE Groups. This allocated profit is termed as 'Amount A'. Market jurisdictions must fulfil the nexus test to be eligible for 'Amount A' allocation.

[3] as of 9 June 2023

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Amount B is a critical component of Pillar One. While the work on Amount A updates the international taxation framework with respect to large and very profitable multinational enterprises (MNE), Amount B simplifies the existing transfer pricing rules for all taxpayers. It is focused on the application of transfer pricing rules to so called baseline marketing and distribution activities, likely the most frequent fact pattern that MNEs encounter in the jurisdictions where they operate. Amount B is intended to increase tax certainty, reduce compliance and administrative costs and in particular assist low-capacity jurisdictions that often suffer from the absence of local market comparables.

The Inclusive Framework on BEPS is nearing completion of negotiations on a final package on Pillar One. This includes the text of Multilateral Convention (MLC) for Amount A and a framework for Amount B.

Broadly, the material released by OECD till date, explain Amount A and Amount B as under:

Amount 'A'

In-scope companies are the MNEs with global turnover above 20 billion euros and profitability above 10% (i.e., profit before tax/revenue). Extractives and regulated financial services are out of the scope.

Amount A is **25% of the residual profit** defined as profit in excess of 10% of revenue that will be allocated to market jurisdictions with nexus using revenue-based allocation keys.

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Allocation of Amount A is majorly based on the following two factors:

(i) Nexus Test

(ii) Revenue Sourcing Rules

Nexus test

The new special-purpose nexus rule applies solely to determine whether a jurisdiction qualifies for profit reallocation under Amount A. These rules will not alter the nexus for any other tax or non-tax purpose. Amount A is allocated to the market jurisdiction only if the nexus exists. To determine whether an MNE in-scope of Amount A satisfies the nexus test for Amount A in a jurisdiction, it will have to apply the **revenue sourcing rules** to identify the jurisdiction in which revenue arises for purposes of Amount A.

To establish nexus, the market revenue thresholds is:

- Greater than or equal to €1 million for jurisdiction with annual GDP ≥ €40 billion
- Greater than or equal to €250,000 for jurisdiction with annual GDP < €40 billion

It transfers taxing rights over residual profits to jurisdictions with business activities regardless of the physical presence.

Revenue sourcing rules

Revenue will be sourced to the end market jurisdictions where goods or services are used or consumed. To facilitate the application of this principle, detailed source rules for specific categories of transactions will be developed. In applying the sourcing rules, an MNE must use a reliable method based on the MNE's specific facts and circumstances.

Revenues must be sourced according to the category of Revenues earned. Revenues that fall under more than one category are sourced according to their predominant character. Revenues derived from Supplementary Transactions may be sourced in accordance with the revenue sourcing rule that applies to the Revenues that they supplement.

Specific revenue sourcing rules provide a common basis for identifying an MNE's market countries that will benefit from Amount A, categorised per type of revenue. For revenues from online advertising, for example, the sourcing principle is based on the "eyeballs" of the viewer, and not on the location of the advertiser. To identify the viewer, the MNE should use data points that reliably

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indicate the location of the viewer, such as IP address or geolocation, or other reliable commercial information.

In some cases, it will be very challenging for an MNE to locate the end-user. This may be the case, for example, for revenues from cloud computing services, where the MNE may not have information available on where its customer's employees use the service. In order to provide certainty in these more challenging cases, the MNE is allowed to use targeted proxies or allocation keys, which approximate the market country (such as allocation keys based on statistical information on aggregated headcount data or macroeconomic proxies). This is a way to balance the compliance burden while ensuring that Amount A profits are reliably reallocated in all cases.

Once an MNE has determined how much revenue it generates in each of its market countries, Amount A profit will be reallocated only to the market countries where the MNE meets a new quantitative special purpose nexus test.

Process to be followed while applying the nexus test and the revenue sourcing rules is summarized as under:

Amount 'B'

The Inclusive Framework on BEPS released a report on Amount B of Pillar One on 19 February 2024, aimed at simplifying and streamlining the application of the arm's length principle to in-country baseline marketing and distribution activities, with a particular focus on the needs of low-capacity jurisdictions. On 17 June 2024, the Inclusive Framework published the pending design aspects of Amount B.

