STUDY MATERIAL

PROFESSIONAL PROGRAMME

DIRECT TAX LAW & PRACTICE

MODULE 3
ELECTIVE PAPER 9.5

THE INSTITUTE OF
Company Secretaries of India
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
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PROFESSIONAL PROGRAMME

DIRECT TAX LAW & PRACTICE

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

The subject of Direct Tax Law & Practice is inherently complicated and is subjected to constant refinement through new primary legislations, rules and regulations made thereunder and court decisions on specific legal issues. It therefore becomes necessary for every student to constantly update himself with the various changes made as well as judicial pronouncements rendered from time to time by referring to the Institutes journal ‘Chartered Secretary’ and ‘Student Company Secretary e-bulletin’ as well as other law/professional journals on direct tax laws. The purpose of this study material is to impart conceptual understanding to the students of the provisions of the Direct Tax covered in the Syllabus. This study material has been updated upto 31st October, 2020 and contains relevant amendments made by Finance Act, 2020 applicable for the Assessment Year 2021-22. This is relevant for students appearing in June, 2021 session. However, it may so happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore, advised to refer to the Student Company Secretary e-bulletin and other publications for updation of the study material. In the event of any doubt, students may write to the Institute at **academics@icsi.edu** for clarification.

Although care has been taken in publishing this study material yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute should not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf. Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same are brought to its notice for issue of corrigendum in the Student Company Secretary e-bulletin.

These are for practice purpose only, not to be sent to the institute.

There is open book examination for this Elective Subject of Professional Programme. This is to inculcate and develop skills of creative thinking, problem solving and decision making amongst students of its professional programme and to assess their analytical ability, real understanding of facts and concepts and mastery to apply, rather than to simply recall, replicate and reproduce concepts and principles in the examination.

Note: This study material is based on Finance Act, 2020 applicable for Assessment Year 2021-22 and is useful for students appearing in June, 2021 session. The students are expected to update themselves from reference materials available on the Academic Corner of ICSI website. The students may also update themselves of the latest developments, notifications and circulars on Direct Tax from www.incometaxindia.gov.in.

PROFESSIONAL PROGRAMME – DIRECT TAX LAW & PRACTICE

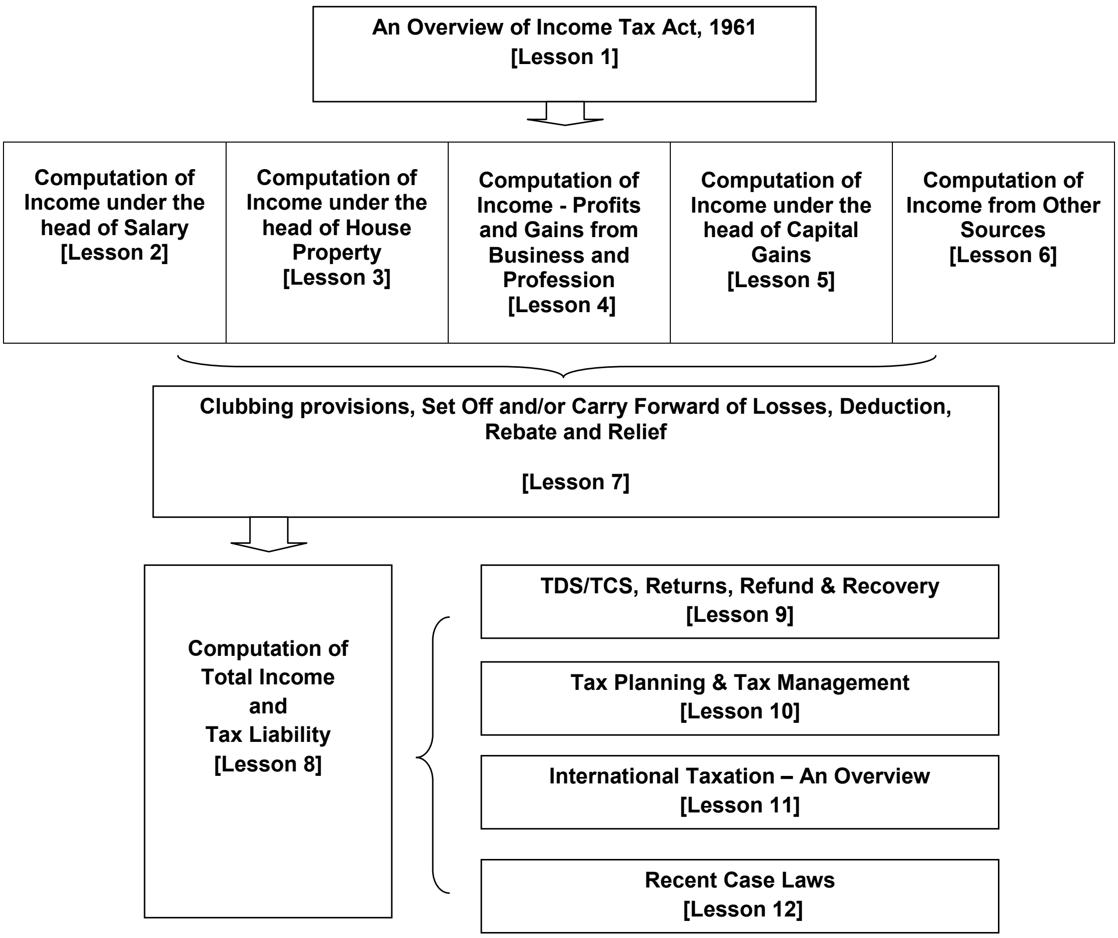
An income tax is a tax that governments impose on income generated by businesses and individuals within their jurisdiction. By law, taxpayers must file an income tax return annually to determine their tax obligations. Income taxes are a source of revenue for governments. They are used to fund public services, pay government obligations, and provide goods for citizens.

Income Tax Act, 1961 provides for levy, administration, collection and recovery of Income Tax. It provides progressive rate schedule, exemption limits, and incorporates number of incentive provisions. It provides sound tax system. Rate schedule & Exemption limits are prescribed by Finance Act.

Indian tax legislative and judicial environment is constantly evolving, along with globalization, economic shifts, and operational adjustments. Businesses are faced with a tax regime with greater complexities and challenges, nonetheless moving towards a globally cohesive tax world. Now, more than ever, businesses must have an ongoing system for adapting to and staying on top of these complex changes.

The tax laws of the country undergo significant changes every year on the passing of Annual Finance Act. Apart from the amendments coming out every year through the Finance Act, there are circulars / notifications issued by the CBDT / CBEC to implement the provision of the act, clarifying the scope of the provision.

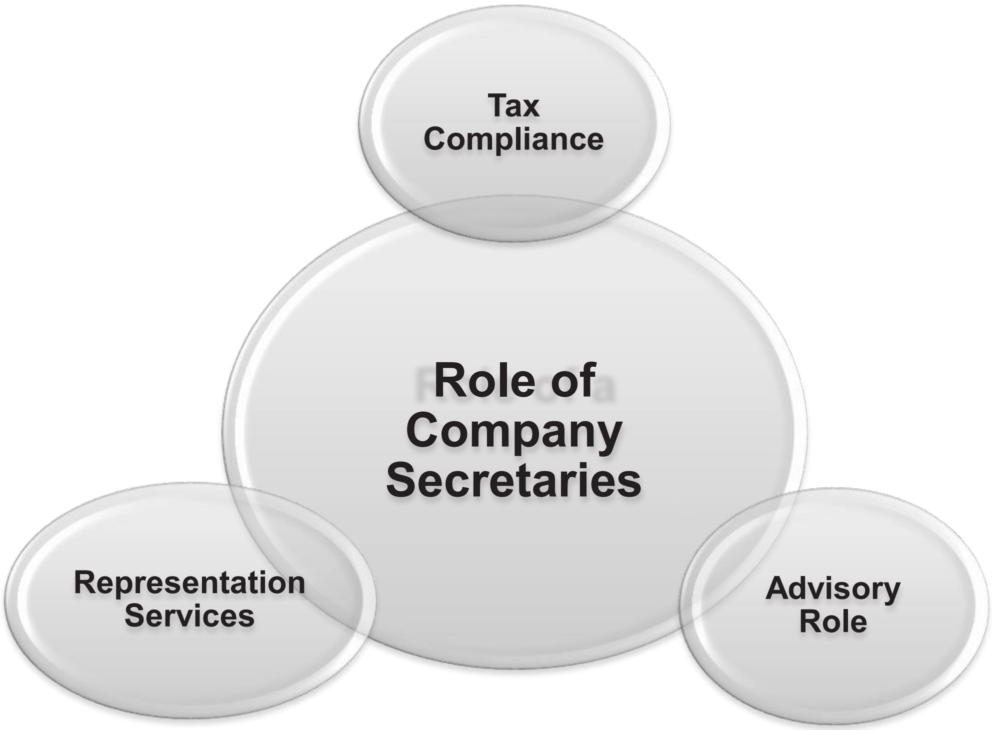
The study material contains detailed provisions related to Direct Taxes and comprises of Total 12 lesson. The broad coverage of the lessons is summarized in the below chart.



ROLE OF COMPANY SECRETARIES IN DIRECT TAX LAW

The Company Secretaries as experienced tax professionals can assist in resolving various challenges such as keeping abreast with tax regulations, efficiently manage compliances, address uncertain tax positions, among many others. The Company Secretaries can provide with an insight into how to best work to meet the business needs.

The following are the key important areas under the direct tax regime where a Company Secretaries can play a vital role.