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In summary, the framework for Amount B, as outlined in the report, is as follows:

Broadly, the steps involved in applying Amount B are as under:

- **STEP 1: SCOPING CONDITIONS**

The purpose of Step 1 is to determine whether baseline marketing and distribution activities carried out by a tested party are in-scope of Amount B.

When a tested party is involved in a qualifying transaction (Step 1-1) that meets the scoping criteria (Step 1-2), then the transaction is in-scope of Amount B.

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- **STEP 2: PRICING OF IN-SCOPE TRANSACTIONS**

If a qualifying transaction is determined to be within the scope of Amount B, it is priced using the Amount B pricing framework, unless a reliable internal Comparable Uncontrolled Price (CUP) is available. The pricing framework comprises the following three sub-steps:

Step 2-1: Application of the Pricing Matrix

The purpose of step 2-1 is to determine the return on sales percent in the pricing matrix of Amount B:

Factor Intensity	Industry Grouping 1	Industry Grouping 2	Industry Grouping 3
(A) OAS 45% or more, any level of OES	3.50%	5.00%	5.50%
(B) OAS 30% to 44.99%, any level of OES	3.00%	3.75%	4.50%
(C) OAS 15% to 29.99%, any level of OES	2.50%	3.00%	4.50%
(D) OAS less than 15%, OES 10% or more	1.75%	2.00%	3.00%
(E) OAS less than 15%, OES less than 10%	1.50%	1.75%	2.25%

*OAS – Operating Assets Intensity
OES – Operating Expenses Intensity

The pricing matrix is derived from a global dataset of comparable companies engaged in baseline marketing and distribution activities. Their financial information, filtered using benchmarking criteria and scoping conditions, has been used to approximate arm's length returns, expressed as **return on sales**.

Note:

Industry grouping refers to the categorisation of specific industries and industry sectors in which in-scope distributors operate into three pre-defined groupings based on the observed relationships between specific industries / products and the profitability attributed to baseline distribution of those products. The categories of goods falling into each of the three industry groups are:

Group 1	perishable foods, grocery, household consumables, construction materials and supplies, plumbing supplies and metal.
Group 2	IT hardware and components, electrical components and consumables, animal feeds, agricultural supplies, alcohol and tobacco, pet foods, clothing footwear and other apparel, plastics and chemicals, lubricants, dyes, pharmaceuticals, cosmetics, health and wellbeing products, home appliances, consumer electronics, furniture, home and office supplies, printed matter, paper and packaging, jewellery, textiles hides and furs, new and used domestic vehicles, vehicle parts and supplies, mixed products and products and components not listed in group 1 or 3.
Group 3	medical machinery, industrial machinery including industrial and agricultural vehicles, industrial tools, industrial components miscellaneous supplies.

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Step 2-2: Application of the operating expense cross-check (OECC)

The purpose of Step 2-2 is to apply the operating expense cross check (OECC) which works as a corroborative check by assessing the return derived from the matrix by reference to the operating expense level of the tested party.

Where the application of the return on sales net profit indicator produces a result outside of the pre-defined operating expense cap-and-collar range, the profitability of the tested party will be adjusted.

Step 2-3: Application of the data availability mechanism (DAM)

Step 2-3 applies the data availability mechanism (DAM) which provides for upward adjustments to the return derived from the pricing matrix in certain cases. The mechanism is intended to account for cases where there is no or insufficient data in the global dataset for a particular tested party jurisdiction upon which to validate the appropriateness of the Amount B pricing matrix coupled with evidence that that jurisdiction could be reasonably considered a 'higher risk' jurisdiction.

In order to simplify compliance burdens associated with administering the simplified and streamlined approach, the analysis supporting the determination of the pricing matrix and operating expense cap-and-collar rates will be updated every five years unless there is a significant change in market conditions that warrants an interim update. The financial data and other datapoints will be reviewed annually and updated where necessary.

The Inclusive Framework continues working on an Amount B framework that goes beyond the elective approach and is linked with Amount A.

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28.3.3 Pillar Two

(1) Introduction

This pillar explores the design of a system to ensure that MNEs pay a minimum level of tax. This pillar is intended to address the remaining issues identified by the OECD/G20 BEPS initiative by providing countries with new tools to protect their tax base from profit shifting to jurisdictions that tax these profits at below the minimum rate.

Pillar Two consists of the Global Anti-Base Erosion (GloBE) Rules and a treaty-based Subject to Tax Rule (STTR).

The GloBE Model Rules for the minimum tax were released in December 2021, followed by the related Commentary and Administrative Guidance. The GloBE Model Rules consist of an interlocking and coordinated system of rules which are designed to be implemented into the domestic law of each jurisdiction. The GloBE Rules introduced a 15% global minimum tax that applies to MNE groups with consolidated revenues of at least EUR 750 million. They consist of a coordinated system of rules, under a common framework, which ensures in-scope MNE groups pay at least the agreed minimum level of tax on the income arising in each of the jurisdictions in which they operate. The minimum level of tax may also be imposed locally under a qualified domestic minimum top-up tax. The implementation of the GloBE Rules has begun globally.

The STTR takes priority over the GloBE Rules. STTR is a treaty-based rule that allows jurisdictions to impose limited additional taxation on certain cross-border payments between connected companies where the recipient is subject to a nominal corporate income tax rate below 9%. The rule has been developed to cater for the priorities of developing countries and is an important part of achieving consensus on Pillar Two for developing countries. Inclusive Framework members can elect to implement the STTR by signing the MLI, or bilaterally amending their treaties to include the STTR when requested by developing Inclusive Framework members.

Common Approach: The jurisdictions are not required to adopt the GloBE rules, but if they choose to do so, they agree to implement them in a way that is consistent with the agreed outcomes.

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(2) Key highlights of Pillar 2

Jurisdictional Blending	• Tax liability to be determined on a jurisdictional basis and will arise when the effective tax rate (ETR) of a jurisdiction in which the MNE Group operates is below the agreed minimum rate
Minimum Tax Rate	• Pillar 2 prescribes minimum rate of tax liability to be applied on MNEs, i.e., 15% under GloBE rules and 9% under STTR
Rule Order	• Under the model rules, a priority order is prescribed to be followed while applying the Pillar 2 rules
Deminimus Exclusion	• A simplification measure to exclude jurisdictions from the GloBE rules that have less than a certain percentage of the MNE Group's profit
Substance based Income Exclusion	• Provided to exclude a fixed return for substantive activities within a jurisdiction from the application of the GloBE Rules

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(3) STTR and Globe Rules

As already mentioned, Pillar Two consists of the Global Anti-Base Erosion (GloBE) Rules and a treaty-based Subject to Tax Rule (STTR). However, STTR rules works in prior to GloBE Rules. The model rules stipulate an order for applicability of the same, as provided under:

Subject to Tax Rules (STTR)

Overview

Works in priority to GloBE rules, STTR is a treaty-based rule that enables developing countries (source jurisdictions) to tax certain inter-company payments at source which are subject to nominal corporate income tax (at rates below the STTR minimum rate, i.e., **9%).** The STTR is based on an understanding that where, under a tax treaty, a source state has ceded taxing rights on certain outbound intragroup payments, it should be able to recover some of those rights where the income in question is taxed (if at all) in the state of the payee (i.e., the residence state) at a rate below 9%.

The objective is to prevent base erosion in 'developing countries' which are defined to have a gross national income per capita, calculated using the World Bank Atlas method, of USD 12,535 or less in 2019 (to be regularly updated).

Applicability

- Applicable only to covered payments, by an entity in a developing country, made to a group entity in another country, i.e., connected persons.
- Applies only if the total sum of covered income arising in the source country exceeds threshold of €250,000 or €1 mn per year (depending on the GDP of source country is above or below €40 bn).

Covered payments constitute Interest; Royalties; Payments for distribution rights for a product or service; Insurance or reinsurance premiums; Payments of guarantee or financing fees; Rental payments for industrial, commercial, or scientific equipment; Payments for services, etc.

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Connected persons are defined to have legal (direct or indirect ownership of more than 50% of the interests) or de facto control relationship.

Specified rate

The STTR specified rate is equal to the difference between 9% and the nominal rate applied in the resident State, further reduced by any source taxation already allocated to the source jurisdiction in accordance with other articles of the treaty.