Tax Compliance : As the complexities of businesses increase, the amount of time spent by professionals in cracking up the law codes increases. However, tax and regulatory systems of even the most developed countries cannot keep pace with the developments across each industry as businesses emerge day by day. These also bring out the requirements for new compliances and the challenges of meeting them every single day. More detailed Income Tax Return forms including disclosures on tax residency certificates and details of foreign assets, and higher penalties for non disclosures require businesses to gear up for efficient tax compliance. Following are the areas or avenues where company secretaries can assist client:

- Assist in obtaining Permanent Account Number 'PAN No.' Tax Deduction / Collection Account Number 'TAN No.'
- Filling of Income tax Returns
- Filling of TDS / TCS returns
- Tax Payroll assistance
- Income tax clearance certificate
- Tax Residency Certificate

Advisory : Corporate taxation is an essential aspect of doing business in India and its importance cannot be undermined. The Company Secretaries can provide the corporate tax advisory services in the following areas:

- Establishing tax efficient Indian business presence for an MNC.
- Planning a heavy capital outlay in the existing business
- Addressing concerns about cash flow and examining tax inefficiencies
- Ensuring that the tax function is aligned with the business plan
- Assessing the impact of any tax and regulatory changes/ amendments

Representation Services : The Appellate hierarchy in India consists of assessing officer, first appellate authority, Appellate Tribunal, High Court and Supreme Court. The Company Secretaries can provide the following range of services comprise of:

- Assisting in filing appeals before the appellate authorities and complying with appellate requirements and procedure
- Determining the appeal strategy and approach and drafting of legal submissions
- In-house service of the expert counsel with experience in representation before appellate authorities
- Advising on the course of action to be adopted before revenue authorities to mitigate the risk of penal consequences
- Reviewing pending litigation and other uncertain tax positions, to comment on adequacy of defense, probability of success and prevention of recurrence
- Assisting the external legal counsel in preparing or representing for appeals, writ petition and special leave petition before the Supreme Court and court subordinate to it (High Court)

***Note* : The Study material is based on the provisions of Income Tax Law as amended by the Finance Act, 2020. The study has been updated till 31st October, 2020. The computational / practical problems have been solved on the basis of the provisions of Income Tax Laws applicable for AY 2021-22 i.e. FY 2020-21. The study material is relevant for the students for June, 2021 examination.**

PROFESSIONAL PROGRAMME
Module 3
Elective Paper 9.5
Direct Tax Law & Practice (Max Marks 100)

SYLLABUS

Objective

To provide advanced knowledge on practical application of Direct Tax Practice.

Detailed Contents

1. **An Overview of Income Tax Act, 1961** : Background, Important definitions, Residential Status, Basis of Charge, Scope of Total Income, Tax Rates in accordance with the applicable Finance Act for the relevant assessment year.
2. **Computation of Income under the head of Salary** : Salary – Coverage, Employer and Employee Relationship, Allowances, Monetary and Non-Monetary Perquisites – Valuation and Taxability, Profits in lieu of Salary, Deductions against Salary, Incomes exempt from Tax and not includible in 'Salary', Deduction to be made from salary in respect of Provident Fund under the provisions of the Provident Fund and Miscellaneous Provisions of Act 1952 and tax treatment of employers' contribution to Provident Fund, Tax Deducted at Source on Salary Income and Compliances, Practical Case Studies.
3. **Computation of Income under the head of House Property** : Chargeability, Owner of house property, Determination of Annual Value, Deduction from Net Annual Value, Treatment of Unrealized Rent, Arrears of Rent, Exemptions, Computation of Income from a let out House Property, Self-Occupied Property, Practical Case Studies.
4. **Computation of Income – Profits and Gains from Business and Profession** : Profits and Gains from Business and Profession: Business and Profession – An overview, Chargeability, Profits and Losses of Speculation Business, Deductions Allowable, Expenses Disallowed, Deemed Profits u/s 41, Maintenance of Accounts, Tax Audit, Presumptive Base Taxation, Practical Case Studies.
5. **Computation of Income under the head of Capital Gains** : Chargeability, Capital Gains, Capital Assets & Transfer, Types of Capital Gains, Mode of Computation of Capital Gains, Exemptions and Deduction, Special Provision – Slump Sale, Compulsory Acquisition, Fair Market Value, Reference to valuation officer, Practical Case Studies.
6. **Computation of Income from Other Sources** : Taxation of Dividend u/s 2(22)(a) to (e), Provisions relating to Gifts, Deductions, Other Miscellaneous Provisions, Practical Case Studies.
7. **Exemptions/Deduction, Clubbing provisions, Set Off and/or Carry Forward of Losses, Rebate and Relief** : Income's not included in Total Income, Tax holidays, Clubbing of Income, Aggregation of Income, Set off and/or Carry forward of losses, Deductions (General and Specific), Rebates and Reliefs.
8. **Computation of Total Income and Tax Liability**

9. **TDS/TCS, Returns, Refund & Recovery** : Tax Deduction at Source 'TDS' & Tax Collection at Source 'TCS', Advance Tax &Self-Assessment Tax 'SAT', Returns, Signatures, E-Filing, Interest for default in furnishing return of Income, Collection, Recovery of Tax, & Refunds, Assessment, Appeals, Revisions, Settlement of Cases, Penalties etc., Assessment, Appeals & Revisions, Settlement of Cases, Penalties, Offences & Prosecution, Practical Case Studies.

10. **Tax Planning & Tax Management** : Tax Planning, Tax Management and Tax avoidance though legitimate tax provisions, Various Avenues, Practical Case Studies.

11. **International Taxation – An Overview** : Double Taxation Avoidance Agreement 'DTAA', Residency Issues, Tax Heaven, Controlled Foreign Corporation (CFC), Concept of Permanent Establishment, Business Connection, General Anti Avoidance Rules 'GAAR', Advance Ruling – Practical Aspect, Transfer Pricing –An Overview, Practical Case Studies.

12. **Recent Case Laws** : Practical Case Studies, Case Laws, Case Studies & Practical Aspects.

LESSON WISE SUMMARY
DIRECT TAX LAW & PRACTICE

Lesson 1: An Overview of Income Tax Act, 1961

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

The coverage of the lesson would include:

- Constitutional Provision
- Some basic concepts like assessment year, previous year, income, person, assessee
- Basic steps in the calculation of tax liability
- Determination of Residential Status of a person
- Scope of total income
- Rates of Tax
- Concept of Marginal Relief
- Concept of Place of Effective Management 'POEM'

Lesson 2: Computation of Income under the head of Salary

Section 14 of the Income Tax Act, 1961 enumerates the heads of income under which the income of an assessee will fall. The rules for computing income and the permissible deductions under different heads of income, are dealt in different sections of the Act. The heads of income, along with their corresponding set of sections for the purpose of computation of income, are given below:

(A) Salaries (Sections 15 to 17)

(B) Income from house property (Sections 22 to 27)

(C) Profits and gains of business or profession (Sections 28 to 44D)

(D) Capital gains (Sections 45 to 55A)

(E) Income from other sources (Sections 56 to 59)

The coverage of the lesson would include the computation of income under the head salaries, the deductions, exemptions available while computing income under the head from salaries.

Lesson 3: Computation of Income under the head of House Property

The provisions for computation of Income from house property are covered under sections 22 to 27 of the Income Tax Act, 1961. Section 22 of the Act is the charging section that identifies the basis of charge wherein the annual value is prescribed as the basis for computation of Income from House Property. The process of computation of "Income from House Property" starts with the determination of annual value of the property. The concept of annual value and the method of determination are laid down in section 23. The admissible deductions available from house property are mentioned in section 24.

The coverage of the lesson would include the computation of income under the head of House Property. The conditions to be satisfied for income to be chargeable under this head. How to determine the annual value of different type of house properties, admissible deductions and inadmissible deductions from annual value, tax treatment of unrealized rent, who are deemed owners, what is meant by co-ownership and what is its tax treatment etc.

Lesson 4: Computation of Income - Profits and Gains from Business and Profession

The provisions for computation of Income from Business or Profession are applicable for Persons who are not in employment and earn income being their own masters. There are many deductions allowed to such persons from their Income but there also many conditions for allowability of the same.

The coverage of the lesson would include:

- The incomes chargeable under the head Business or Profession.
- The expenses which are admissible / inadmissible while computing the Income from Business or Profession.
- Certain receipts deemed to be Income chargeable to tax under this head.
- Deductions allowable on actual payment basis.
- Assessee's who are required to compulsorily maintain Books of Accounts.
- Compulsory Audit of Accounts

Lesson 5: Computation of Income under the head of Capital Gains

The provisions for computation of Income from Capital Gains are applicable for incomes from transfer of Capital Asset. The broad coverage of the lesson would include:

- Chargeability of Income under Capital Gains [Section 45(1)]
- Definition of Capital Asset [Section 2(14)] , Transfer [Section 2(47)]
- Computation of Short term and long-term capital gains
- Special cases of computation of capital gains e.g. Slump Sale, Destruction, and Compulsory Acquisition etc
- Certain transfers not treated as transfer [Section 47]
- Special cases of computation of full value of consideration [Section 50C / Section 50D]
- Reference to Valuation Officer [Section 55A]
- Exemptions from Capital Gains
- Tax rates of Capital Gains

Lesson 6: Computation of Income from Other Sources

Income which are not chargeable under the previous four heads and which are not exempt u/s 10, must be charged to tax as "Income from other sources". In addition to the taxation of income not covered by the other heads, Section 56(2) specifically provides certain items of incomes as being chargeable to tax under the head in every case.

The broad coverage of the lesson would include:

- The income which are chargeable under the head income from other sources,
- Taxability of Dividend
- Taxability of Casual Incomes
- Deductions admissible / inadmissible while computing under income the under head of Other sources.
- Provisions of taxability of gift in kind or in cash from relative or unrelated persons.

Lesson 7: Clubbing provisions, Set Off and/or Carry Forward of Losses, Deduction, Rebate and Relief

The broad coverage of the lesson would include:

- Income which does not form part of the total income.
- The applicability of Clubbing Provisions
- The Provisions related to Set Off and / OR Carry Forward of Losses
- The provisions related to various deductions available while computing income
- The provisions related to Rebate and Relief

Lesson 8: Computation of Total Income and Tax Liability

Income tax being direct tax is a major source of revenue for the Central Government. The entire amount of income tax collected by the Central Government is classified under the head:

(a) Corporation Tax (Tax on the income of the companies) and

(b) Income Tax (Tax on income of the non-corporate assesses).