Country A and Country B incorporated STTR provisions under their Tax Treaty	Rate
STTR rate	9%
Nominal tax rate applied in the resident jurisdiction [Country B]	1%
The payor jurisdiction [Country A] retains the 5% withholding tax right under the tax treaty	5%
STTR Specified rate [Country A to tax under STTR]	**3%**

Facts

- Company A is a company resident in Country A (a developing country) and has entered into a royalty agreement (payable in respect of the grant of license to use trademark owned by Company B) with Company B (resident of Country B). Accordingly, Country A shall be the 'source jurisdiction' and Country B shall be the 'resident jurisdiction.'
- In consideration, royalty is payable by Company A to Company B.
- Country A and B has entered into a DTAA, i.e., Double Tax Avoidance Agreement or Tax Treaty, wherein the source jurisdiction retains withholding taxing rights @5% on royalty payments.
- Royalty payments are taxable @ 1% in Country B.

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Observations

In the above example, if a payor jurisdiction can impose a 5% withholding tax on a payment of Covered Income and the recipient is subject to a 1% nominal tax rate, the payor jurisdiction retains the 5% withholding tax right. However, as per the STTR, the payor jurisdiction can impose an additional tax equal to 3% of the Covered Income amount (9% - 5% - 1% = 3%).

GloBE Rules

Scope

The GloBE Rules apply to Constituent Entities that are members of an MNE Group that has annual revenue of EUR 750 million or more in the Consolidated Financial Statements of the Ultimate Parent Entity (UPE) in at least two of the four Fiscal Years immediately preceding the tested Fiscal Year.

MNE Group means any Group that includes at least one Entity or Permanent Establishment not located in the jurisdiction of the Ultimate Parent Entity whereas a Group means a collection of Entities that are related through ownership or control such that the assets, liabilities, income, expenses, and cash flows of those Entities are included in the Consolidated Financial Statements of the Ultimate Parent Entity.

Entities that are 'Excluded Entities' are not subject to the GloBE Rules. However, their revenue is still taken into account for the purposes of the consolidated revenue test. The Excluded Entities are Government entities, international organizations, non-profit organizations, pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organizations or funds. However, this exclusion does not affect the MNE Group owned by such entities, which will remain in scope of the GloBE rules if the group as a whole otherwise meets the consolidated revenue threshold.

Overall design

Pillar Two consists of the following rules (together the GloBE rules):

(i) **Qualified Domestic Minimum Top-up Tax (QDMTT):** QDMTT imposes a jurisdictional top-up tax on the constituent entity located in a low-taxed jurisdiction (LTJ). It allows the LTJ to collect the top-up tax computed in accordance with the GloBE rules.

QDMTT provides the right to the LTJ to collect the jurisdictional top-up tax by way of the introduction of QDMTT in its domestic tax laws. This would preserve a jurisdiction's primary right of taxation over its own income.

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(ii) **Income Inclusion Rule (IIR):** IIR imposes a top-up tax on a parent entity in respect of the constituent entity located in low-taxed jurisdiction.

A Constituent Entity, that is the UPE of an MNE Group, located in a GloBE implementing jurisdiction that owns (directly or indirectly) an Ownership Interest in a Low-Taxed Constituent Entity at any time during the Fiscal Year shall pay a tax in an amount equal to its Allocable Share of the Top-Up Tax of that Low-Taxed Constituent Entity for the Fiscal Year.

(iii) **Undertaxed Payment Rule (UTPR):** UTPR imposes deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR.

UTPR is triggered where the UPE jurisdiction does not implement IIR or does not adopt GloBE rules. Thus, UTPR serves as a backstop to IIR. UTPR transfers the levy of top-up tax to other constituent entities of the MNE group located in the jurisdiction where the GloBE rules are implemented.

Let us understand the mechanism of these three rules from the example below:

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Observations

The UPE of an MNE group located in Country X has three wholly owned subsidiaries ("WOS") in Country A, B, and C. Let's say, Country C is a low-taxed jurisdiction ("LTJ"). The priority ranking as per the model GloBE rules prescribes that:

Priority 1 – Where Country C imposes QDMTT in its jurisdiction, the jurisdictional top-up tax shall be imposed on WOS 3 (refer to the diagram above).

Priority 2 – Where Country C does not impose QDMTT in its jurisdiction, the UPE of an MNE Group located in Country X which has implemented IIR under GloBE rules shall be liable to pay a tax in an amount equal to its Allocable Share of the Top-Up Tax of WOS 3 in Country C

Priority 3 – At last where neither Country C nor Country X implements QDMTT or IIR respectively, and Country A and Country B has implemented UTPR under GloBE rules, WOS 1 and WOS 2 shall be liable to pay jurisdictional top-up (pertaining to WOS 3) tax under UTPR in their jurisdictions, i.e., Country A and B respectively.

Other Important Topics under GloBE Rules

(i) **Effective Tax Rate (ETR):** The GloBE rules will operate to impose a top-up tax using an **effective tax rate** test that is calculated on a **jurisdictional basis.** If the jurisdictional ETR is below the 15% minimum rate, the jurisdiction is treated as a low-tax jurisdiction and the constituent entities are treated as low-taxed constituent entities (LTCE). The Effective Tax Rate of the MNE Group for a jurisdiction shall be calculated for each Fiscal Year.

Effective Tax Rate = Total of Adjusted Covered Taxes of each Constituent Entity located in the jurisdiction / Net GloBE Income of the jurisdiction

Where,

– Adjusted Covered Taxes are the taxes attributable to the income of a Constituent Entity.

The amount of a Constituent Entity's Covered Taxes is determined by taking the Constituent Entity's current taxes for the Fiscal Year, adjusted to reflect certain timing differences. Covered Taxes are allocated from one Constituent Entity to another in certain cases. To the extent there are changes in tax liability after filing, additions or reductions to taxes are identified and allocated to a particular jurisdiction and time period.

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– the Net GloBE Income of a jurisdiction for a Fiscal Year is the positive amount, if any, computed in accordance with the following formula:

Net GloBE Income = GloBE Income of all Constituent Entities – GloBE Losses of all Constituent Entities

Under the OECD Model Rules, the jurisdictional net GloBE income is the total GloBE income of all constituent entities in the jurisdiction, less any GloBE losses of constituent entities in the jurisdiction.

If there is a net GloBE loss, this means the ETR need not be calculated. In most cases this would mean no top-up tax would be due.

(ii) **Jurisdictional Blending:** The ETR computation is determined on a **jurisdictional blending basis**. **Jurisdictional blending** allows all the profits, losses, and taxes of the Constituent Entities of the MNE Group located in the same jurisdiction to be blended for purposes of the effective tax rate calculation.

Note - For the purpose of determining the applicability of the GloBE Rules, global revenue is considered. However, for determining ETR, the calculation is done on jurisdictional basis.

Let us understand the above concepts with the help of following example:

UPE Co. (Country A) has wholly owned subsidiaries B Co. and C Co. in Country B.

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Details related to both the subsidiaries are as follows:

Particulars	Company B	Company C
GloBE income	5,000,000 euros	10,000,000 euros
Adjusted covered taxes	1,000,000 euros	1,000,000 euros
Investments in qualifying local tangible assets and payroll costs	10,000,000 euros	20,000,000 euros

The calculation of ETR:

Adjusted Covered Taxes of Country B (i)	2,000,000 euros
Net GloBE Income in Country B (ii)	15,000,000 euros
ETR (i)/(ii)	13.3333%

Thus, the ETR of the above MNE group for Country B is 13.3333%.

Further, if Company B had incurred losses of 5,000,000 euros, the net GloBE income for Country B would have been 5,000,000 euros instead of 15,000,000 euros. This is because of the concept of jurisdictional blending.

(iii) **Substance-based Income exclusion (SBIE) or Substance-based carve-outs:** The Net GloBE Income for the jurisdiction shall be reduced by the Substance-based Income Exclusion for the jurisdiction to determine the Excess Profit for purposes of computing the Top-up Tax.

The GloBE rules provides the SBIE amount for a jurisdiction which is the sum of the payroll carve-out and the tangible asset carve-out for each Constituent Entity in that jurisdiction. The amount of this substance-based income exclusion is equal to the sum of (i) 5% of the carrying value of tangible assets located in the jurisdiction and (ii) 5% of the payroll costs for employees who perform activities in the jurisdiction. The GloBE rules also provide for a 10-year transition period in recognition of the potential impact of the GloBE rules on existing incentives and existing investment. It shall be 8% of carrying value of eligible tangible assets and 10% of eligible payroll costs, both will phase down to 5% over 10 years.

A substance carve-out based on assets and payroll costs allows a jurisdiction to continue to offer tax incentives that reduce taxes on routine returns from investment in substantive activities, without triggering additional GloBE top-up tax.