This lesson is divided into two parts i.e.

1) Computation of taxable income and tax liability of corporate entity and

2) Computation of taxable income and tax liability of non-corporate entities.

Lesson 9: TDS/TCS, Returns, Refund & Recovery

The Income-tax Act provides for collection and recovery of income-tax in the following ways, namely,

(i) Deduction of tax at source

(ii) Advance payment of income-tax before the assessment by the assessee himself;

(iii) Self-assessment tax

(iv) payment made after the assessment is made by the Assessing Officer.

Once the tax is deducted, it is duty to deposit the same to the credit of the Central Government under prescribed procedures stated under the Income Tax Act, 1961.

The procedure under the Income-tax Act for making an assessment of income begins with the filing of a return of income. Section 139 of the Act contains the relevant provisions relating to the furnishing of a return of income. On the basis of return of income the income tax authority makes the assessment. Further, the Income-tax Act provides for various remedies to an assessee on completion of the assessment. The main remedies available to an assessee on completion of the assessment are Appeals, Revision, and Rectification.

The broad coverage of the lesson would include:

- The provisions related to tax deducted at source and tax collected at source
- The provisions related to Returns, Signature – E-Filing
- The provisions related to Fee and Interest, collection and recovery of tax
- The provisions related to Assessment, Appeal, Revision etc.

Lesson 10: Tax Planning & Tax Management

Tax planning is an activity undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions etc., while Tax management consists of steps taken to comply with Income Tax law e.g. maintaining of books of account, computing the income , deposit of tax, filing of returns etc.

The broad coverage of the lesson would include:

- The meaning of tax planning, tax avoidance and tax evasion and their difference
- The tools of tax planning
- Major areas of tax planning

Lesson 11: International Taxation – An Overview

After the liberalization of Indian economy and easing of restrictions on the entry of foreign entities, cross border business transactions have increased manifold. With the ratification of WTO by the Government of India, our economy has become robust and an atmosphere has sprung up where FII investments in India have increased tremendously. All these economic activities has ramifications for tax laws of the country. Issues like tax havens, transfer pricing, double taxation, WTO, Subpart F, etc. are required to be taken care of and have become part and parcel of international taxation regime.

The broad coverage of the lesson would include:

- The need for double taxation relief
- The type of double taxation
- The Residency Issues – Determining Residential Status in cases of Duel Residency
- Concept of Tax Heaven
- Concept of Controlled Foreign Corporation 'CFC'
- The concept of Permanent Establishment 'PE' and Business Connection 'BC' under double taxation avoidance agreements and its relevance
- The impermissible avoidance agreements and its consequences?
- Transfer Pricing provisions in the Income Tax Act, 1961
- Meaning and scope of the term 'Advance Ruling' and the need for obtaining Advance Ruling

Lesson 12: Recent Case Laws

Tax is a Dynamic law and is always evolving. Law makers try to cover every situation while formulating the law. However, sometimes certain situations cannot be foreseen. This situation creates conflicts between the Assessee and the Department. Here the role of the courts comes into picture. It is therefore important to study the Judicial decisions as it helps to interpret the law in a better manner. The broad coverage of the lesson would include the Latest Supreme Court and High Court Judgements.

LIST OF RECOMMENDED BOOKS

PROFESSIONAL PROGRAMME – DIRECT TAX LAW & PRACTICE

MODULE 3 – ELECTIVE PAPER - 9.5

READINGS

1. Bharat's Law House – Income Tax Act
2. Bharat's Law House – Income Tax Rules
3. Taxmann's – Income Tax Act
4. Taxmann's – Income Tax Rules
5. Taxmann's – Yearly Tax Digest and Referencer
6. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice [Taxmann's]
7. D. P. Mittal – Indian Double Taxation Agreements & Tax Laws
8. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice [Wolters Kluwer]
9. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner [Taxmann's]
10. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.aspx
11. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

ARRANGEMENT OF STUDY LESSON

Module-3 – Elective Paper-9.5

DIRECT TAX LAW & PRACTICE

CONTENTS

LESSON 1

AN OVERVIEW OF INCOME TAX ACT, 1961

LESSON 2

COMPUTATION OF INCOME UNDER THE HEAD OF SALARY

LESSON 3

COMPUTATION OF INCOME UNDER THE HEAD OF HOUSE PROPERTY [SECTION 22 TO 27]

LESSON 4

COMPUTATION OF INCOME – PROFITS AND GAINS FROM BUSINESS AND PROFESSION

LESSON 5

COMPUTATION OF INCOME UNDER THE HEAD OF CAPITAL GAINS

LESSON 6

COMPUTATION OF INCOME FROM OTHER SOURCES

LESSON 7

CLUBBING PROVISIONS, SET OFF AND/OR CARRY FORWARD OF LOSSES, DEDUCTION, REBATE AND RELIEF

LESSON 8

COMPUTATION OF TOTAL INCOME AND TAX LIABILITY

LESSON 10

TAX PLANNING AND TAX MANAGEMENT

LESSON 11

INTERNATIONAL TAXATION – AN OVERVIEW

LESSON 12

RECENT CASE LAWS

TEST PAPER

Lesson 1
An Overview of Income Tax Act, 1961

LESSON OUTLINE

- Introduction and Constitutional Provision
- Important Definitions
- Income [Section 2(24)]
- Computation of Taxable Income and Tax Liability of an Assessee
- Tax Rates AY 2021-22
- Rebate [Section 87A]
- Rates of Surcharge
- Marginal Relief
- Case Studies
- Determination of Residential Status
  - Individual
  - Other Person (except company) – HUF, Firms, AOP/BOI, Local Authority, AJP
  - Company
- Guiding Principles of Place of Effective Management 'POEM'
- Scope of Total Income
- Income deemed to accrue or arise in India [Section 9]
- Case Studies
- Exemptions: Income which do not from a part of Total Income
- LESSON ROUND UP
- TEST YOURSELF

LEARNING OBJECTIVES

Basic Concept : The taxes are the basic source of revenue for the Government. Revenue raised from the taxes are utilized for meeting expense of Government like, provision for education, infrastructure facilities such as roads, dams etc. Taxes are broadly divided into two parts i.e. direct taxes and indirect taxes. The tax that is levied directly on the income or wealth of a person is called direct tax. Income tax is one of form of direct taxes. The levy of income tax in India is governed by the Income Tax Act, 1961 and Income Tax Rules, 1962. It is charged on the Total Income and to derive the total income one must know certain concepts of the Income Tax Act, such as residential status, assessment year, previous year, assessee etc. Income tax is leviable on taxable income and to determine taxable income, residential status of the person and scope of total income are the initial steps. There are two types of taxpayers from residential point of view.

Resident in India and Non-resident in India. Sourced based income in India is taxable in India whether the person earning income is resident or non-resident. Conversely, foreign sourced income of a person is taxable in India only if such person is resident in India. Therefore, the determination of the residential status of a person is very significant in order to find out his tax liability.

Exemptions: Tax is calculated on the income earned in the previous year. For providing relief to the tax payers from payment of tax, income tax law contains certain provisions relating to exemption and deduction. Exempted income means the incomes which are not charged to tax. Under Income Tax Act, section 10 provides for incomes which are exempted from levy of income tax for example Scholarship. Further, deduction means the amount which needs to be included in the income first and then they are allowed for deduction in full or in part on fulfillment of certain conditions. For example, deduction for payment of donations under section 80G. Section 10 provides for various categories of income that are exempt from tax.

At the end of this lesson, students will be able to understand:

- Constitutional Provision
- Some basic concepts like assessment year, previous year, income, person, assessee
- Basic steps in the calculation of tax liability
- Be able to determine the residential status of a person
- Be aware of the importance of residential status for tax purposes
- The scope of total income
- The rates of tax
- Concept of Marginal Relief
- Concept of POEM
- Exemptions available under Income Tax Act, 1961

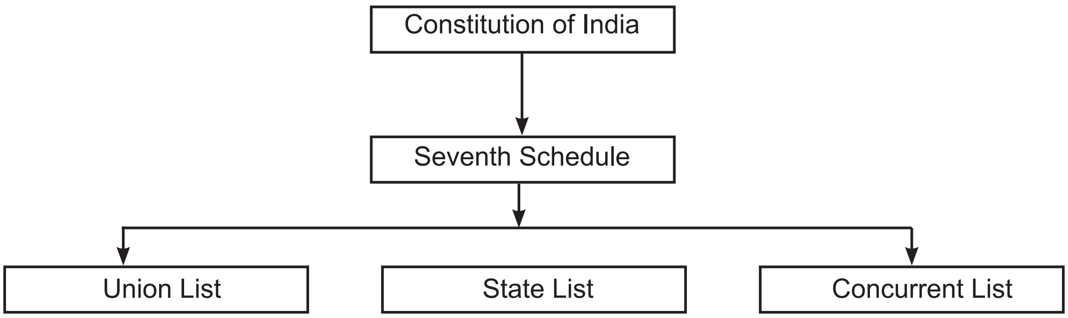
INTRODUCTION AND CONSTITUTIONAL PROVISION

India is a federal union of States with distribution of powers. Articles 245 to 255 of the Constitution of India relate to legislative relations between the Union and States in the form of distribution of legislative powers between the Parliament and the Legislature of a State.

Powers to make laws are conferred by Articles 245, 246 and 248 of the Constitution while subject matters of laws to be made by Parliament and Legislature of a State are listed in Schedule VII to the Constitution.

As per Article 265, No tax shall be levied or collected except by authority of law. Distribution of legislative powers is stipulated in **Article 246 read with Schedule VII of the Constitution** of India. There are three lists in Schedule VII in respect of which Union or State or both will have concurrent power to make laws.