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(iv) **Top-up Tax:** The Jurisdictional Top-up Tax for a jurisdiction for a Fiscal Year is equal to the positive amount, if any, computed in accordance with the following formula:

Jurisdictional Top-up Tax = (Top-up Tax Percentage X Excess Profit) + Additional Current Top-up Tax – Domestic Top-up Tax

Where,

– the Top-up Tax Percentage for a **jurisdiction** shall be the positive percentage point difference, if any, computed in accordance with the following formula:

Top up Tax Percentage = Minimum Rate – Effective Tax Rate [ETR]

– the Excess Profit for the jurisdiction is the positive amount, if any, computed in accordance with the following formula:

Excess Profit = Net GloBE Income – Substance Based Income Exclusion

Note: The Top-up tax percentage is calculated based on the aggregate profits, i.e., Net GloBE income. However, it is applied to the excess income, i.e., Net GloBE income – substance-based income inclusion in order to provide the benefits of incentives to MNEs.

Continuing our example, we refer to the information collated below:

Minimum tax rate (i)	**15%**
ETR (ii)	13.333%
Net GloBE Income in Country B (iii)	15,000,000 euros
Substance-based income exclusion [4] (iv)	1,500,000 euros
Top up Tax Percentage (i) - (ii)	**1.6667%**
Excess Profit (iii) - (iv)	**13,500,000 euros**
Top-up tax for Country B*	**225,004 euros**

*Assuming there is no additional top-up tax or any tax payable under a qualifying domestic top-up tax.

[4] calculated@5%of eligible tangible assets and eligible payroll costs

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The concepts explained in the earlier points are summarized as under:

(v) **De-minimis Exclusion:** The GloBE rules, at the election of the Filing Constituent Entity, provides a jurisdictional exclusion for LTCEs of an MNE Group on meeting the following criterion:

– the Average GloBE Revenue of such jurisdiction is less than EUR 10 million; and

– the Average GloBE Income or Loss of such jurisdiction is a loss or is less than EUR 1 million

The policy intent underlying the above exclusion is to avoid the complexities of a full ETR computation in cases where the amount of any Top Up Tax would not seem to justify the associated compliance and administrative costs.

Resources: The discussion on Pillar One and Pillar Two contained in this chapter is primarily based on the content available at the website http://www.oecd.org

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ANNEXURE

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ANNEXURE – 1

Rule 115 - Rate of exchange for conversion into rupees of income expressed in foreign currency

(1) The rate of exchange for the calculation of the value in rupees of any income accruing or arising or deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him or on his behalf in foreign currency shall be the telegraphic transfer buying rate of such currency as on the specified date.

Explanation: For the purposes of this rule,—

(1) "telegraphic transfer buying rate" shall have the same meaning as in the Explanation to rule 26;

(2) "specified date" means—

(a) in respect of income chargeable under the head "Salaries", the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears;

(b) in respect of income by way of "interest on securities", the last day of the month immediately preceding the month in which the income is due;

(c) in respect of income chargeable under the heads "Income from house property", "Profits and gains of business or profession" not being income referred to in clause (d) and "Income from other sources" (not being income by way of dividends and "Interest on securities"), the last day of the previous year of the assessee;

(d) in respect of income chargeable under the head "Profits and gains of business or profession" in the case of a non-resident engaged in the business of operation of ships, the last day of the month immediately preceding the month in which such income is deemed to accrue or arise in India;

(e) in respect of income by way of dividends, the last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company;

(f) in respect of income chargeable under the head "Capital gains", the last day of the month immediately preceding the month in which the capital asset is transferred :

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Provided that the specified date, in respect of income referred to in sub-clauses (a) to (f) payable in foreign currency and from which tax has been deducted at source under rule 26, shall be [the date on which the tax was required to be deducted] under the provisions of the Chapter XVII-B.

(2) Nothing contained in sub-rule (1) shall apply in respect of income referred to in clause (c) of the Explanation to sub-rule (1) where such income is received in, or brought into India by the assessee or on his behalf before the specified date in accordance with the provisions of the Foreign Exchange Regulation Act, 1973 (46 of 1973).

Rule 26 - Rate of exchange for the purpose of deduction of tax at source on income payable in foreign currency

For the purpose of deduction of tax at source on any income payable in foreign currency, the rate of exchange for the calculation of the value in rupees of such income payable—

(i) to an assessee outside India;

(ii) to a Unit located in an International Financial Services Centre;

(iii) by a Unit located in an International Financial Services Centre to an assessee in India,

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 under the provisions of Chapter XVIIB by the person responsible for paying such income.

Explanation — For the purposes of this rule,—

(i) "International Financial Services Centre" shall have the meaning assigned to it in clause (q) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005);

(ii) "telegraphic transfer buying rate", in relation to a foreign currency, means the rate or rates of exchange adopted by the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), for buying such currency, having regard to the guidelines specified from time to time by the Reserve Bank of India for buying such currency, where such currency is made available to that bank through a telegraphic transfer;

(iii) "Unit" shall have the meaning assigned to it in clause (zc) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005).

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ANNEXURE – 2

Rule 128 Foreign Tax Credit

(1) An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered to tax or assessed to tax in India, in the manner and to the extent as specified in this rule :

Provided that in a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.

(2) The foreign tax referred to in sub-rule (1) shall mean,—

(a) in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A, the tax covered under the said agreement;

(b) in respect of any other country or specified territory outside India, the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in clause (iv) of the Explanation to section 91.

(3) The credit under sub-rule (1) shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.

(4) No credit under sub-rule (1) shall be available in respect of any amount of foreign tax or part thereof which is disputed in any manner by the assessee:

Provided that the credit of such disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India if the assessee within six months from the end of the month in which the dispute is finally settled, furnishes evidence of settlement of dispute and an evidence to the effect that the liability for payment of such foreign tax has been discharged by him and furnishes an undertaking that no refund in respect of such amount has directly or indirectly been claimed or shall be claimed.

(5) The credit of foreign tax shall be the aggregate of the amounts of credit computed separately for each source of income arising from a particular country or specified territory outside India and shall be given effect to in the following manner:—

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(i) the credit shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income :

Provided that where the foreign tax paid exceeds the amount of tax payable in accordance with the provisions of the agreement for relief or avoidance of double taxation, such excess shall be ignored for the purposes of this clause;

(ii) the credit shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted.

(6) In a case where any tax is payable under the provisions of section 115JB or section 115JC, the credit of foreign tax shall be allowed against such tax in the same manner as is allowable against any tax payable under the provisions of the Act other than the provisions of the said sections (hereafter referred to as the "normal provisions").

(7) Where the amount of foreign tax credit available against the tax payable under the provisions of section 115JB or section 115JC exceeds the amount of tax credit available against the normal provisions, then while computing the amount of credit under section 115JAA or section 115JD in respect of the taxes paid under section 115JB or section 115JC, as the case may be, such excess shall be ignored.

(8) Credit of any foreign tax shall be allowed on furnishing the following documents by the assessee, namely:—

(i) a statement of income from the country or specified territory outside India offered for tax for the previous year and of foreign tax deducted or paid on such income in Form No.67 and verified in the manner specified therein;

(ii) certificate or statement specifying the nature of income and the amount of tax deducted therefrom or paid by the assessee,—

(a) from the tax authority of the country or the specified territory outside India; or

(b) from the person responsible for deduction of such tax; or

(c) signed by the assessee:

Provided that the statement furnished by the assessee in clause (c) shall be valid if it is accompanied by,—

(A) an acknowledgement of online payment or bank counter foil or challan for payment of tax where the payment has been made by the assessee;

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(B) proof of deduction where the tax has been deducted.

(9) The statement in Form No. 67 referred to in clause (i) of sub-rule (8) and the certificate or the statement referred to in clause (ii) of sub-rule (8) shall be furnished on or before the end of the assessment year relevant to the previous year in which the income referred to in sub-rule (1) has been offered to tax or assessed to tax in India and the return for such assessment year has been furnished within the time specified under sub-section (1) or sub-section (4) of section 139:

Provided that where the return has been furnished under sub-section (8A) of section 139, the statement in Form No. 67 referred to in clause (i) of sub-rule (8) and the certificate or the statement referred to in clause (ii) of sub-rule (8) to the extent it relates to the income included in the updated return, shall be furnished on or before the date on which such return is furnished.

(10) Form No.67 shall also be furnished in a case where the carry backward of loss of the current year results in refund of foreign tax for which credit has been claimed in any earlier previous year or years.

Explanation — For the purposes of this rule 'telegraphic transfer buying rate' shall have the same meaning as assigned to it in Explanation to rule 26.

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