List I	Union List comprises of several items or subjects over which the Union i.e. Central Government has exclusive powers of legislation.
List II	State List comprises of several items or subjects over which the State Legislature shall have the exclusive powers of legislation.
List III	Concurrent list Comprises of several items over which the Parliament and the Legislatures of States shall have concurrent powers of legislation.



In respect of levy of taxes and duties, Union and States have respective powers under Union List and State List, the summary of which is provided as under:

1. Tax-related entries in the Union List (List-I of Schedule VII)

Entry No.	Particulars
82	Taxes on income other than agricultural income.
83	Duties of customs including export duties.
84	Duties of excise on the following goods manufactured or produced in India, namely : (a) petroleum crude; (b) high speed diesel; (c) motor spirit (commonly known as petrol); (d) natural gas; (e) aviation turbine fuel; and (f) tobacco and tobacco products
85	Corporation tax
86	Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies.
87	Estate duty in respect of property other than agricultural land.

88	Duties in respect of succession to property other than agricultural land.
89	Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freights.
90	Taxes other than stamp duties on transactions in stock exchanges and futures markets.
91	Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.

2. Tax-related entries in the State List (List - II of Schedule VII)

Entry No.	Particulars
46	Taxes on agricultural income.
47	Duties in respect of succession to agricultural land.
48	Estate duty in respect of agricultural land.
49	Taxes on lands and buildings.
50	Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.
51	Duties of excise on the following goods manufactured or produced in the State and countervailing duties at the same or lower rates on similar goods manufactured or produced elsewhere in India : (a) alcoholic liquors for human consumption; (b) opium, Indian hemp and other narcotic drugs and narcotics; but not including medicinal and toilet preparations containing alcohol or any substance included in sub-paragraph (b) of this entry.
53	Taxes on the consumption or sale of electricity
54	Taxes on the sale of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption, but not including sale in the course of inter-State trade or commerce or sale in the course of international trade or commerce of such goods.
56	Taxes on goods and passengers carried by road or on inland waterways.
57	Taxes on vehicles, whether mechanically propelled or not, suitable for use on roads, including tramcars subject to the provisions of entry 35 of List III.
58	Taxes on animals and boats.
59	Tolls.
60	Taxes on professions, trades, callings and employments.
61	Capitation taxes.
62	Taxes on entertainments and amusements to the extent levied and collected by a Panchayat or a Municipality or a Regional Council or a District Council
63	Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.

3. Other constitutional provisions:

Article No.	Particulars
Article 13	Laws inconsistent with or in derogation of the fundamental rights.
Article 245	Extent of laws made by Parliament and by the Legislatures of States.
Article 246	Subject matter of laws made by Parliament and by the Legislatures of States.
Article 246A	1. Notwithstanding anything contained in articles 246 and 254, Parliament, and, subject to clause (2), **the Legislature of every State**, have power to make laws with respect to goods and services tax **imposed by the Union or by such State.** 2. **Parliament** has exclusive power to make laws with respect to goods and services tax where the supply of goods, or of services, or both takes place **in the course of inter-State trade or commerce**. **Explanation-** The provisions of this article, shall, in respect of goods and services tax referred to in clause (5), of article 279A, take effect from the date recommended by the Goods and Services Tax Council.''.
Article 248	Residuary powers of legislation.
Article 265	Taxes not to be imposed save by authority of law.
Article 269	Taxes levied and collected by the Union but assigned to the States. (1) Taxes on the sale or purchase of goods and taxes on the consignment of goods except as provided in Article 269A shall be levied and collected by the Government of India but shall be assigned and shall be deemed to have been assigned to the States on or after the 1st day of April, 1996 in the manner provided in clause (2).
Article 269A	Goods and services tax on supplies in the course of **inter-State trade or commerce** shall be levied and collected by the Government of India and such tax shall be **apportioned** between the Union and the States in the manner as may be provided by Parliament by law on the recommendations of the Goods and Services Tax Council. **Explanation:** For the purposes of this clause, supply of goods, or of services, or both in the course of **import into the territory of India** shall be deemed to be supply of goods, or of services, or both in the course of **inter-State trade or commerce**.
Article 270	Taxes levied and distributed between the Union and the States.- (1) All taxes and duties referred to in the Union List, except the duties and taxes referred to in articles 268, *268A and 269, respectively, surcharge on taxes and duties referred to in article 271 and any cess levied for specific purposes under any law made by Parliament shall be levied and collected by the Government of India and shall be distributed between the Union and the States in the manner provided in clause (2).
Article 271	Surcharge on certain duties and taxes for purposes of the Union.
Article 273	Grants in lieu of export duty on jute and jute products.
Article 274	Prior recommendation of President required to Bills affecting taxation in which States are interested.

Article 276	Taxes on professions, trades, callings and employments.
Article 279A	1. The President shall, **within sixty days** from the date of commencement of the Constitution (One Hundred and First Amendment) Act, 2016, by **order, constitute a Council** to be called the Goods and Services Tax Council. 2. The Goods and Services Tax Council shall consist of the following members, namely: (a) the Union Finance Minister - Chairperson; (b) the Union Minister of State in charge of Revenue or Finance - Member; (c) the Minister in charge of Finance or Taxation or any other Minister nominated by each State Government-Members. The **Members** of the Goods and Services Tax Council referred to in sub clause (c) of clause (2) shall, as soon as may be, **choose one amongst themselves** to be the **Vice-Chairperson** of the Council for such period as they may decide.
Article 286	Restrictions as to imposition of tax on the sale or purchase of goods.
Article 289	Exemption of property and income of a State from Union taxation.
Article 298	Power to carry on trade, etc. The executive power of the Union and of each State shall extend to the carrying on of any trade or business and to the acquisition, holding and disposal of property and the making of contracts for any purpose.
Article 304	Restrictions on trade, commerce and intercourse among States.
Article 366	Definitions (6) "**corporation tax**" means any tax on income, so far as that tax is payable by companies and is a tax in the case of which the following conditions are fulfilled:- (a) that it is not chargeable in respect of agricultural income; (b) that no deduction in respect of the tax paid by companies is, by any enactments which may apply to the tax, authorised to be made from dividends payable by the companies to individuals; (c) that no provision exists for taking the tax so paid into account in computing for the purposes of Indian income-tax the total income of individuals receiving such dividends, or in computing the Indian income-tax payable by, or refundable to, such individuals; (12) "goods" includes all materials, commodities, and articles; **(12A) "goods and services tax"** means any tax on supply of goods, or services or both **except** taxes on the supply of the alcoholic liquor for human consumption;'

Income tax being direct tax happens to be one of the major source of revenue for the Central Government. The entire amount of income tax collected by the Central Government is classified under the head:

1. Corporation Tax (Tax on the income of the companies); and
2. Income tax (Tax on income of the non-corporate assessees)

The classification of Income tax into above two categories is of great assistance to Central Government while preparing budget estimates and setting the target. **It is also important for easy division of tax between the**

Central and State Government as the proceeds from Corporation tax are not divisible with the States [Article 270(1) read with Article (4)(a)].

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–

COMPONENTS OF INCOME TAX LAW

- **Income Tax Act**
- **Finance Act**
- **Income Tax Rules**
- **Circulars/Notifications**
- **Legal Decisions of Courts**

The various components of income-tax law are explained below:

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

    - It came into force on 1st April, 1962.
    - It contains 298 sections and XIV schedules.
    - A section may have **sub-sections, clauses and sub-clauses.** For example,
        - ➢ The clauses of section 2 define the meaning of terms used in the Income-tax Act, 1961. Clause (1A) defines “agricultural income”, clause (1B) defines “amalgamation” and so on.

          Likewise, the clauses of section 10 contain the exemptions in respect of certain income, like clause (1) provides for exemption of agricultural income and clause (2) provides for exemption of share income of a member of a hindu undivided family and so on.
        - ➢ Section 5 defining the scope of total income has two sub-sections and (2). Sub-section (1) defines the scope of total income of a resident and sub-section (2) defines the scope of total income of a non-resident.
    - A section may also have **Provisos and Explanations**.
        - ➢ The Proviso(s) to a section/sub-section/clause spells out the exception(s) to the provision contained in the respective section/sub- section/clause.
        - ➢ The Explanation to a section/sub-section/clause gives a clarification relating to the provision contained in the respective section/sub- section/clause.
        - ➢ For example, Sections 80GGB and 80GGC provides for deduction from gross total income in respect of contributions made by Indian companies and other persons, respectively, to political parties or an electoral trust. The proviso to sections 80GGB and 80GGC provide 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 proviso to these sections spell out the circumstance when deduction would not be available thereunder in respect of contributions made.
    - 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.

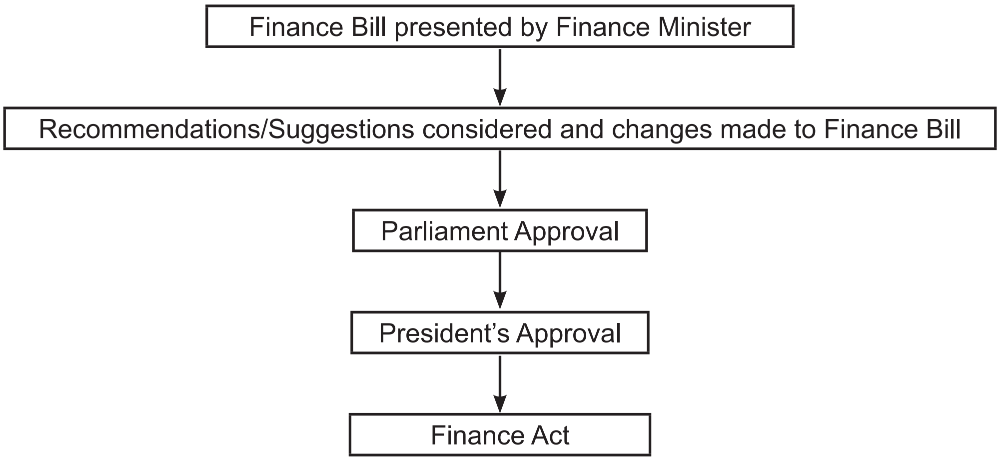
- It undergoes change every year with additions and deletions brought out by the Annual Finance Act passed by Parliament.
- In pursuance of the power given by the Income-tax Act, 1961 rules have been framed to facilitate proper administration of the Income-tax Act, 1961.

2. **Finance Act:** The Finance Act contains necessary amendments in the Direct taxes (e.g. Income tax) and Indirect taxes (e.g. GST, custom duties) signifying the policy decisions of the Union Government.

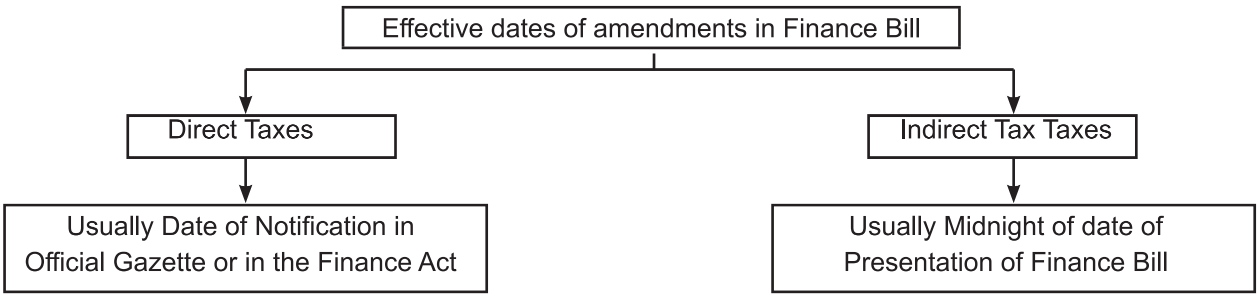
3. **Computation and assessment of income are basically governed by the provisions of income tax Act but tax rates are not provided by the income tax Act and it is given by the Finance Act every year.**

Finance Bill is presented usually in the month of February every year and this bill contains amendments in direct as well as indirect taxes. It is usually presented in the Parliament by the Finance Minister.

The finance bill is passed by both the houses of Parliament after it is being tabled and necessary recommendation/amendments have been made in it. Once this bill has been passed by the Parliament, it goes to the President for his assent. After President's assent, the finance bill becomes the Finance Act.



The effective date of applicability of provisions of the Finance Act is usually mentioned in the notification in the official gazette or in the Act itself. Generally, the amendments by the Finance Act are made applicable from the first day of the next financial year e.g. most of the amendments by Finance Act, 2020 are effective from 1st April, 2020.



The First schedule to the annual Finance Act is divided into four parts:

- **Part I** of the First Schedule to the Finance Act specifies the rates of income tax for respective assessees applicable for the current **Assessment Year.**
- **Part II** specifies the rates at which tax is deductible at source for the current Financial Year.

- **Part III** gives the rates for calculating income-tax for deducting tax from income chargeable under the head "Salaries" and computation of advance tax.
- **Part IV** gives the rules for computing net agricultural income.

4. **Income Tax Rules, 1962**
   - 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.
   - It is important to keep in mind that along with the Income-tax Act, 1961, these rules should also be studied.

5. **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.

6. **Case Law**

   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.

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 '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.

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.

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

Assessment year [Section 2(9)]	1. Period starting from April1 and ending on March 31 of the next year. 2. Income of previous year of an assessee is taxed during the next following assessment year. 3. It is always a period of 12 months. 4. Income is a concept of flow, it means it cannot be taxed as and when it accrue or arised, hence we need period of income and after that period we need time for assessment of tax on the income so earned in that period. 5. That's why there is a concept of previous year and assessment year. In previous year income is earned and "assessed and taxed in assessment year".
Previous year [Section 2(34)]	1. Previous year means the previous year as defined in section 3; 2. As per section 3 **"previous year"** means the financial year immediately preceding the assessment year. 3. Year in which income is earned is known as previous year. 4. All assessee required to follow financial year (i.e. April 1 to March 31) as the previous year.
Previous year in the case of newly set-up business/ profession.	1. The first previous year commences on the date of setting up of the business/ profession or the date on which the source of income newly comes into existence and ends on the immediately following March 31. 2. The first previous year is a period of 12 months or less than 12 months. It can never exceed 12 months. 3. The second and subsequent previous years are always of 12 months each (i.e. April to March.)
Exception to the previous year rule	**Rule –** Income of a previous year is taxable in the immediately following assessment year. Exceptions – 1. Income of a non-resident from shipping. [Section 172] (7.5% is taxable portion) 2. Income of persons leaving India either permanently or for a long period of time. [Section 174] 3. Income of bodies formed for short durations. [Section 174A] 4. Income of a person trying to alienate his assets with a view to avoiding payment of tax; and [Section 175] 5. Income of a discontinued business. [Section 176] It means in above stated exceptions(circumstances) such incomes are liable to be taxed and assessed in the year in which it is / was earned rather than in assessment year.

Previous year for undisclosed sources of income	1. Cash Credits [Section 68] 2. Unexplained Investments [Section 69] 3. Unexplained money etc. [Section 69A] 4. Amount of investments etc., not fully disclosed in the books of account [Section 69B] 5. Unexplained expenditure [Section 69C] 6. Amount borrowed or repaid on hundi [Section 69D] Taxation of Cash Credits, Unexplained Money, Investments, etc. [Section 115BBE] (a) Unexplained amounts treated as income under sections 68, 69, 69A, 69B, 69C and 69D of the Act will now be taxed at a flat rate of 60% (plus surcharge@25% of tax and cess @4 % of tax and surcharge) without granting any deduction of expenditure or allowance there against. Thus, the effective rate of tax is 78%. (b) The benefit of threshold exemption and lower slab rates for individuals and HUFs will not be available to such amounts. (c) 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.
Person [Section 2(31)]	**Includes** An individual, HUF, company, firm, AOP, BOI, local authority; and every artificial juridical person not falling above.
Assessee [Section 2(7)]	**"Assessee"** means a person by whom income tax or any other sum of money is payable under this Act, and includes- (a) Every person in respect of whom any proceeding under the Act has been taken for the assessment of his income or the income of any other person in respect of which he is assessable; (b) Every person who is deemed to be an assessee under any provision of this Act [u/s 160(2)], or (c) Every person who is an assessee in default under any provision of this Act under any provision of this Act [u/s 201(1)].

Definition of Agricultural Income [Section 2(1A)]

Agricultural Income means:-

a) Any rent or revenue received from land that is situated in India and is used for agricultural purposes

b) Any income received from such land through agricultural operations including processing of the agricultural produce, raised or received as rent in kind so as to provide it fit for the market , or sale of such produce

c) any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator or the receiver of rent-in-kind, of any land with respect to which, or the produce of which, any process mentioned in paragraphs (*ii*) and (*iii*) of sub-clause (*b*) is carried on :

d) Provided that—

(*i*) the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator, or the receiver of rent-in-kind, by reason of his connection with the land, requires as a dwelling house, or as a store-house, or other out-building, and

(*ii*) the land is either assessed to land revenue in India or is subject to a local rate assessed and collected by officers of the Government as such or where the land is not so assessed to land revenue or subject to a local rate, it is not situated—

(*A*) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name) or a cantonment board and which has a population of not less than ten thousand; or

(*B*) in any area within the distance, measured aerially:

Aerial distance from municipality*	Population as per last preceding census.
Within 2 kms	10,000 to 1,00,000
Within 6 kms	1,00,000 to 10,00,000
Within 8 kms	> Rs. 10,00,000

Note :- For the purposes of this clause, any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income (w.e.f. Assessment Year 2009-10).

PARTIALLY INTEGRATED TAXATION OF NON-AGRICULTURAL INCOME WITH AGRICULTURAL INCOME *

Applicable if the following 3 conditions are satisfied :-

1) The taxpayer is an individual, a HUF, a body of individual, an association of persons or a artificial juridical person (not applicable in case of a firm, company, co-operative society, etc).

2) The non-agricultural income of the taxpayer exceeds the exemption limit.

3) The taxpayer's agricultural income exceeds Rs 5,000.

*The clubbing of agricultural income and non-agricultural income as provided by the Finance Act is not unconstitutional – Union Home Products Ltd. v. Union of India [1995] 215 ITR 758 (Kar.).

CALCULATION OF NET AGRICULTURAL INCOME

The net agricultural income (having net agricultural income in addition to the non-agricultural income) will be computed as follows:

Rule 1 - Agricultural income of the nature referred in section 2(1A)(a) will be computed on the same basis as is adopted for the computation of income chargeable under the head "Income from other sources" under sections 57 to 59.

Rule 2 - Agricultural income of the nature referred in section 2(1A)(b) will broadly be computed as if it were income chargeable to tax under the head "Profits and gains of business or profession" and the provisions of sections 30 to 32, 36, 37, 40, 40A [other than sub-sections (3) and (4)], 41, 43, 43A, 43B and 43C will apply accordingly.

Rule 3 - Agricultural income of the nature referred in section 2(1A)(c) will be computed as if it were income chargeable under the head “Income from house property” under sections 23 to 27.

Rule 4 - Where an assessee derives income from sale of tea grown and manufactured by him in India, 60% of the total income from such business, as computed in accordance with rule 8 of the Income-tax Rules, will be regarded as agricultural income.

Rule 5 - Where the assessee is a member of an association of persons or a body of individuals (other than a Hindu undivided family, a company or a firm) which, in the previous year, has either no income chargeable to tax or has non-agricultural income not exceeding the maximum amount not chargeable to tax in the case of an association of persons or a body of individuals, but has agricultural income, then the agricultural income or loss of the association or body is to be computed in accordance with these rules and the share of the assessee in the agricultural income or loss so computed will be regarded as agricultural income or loss of the assessee.

Rule 6 - Loss incurred in agriculture will be allowed to be set off against gains from agriculture. No set off will, however, be allowed in respect of assessee’s share in agricultural loss of an association of persons or a body of individuals.

Rule 7 – Deduction will be allowed on any tax levied by a State Government on agricultural income.

Rule 8 - The unabsorbed loss from agricultural activities during the previous years relevant to the assessment years 2010-11 to 2017-18 will be set off against the agricultural income of assessment year 2018-19 in chronological order. Likewise, an unabsorbed loss from agriculture during the previous year relevant to the assessment years 2011-12 to 2018-19 will be taken into account in determining the net agricultural income for the purpose of payment of advance tax during the financial year 2018-19. The set off of loss will, in either case, be allowed only if such loss has already been determined. Where a person is succeeded by another person (otherwise than by inheritance), the person (other than the person who has incurred the loss) cannot claim the set off as discussed above.

Rule 9 - Where the net result of computation of agricultural income from various sources is a loss, the loss will be disregarded and the net agricultural income of the assessee shall be taken as nil.

Rule 10 - The net agricultural income of the assessee will be rounded off to the nearest multiple of Rs. 10.

COMPUTATION OF TAX COVERED IN THIS SCHEME

Taxation will be computed in the following manner :-

Step 1 – Net agricultural income is to be calculated as if it were income chargeable to income tax.

Step 2 – Aggregate the agricultural and non-agricultural income of the assessee and income tax is calculated on the aggregate income as if such aggregate income were the total income.

Step 3 – The income calculated in step 1 is the increased by the first slab of income on which tax is charged at nil rate and income tax is calculated on net agricultural income, as if such income were the total income of the assessee.

Step 4 – The amount of income tax determined in step 2 will be reduced by the amount of income tax determined in step 3

Step 5 – Then find out the balance. Now deduct rebate under section 87A. Add Surcharge and education cess/ secondary and higher education cess or health education cess.

Step 6 – The amount so calculated is the income tax which is payable by the assessee.

INCOME [SECTION 2(24)]

"Income is the consumption and savings opportunity gained by an entity within a specified timeframe, which is generally expressed in monetary terms. However, for households and individuals, "income is the sum of all the wages, salaries, profits, interests payments, rents, and other forms of earnings received in a given period of time."

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

The definition of Income as given in Section 2(24) of the Act starts with the word includes therefore the list is inclusive not exhaustive. The definition enumerates certain items, including those which cannot ordinarily be considered as income but are treated statutorily as such.

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

S. No.	Income under Section 2(24)	Head Of Income
1.	Profits and gains	PGBP
2.	Dividend	Other Sources
3.	Voluntary contributions received by a trust/institution created wholly or partly for charitable or religious purposes or by certain research association or universities and other educational institutions or hospitals and other medical institutions or an electoral trust.	Generally exempt under Section 11 and 12
4.	The value of any perquisite or profit in lieu of salary taxable	Salary
5.	Any special allowance or benefit specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.	Salary (Generally exempt)
6.	City Compensatory Allowance/ Dearness allowance : Any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.	Salary
7.	Benefit or Perquisite to a Director : The value of any benefit or perquisite, whether convertible into money or not, obtained from a company by. (a) a director, or (b) a person having substantial interest in the company, or (c) a relative of the director or of the person having substantial interest, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;	Salary (If as per employment agreement) Else under Other Sources (If not in the terms of employment agreement)

8.	Any Benefit or perquisite to a Representative Assessee : The value of any benefit or perquisite (whether convertible into money or not) obtained by any representative assessee under Section 160(1) (iii)/(iv) or beneficiary, or any amount paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary;	Other Sources
9.	Deemed profits chargeable to tax under section 28 or section 41 or section 59	PGBP
10.	Capital Gain : Any capital gains chargeable to tax under Section 45; since the definition of income in Section 2(24) is inclusive and not exhaustive capital gains chargeable under Section 46(2) are also assessable as income.	Capital Gains
11.	Insurance Profit : The profits and gains of any Insurance business carried on by a mutual insurance company or by a co-operative society computed in accordance with the provisions of Section 44 or any surplus taken to be such profits and gains by virtue of the profits contained in the First Schedule to the Income-tax Act	PGBP
12.	Banking income of a Co-operative Society : The profits and gains of any business of banking (including) providing credit facilities carried on by a cooperative society with its members.	PGBP
13.	Winnings from Lottery : Any winnings from lotteries, crossword puzzles, races, including horse-races, card-games and games of any sort or from gambling or betting of any form.	Other Sources
14.	Employees Contribution Towards Provident Fund : Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set-up under the provisions of the Employees State Insurance Act, 1948 (34 of 1948) or any other fund for the welfare of such employees.	PGBP if not deposited by the assessee to the specified fund
15.	Amount Received under Keyman Insurance Policy : Any sum received under a Keyman Insurance Policy including the sum allocated by way of bonus on such policy. Keyman Insurance Policy means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected with the business of the first mentioned person in any manner whatsoever.	PGBP

16.	Amount received for not carrying out any activity : Any sum referred to in Section 28(va), i.e. any sum, whether received or receivable in cash or kind, under an agreement for - (i) not carrying out any activity in relation to any business or profession; [Amendment vide Finance Act, 2016] not sharing any know-how, patent, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services	PGBP
17.	Any sum referred to in clause (v) or (vi) of sub-section (2) of section 56	Other sources
18.	Gift received for an amount exceeding Rs. 50,000 : Any sum of money or value of property referred to in clause (vii) or clause (viia) of sub-section (2) of Section 56	Other sources
19.	Any consideration received for issue of shares as exceeds the fair market value of the shares referred in section 56(2) (viib).	Other sources
20.	Amount received as an advance or otherwise in the course of negotiation for transfer of a capital asset referred to in clause (ix) of section 56(2).	Other sources
21.	Any sum of money or value of property received without consideration or for inadequate consideration as referred to in clause (x) of Section 56(2)	Other sources
22.	Any compensation or payment in connection with termination of employment as referred under clause (xi) of Section 56(2).	Other sources
23.	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 other than the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43.	PGBP

CASE STUDIES

APPROPRIATION OF PAYMENT BETWEEN CAPITAL AND INTEREST - Where interest is due on capital and the creditor gets an open payment from the debtor, the creditor is at liberty to appropriate the payment towards principal – CIT v.Pateshwari Parsad Singh (1970) 76 ITR 208 (all) if , however , neither the debtor nor the creditor makes any appropriation of payment as between capital and interest , the income tax department is entitled to treat the payment as applicable to the outstanding interest and assess it as income – CIT v. Kameshwar Singh [1993] 1 ITR 94 (PC)

IILEGAL INCOME: The income tax does not make any distinction between income accrued or arisen from the legal source and income tainted with illegality. By bringing the profits of an illegal business to tax ,the state does not condone it or take part in crime ,nor does it become a party to the illegality. The assesses might be prosecuted for the offence and yet to be taxed upon profits arising out of its commission – Mann v. Nash [1932] 1 KB 752 . however any expense incurred by an assesee for any purpose which is an offence or which is prohibited by law shall not to be deemed to have been incurred for the purpose of business or profession an no deduction or allowance shall be made in respect of such expenditure however explanation to section 37(1) is applicable only in case expenditure pertaining to illegal business and not in the case of business loss – T.A. Quereshi v. CIT [2006] 157 taxman 514 (SC).

DEVALUATION OF CURRENCY – If an assessee receives extra money on account of devaluation of currency, it is taxable. If the fund is utilised in the course of business for trading purpose, there will be realisation of the profit arising on devaluation and the profit would be taxable. If, on the other hand, the fund is not utilized for a business operation (i.e., for non-trading purpose), like payment of income-tax in the foreign country, there is no profit and the difference in the exchange value cannot be assessed to income-tax – CIT v. Mogul Line Ltd. [1962] 46 ITR 590 (Bom.).

COMPUTATION OF TAXABLE INCOME AND TAX LIABILITY OF AN ASSESSEE

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

1. Determine the residential status of the person as per section 6 of the Act.

2. Calculate the income as per the provisions of respective heads of income. Section 14 classifies the income under five heads:

   (i) Income from salaries (only to be consider for individual)

   (ii) Income from House Property

   (iii) Profits and gains of business or Profession

   (iv) Capital Gains

   (v) Income from other sources

3. Consider all the deductions and allowances given under the respective heads before arriving at the gross income.

4. Exclude the income exempt under section 10 of the Act.

5. Aggregate of incomes computed under the 5 heads of income after applying clubbing provisions and making adjustments of set off and carry forward of losses is known as Gross Total Income.

6. Deduct there from the deductions admissible under Sections 80C to 80U. The balance is called Total income. The total income is rounded off to the nearest multiple of Rupees ten (Section 288A).

7. Add agriculture income in the total income calculated in (6) above. Then calculate tax on the aggregate as if such aggregate income is the Total Income.

8. Calculate income tax on the net agricultural income as increased by *Rs.* 2,50,000/3,00,000/5,00,000 as the case may be, as if such increased net agricultural income were the total income.

9. The amount of income tax determined under (8) above will be deducted from the amount of income tax determined under (7) above.

10. Calculate income tax on capital gains under Section 112/112A/111A, and on other income at specified rates.

11. The balance of amount of income tax left as per (9) above plus the amount of income tax at (10) above will be the income tax in respect of the total income. Applicable surcharge, if any would be levied. Marginal relief would be provided in cases where the assessee's income marginally exceeds the total income on the basis of which surcharge is leviable and the increase in total tax is more than increase in total income. Health and Education Cess @ 4% will be applied on tax including surcharge

12. Deduct the following from the amount of tax calculated under (11) above:

    – Tax deducted and collected at source.

    – Advance tax paid.

    – Self Assessment tax

    – Double taxation relief.

13. The balance of amount left after deduction of items given in (12) above, shall be the net tax payable or net tax refundable for the assessee. Net tax payable/refundable shall be rounded off to the nearest multiple of Ten rupees (Section 288B).

14. Along with the amount of net tax payable, the assessee shall have to pay penalties or fines, if any, imposed on him under the Income-tax Act.

The steps involved for calculation of Taxable Income are discussed in brief as follows:

Particulars	**Amount (Rs.)**
Income (taxable) under the head:	
+ Income from Salaries (only for individuals)	XXX
+ Income from House Property	XXX
+ Profits and gains of business or profession	XXX
+ Capital gains	XXX
+ Income from other sources	XXX
Adjustment in respect of:	
+ Clubbing of Income	XXX
− Set off and carry forward of losses	(XXX)
= Gross Total Income	XXX
− Deductions under section 80C to 80U (or Chapter VIA)	(XXX)
= Total (Taxable) Income	(XXX)

The steps involved for calculation of tax liability are discussed in brief as follows:

Particulars	Amount (Rs.)
Tax on Special Incomes @ specified tax rates (Long term capital gains @ 20%/10% ; Casual Income @ 30% and Short term capital gains (on Securities transaction tax paid securities) @ 15%;	***
Add: Tax on Balance Income @ Slab Rate/Flat Rate (as applicable on assessee)	***
Total Tax (subject to MAT and AMT as the case may be)* Less: Rebate under section 87A (if applicable)	***
Add: Surcharge, if any	***
Less: Marginal Relief, if applicable	(***)
Tax including Surcharge	***
Add: Health and Education Cess @ 4% on tax including surcharge	***
Tax liability Less: rebate u/s 86,89,90,90A and 91	***
Add: Interest under Section 234A/234B/ 234C	***
Net tax liability	***
Less: Taxes paid by way of: – Tax deducted at source (TDS) – Advance tax – Self Assessment Tax	 (***) (***) (***) (***)
Tax Payable/Refundable	***

TAX RATES FOR AY 2021-22

Individuals, Hindu undivided families, AOPs, BOIs - The tax rates applicable to individuals are also applicable to a Hindu undivided family, an association of persons, body of individuals or an artificial juridical person. The rates applicable for the assessment years 2021-22 are as follows:

In case of every **resident** individual, HUF, AOP & BOI, artificial juridical person		In case of **resident** individual, who is of 60 years or more but less than 80 years		In case of **resident** super senior citizen (age 80 or more)	
Income	**Rate**	**Income**	**Rate**	**Income**	**Rate**
Up to Rs. 2,50,000	Nil	Up to Rs. 3,00,000	Nil	Up to Rs. 5,00,000	NIL
Next Rs. 2,50,000 or Above 2.5 lacs & upto 5 Lacs	5%	Next Rs. 3,00,000 or Above 3.0 lacs & upto 5 Lacs	5%		

Next Rs. 5,00,000 or Above 5 lacs & upto 10 Lacs	20%	Next Rs. 5,00,000 or Above 5 lacs & upto 10 Lacs	20%	Next Rs. 5,00,000 or Above 5 lacs & upto 10 Lacs	20%
Balance Income or Above 10 Lacs	30%	Balance Income or Above 10 Lacs	30%	Balance Income or Above 10 Lacs	30%

The aforesaid amount of Rs. 2,50,000 or Rs. 3,00,000 or 5,00,000 is called **"maximum amount not chargeable to tax" or "basic exemption limit"** applicable to the assessee.

Tax Rates in case of assessee other than Individual, HUF, AOP, BOI

(1) In the case of every co-operative society—

Up to Rs. 10,000	10%
Next Rs. 10,000	20%
Balance	30%

(2) In case of other assessee –

Rate of income tax	Partnership firm (including Limited Liability Partnership)/ Local Authority	Domestic Company (Note)	Foreign Company
	30%	a) If Total Turnover or Gross receipts of the company in the last previous year does not exceeds 400 crore rupees : then 25% of the Total Income b) Other Case : then 30% of the Total Income	40% (irrespective of turnover or gross receipts)

Note :- **Domestic Company**

Income-tax rates applicable in case of Domestic Companies for Assessment Year 2021-22

Domestic Company	*Assessment Year 2021-22*
– Where it opted for Section 115BA	25%
- Where it opted for Section 115BAA [This benefit shall be available when total income of the company is computed without claiming specified deductions, incentives, exemptions and additional depreciation available under the Income-tax Act.]	22%
- Where it opted for Section 115BAB [This regime shall be available only for the manufacturing companies incorporated in India on or after 01-10-2019. Hence, old companies will not be able to take the benefit of this section.]	15%
- Where it has not opted for Section 115BAA and the Total Turnover or Gross receipts of the company in the last previous year does not exceeds 400 crore rupees	25%
- Any other domestic company	30%

Add:

a) Surcharge: The amount of income-tax shall be increased by a surcharge at the rate of 7% of such tax, where total income exceeds one crore rupees but not exceeding ten crore rupees and at the rate of 12% of such tax, where total income exceeds ten crore rupees. However, the rate of surcharge in case of a company opting for taxability under Section 115BAA or Section 115BAB shall be 10% irrespective of amount of total income.

b) Health and Education Cess: The amount of income-tax and the applicable surcharge, shall be further increased by health and education cess calculated at the rate of four percent of such income-tax and surcharge.

The new effective tax rate, which will apply to domestic companies availing the benefit of section 115BAA is 25.168%. The break up such tax rate is as follows:

Base tax rate	Surcharge applicable	Cess	Effective tax rate
22%	10%	4%	22*1.1*1.04 = 25.168%

Conditions specified under eligibility criteria of Section 115BAA

All domestic companies shall have an option to pay income tax at the rate of 22% (plus applicable surcharge and cess), provided the following conditions are complied with:

A. Such companies should not avail any exemptions/incentives under different provisions of income tax. Therefore, the total income of such company shall be computed without:

1. Claiming any deduction especially available for units established in special economic zones under section 10AA
2. Claiming additional depreciation under section 32 and investment allowance under section 32AD towards new plant and machinery made in notified backward areas in the states of Andhra Pradesh, Bihar, Telangana, and West Bengal
3. Claiming deduction under section 33AB for tea, coffee and rubber manufacturing companies
4. Claiming deduction towards deposits made towards site restoration fund under section 33ABA by companies engaged in extraction or production of petroleum or natural gas or both in India
5. Claiming a deduction for expenditure made for scientific research under section 35
6. Claiming a deduction for the capital expenditure incurred by any specified business under section 35AD
7. Claiming a deduction for the expenditure incurred on an agriculture extension project under section 35CCC or on skill development project under section 35CCD
8. Claiming deduction under chapter VI-A in respect to certain incomes, which are allowed under section 80IA, 80IAB, 80IAC, 80IB and so on, except deduction under section 80JJAA
9. Claiming a set-off of any loss carried forward from earlier years, if such losses were incurred in respect of the aforementioned deductions

SPECIAL RATES OF INCOME TAX

Section	Nature of Income	Rate of tax
111A	Short-term capital gains from transfer of securities units on which Securities Transaction Tax has been charged	15%
112/112A	Long-term capital gains	20%/10%
	Long-term Capital Gain covered by proviso to Section 112(Listed Bond/ Debenture)	10%
	On Long-term Capital Gain (Listed Share/Unit)	Exempt upto 1 lakh. Excess taxable @10%
115BB	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.	30%
115BBE	Unexplained amounts treated as income under sections 68, 69, 69A, 69B, 69C and 69D of the Act will be taxable @60% without granting any deduction of expenditure or allowance there against. The benefit of threshold exemption and lower slab rates for individuals and HUFs will not be available to such amounts. No set off of any loss against Section 68,69,69B,69C and 69D.	60%
115BBF	Income by way of royalty in respect of a patent developed and registered in India in respect of person who is resident in India. No deduction in respect of any expenditure or allowance or set-off of loss shall be allowed to the assessee in computing the said income	10%
115BBG	Tax on income from transfer of carbon credits [See Note 1]	10%

Note 1:

Insertion of new section 115BBG: After section 115BBF of the Income-tax Act [as inserted by Finance Act, 2016], the following section has been inserted with effect from the 1st day of April, 2018, namely:—

'115BBG. *Tax on income from transfer of carbon credits*: Where the total income of an assessee includes any income by way of transfer of carbon credits, the income-tax payable shall be the aggregate of—

(a) the amount of income-tax calculated on the income by way of transfer of carbon credits, at the rate of ten per cent; and

(b) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the amount of income referred to in clause (*a*).

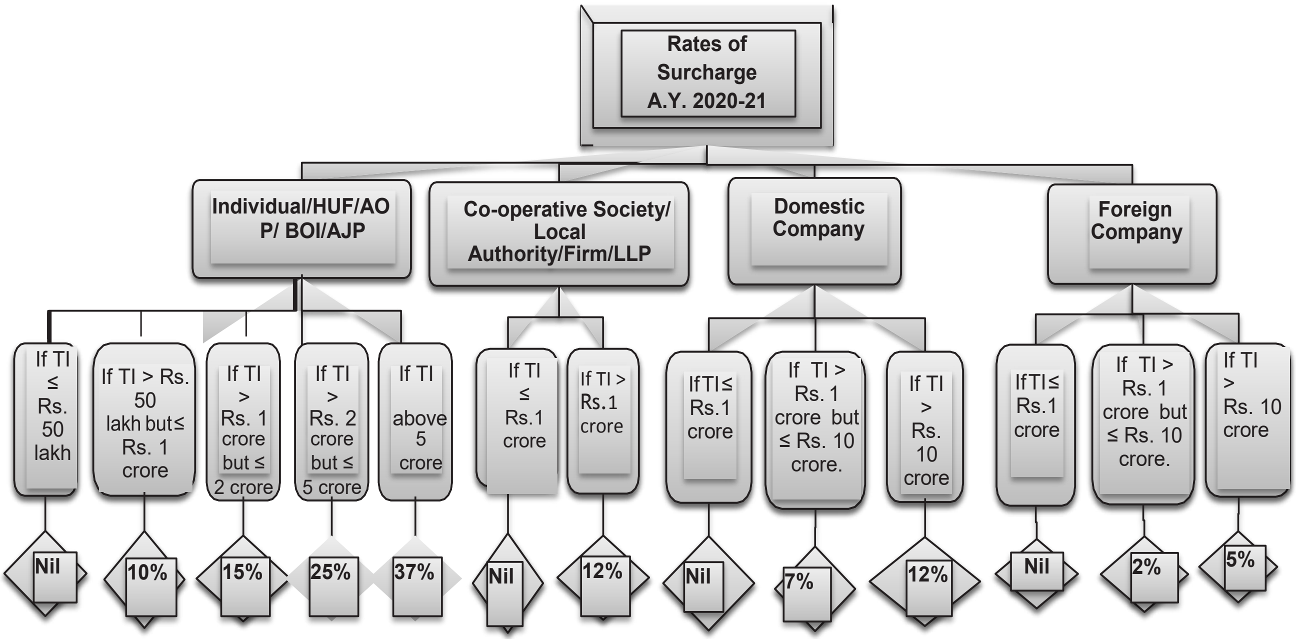
Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of this Act in computing his income referred to in clause (*a*) of sub-section (1).

Explanation.—For the purposes of this section "carbon credit" in respect of one unit shall mean reduction of one tonne 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.'.

REBATE [SECTION 87A]

1. A **RESIDENT INDIVIDUAL** having **TOTAL INCOME** upto **Rs. 5.00 lac** shall be eligible for a rebate of Rs. 12,500 restricted to the amount of tax payable by him.
2. Rebate u/s 87A not available to any other assessee.
3. This rebate is available before charging education cess.

RATES OF SURCHARGE



* The rate of surcharge in case of a company opting for taxability under Section 115BAA or Section 115BAB shall be 10% irrespective of amount of total income.

Special Tax Regime for Individual and HUFs [Section 115BAC]

The Finance Act, 2020, has provided an option to Individuals and HUF for payment of taxes at the following reduced rates from Assessment Year 2021-22 and onwards:

Total Income (Rs)	Rate
Up to 2,50,000	Nil
From 2,50,001 to 5,00,000	5%
From 5,00,001 to 7,50,000	10%
From 7,50,001 to 10,00,000	15%
From 10,00,001 to 12,50,000	20%
From 12,50,001 to 15,00,000	25%
Above 15,00,000	30%

Surcharge: Surcharge is levied on the amount of income-tax at following rates if total income of an assessee exceeds specified limits:

Rs. 50 Lakhs to Rs. 1 Crore	**Rs. 1 Crore to Rs.2 Crores**	**Rs. 2 Crores to Rs. 5 Crores**	**Rs. 5 crores to Rs. 10 Crores**	**Exceeding Rs. 10 Crores**
10%	15%	25%	37%	37%

Note: Marginal relief is available from surcharge.

Health and Education Cess: Health and Education Cess is levied at the rate of 4% on the amount of income-tax plus surcharge.

Alternate Minimum Tax: The assessee opting for this scheme have been kept out of the purview of Alternate Minimum Tax (AMT). Further the provision relating to the computation, carry forward and set off of AMT credit shall not apply to these assessees.

Conditions to be satisfied:

1. The option to pay tax at lower rates shall be available only if the total income of Individual or HUFs is computed without claiming following exemptions or deductions:

a) Leave Travel concession [Section 10(5)]

b) House Rent Allowance [Section 10(13A)]

c) Official and personal allowances (other than those as may be prescribed) [Section 10(14)]

d) Allowances to MPs/MLAs [Section 10(17)]

e) Allowances for income of minor [Section 10(32)]

f) Deduction for units established in Special Economic Zones (SEZ) [Section 10AA];

g) Standard Deduction [Section 16(ia)]

h) Entertainment Allowance [Section 16((ii)]

i) Professional Tax [Section 16(iii)]

j) Interest on housing loan [Section 24(b)]

k) Additional depreciation in respect of new plant and machinery [Section 32(1)(iia)];

l) Deduction for investment in new plant and machinery in notified backward areas [Section 32AD];

m) Deduction in respect of tea, coffee or rubber business [Section 33AB];

n) Deduction in respect of business consisting of prospecting or extraction or production of petroleum or natural gas in India [Section 33ABA];

o) Deduction for donation made to approved scientific research association, university college or other institutes for doing scientific research which may or may not be related to business [Section 35(1) (ii)];

p) Deduction for payment made to an Indian company for doing scientific research which may or may not be related to business [Section 35(1)(iia)];

q) Deduction for donation made to university, college, or other institution for doing research in social science or statistical research [Section 35(1) (iii)];

r) Deduction for donation made for or expenditure on scientific research [Section 35(2AA)];

s) Deduction in respect of capital expenditure incurred in respect of certain specified businesses, i.e., cold chain facility, warehousing facility, etc. [Section 35AD];

t) Deduction for expenditure on agriculture extension project [Section 35CCC];

u) Deduction for family Pension [Section 57(iia)]

v) Deduction in respect of certain incomes other than specified under Section 80JJAA, 80CCD(2) and deduction under section 80LA for Unit located in IFSC [Part C of Chapter VI-A].

1. Total income of the assessee is calculated after claiming depreciation under section 32, other than additional depreciation, and without adjusting brought forward losses and depreciation from any earlier year (if such loss or depreciation pertains to any deduction under the aforesaid sections). Further, loss under the head house property can't be set off against other heads of Income. Moreover, such loss and depreciation will not be carried forward.

2. If the assessee has any unabsorbed depreciation, relating to additional depreciation, which has not been given full effect, the corresponding adjustment shall be made to WDV of the block of assets in the prescribed manner.

3. In case the assessee has business or professional income, this option shall be exercised on or before the due date for furnishing the returns of income.

4. Once the assessee has exercised the option for any previous year, it cannot be subsequently withdrawn for the same or any other previous year. The option once exercised for any previous year can be withdrawn only once in subsequent previous year (other than the year in which it was exercised) and thereafter, he shall never be eligible to exercise this option again except where such person ceases to have any business income.

5. If assessee does not have business or professional income, the option must be exercised along with the return of income for every previous year. If an assessee, after opting for Section 115BAC, claims any of prescribed deduction or allowance in any previous year, then the option to pay tax at concessional rate shall become invalid for that year.

Special Tax Regime applicable to a Co-operative societies [Section 115BAD]

The Finance Act, 2020 has inserted a new section 115BAD in Income-tax Act to provide an option to the resident co-operative societies to get taxed at the rate of 22% plus 10% surcharge and 4% cess. The resident co-operative societies have an option to opt for taxation under newly section 115BAD of the Act w.e.f. Assessment Year 2021-22. The option once exercised under this section cannot be subsequently withdrawn for the same or any other previous year.

If the new regime of Section 115BAD is opted by a co-operative society, its income shall be computed without providing for specified exemption, deduction or incentive available under the Act. The societies opting for this section have been kept out of the purview of Alternate Minimum Tax (AMT). Further, the provision relating to computation, carry forward and set-off of AMT credit shall not apply to these assessees.

The option to pay tax at lower rates shall be available only if the total income of cooperative society is computed without claiming following exemptions or deductions:

a) Deduction for units established in Special Economic Zones (SEZ) [Section 10AA];

b) Additional depreciation in respect of new plant and machinery [Section 32(1)(iia)];

c) Deduction for investment in new plant and machinery in notified backward areas [Section 32AD];

d) Deduction in respect of tea, coffee or rubber business [Section 33AB];

e) Deduction in respect of business consisting of prospecting or extraction or production of petroleum or natural gas in India [Section 33ABA];

f) Deduction for donation made to approved scientific research association, university college or other institutes for doing scientific research which may or may not be related to business [Section 35(1) (ii)];

g) Deduction for payment made to an Indian company for doing scientific research which may or may not be related to business [Section 35(1)(iia)];

h) Deduction for donation made to university, college, or other institution for doing research in social science or statistical research [Section 35(1) (iii)];

i) Deduction for donation made to National Laboratory or IITs, etc. for doing scientific research which may or may not be related to business [Section 35(2AA)];

j) Deduction in respect of capital expenditure incurred in respect of certain specified businesses, i.e., cold chain facility, warehousing facility, etc. [Section 35AD];

k) Deduction for expenditure on agriculture extension project [Section 35CCC];

l) Deduction in respect of certain incomes other than specified under Section 80JJAA [Part C of Chapter VI-A].

Where a co-operative society exercises option for availing benefit of lower tax rate under section 115BAD, it shall not be allowed to claim set-off of any brought forward losses or depreciation attributable to any restricted exemption or deduction in the Assessment Year for which the option has been exercised and for any subsequent Assessment Year.

MARGINAL RELIEF

1) Marginal relief in case of *Individual/HUF/AOP/BOI/Artificial juridical person is available if the total income exceeds Rs. 50 Lacs.*

Case 1: If the total income exceeds Rs 50 Lacs but upto Rs. 1 crores

1.	Tax on total income (plus surcharge)	****	
2.	Tax on (total income of Rs. 50 Lacs) +		
	(Total Income – Rs. 50 Lacs) or	(****)	(****)
3.	1 (–) 2 = Marginal Relief if positive	****	

Illustration: Compute the tax liability of Mr. Atin (aged 32), having total income of* Rs. *51 lakhs for the Assessment Year 2021-22. Assume that his total income comprises of "Salary income" and "Interest from Saving Bank Account".

Solution:

Computation of tax liability of Mr. Atin for the A.Y. 2021-22

(A)	Tax payable including surcharge on total income of Rs. 51,00,000	
	Rs. 2,50,000 – Rs. 5,00,000 @ 5%	Rs. 12,500
	Rs. 5,00,000 – Rs. 10,00,000 @ 20%	Rs. 1,00,000
	Rs. 10,00,000 – Rs. 51,00,000 @30%	Rs. 12,30,000
	Total	Rs. 13,42,500

	Add: Surcharge @ 10%	Rs. 1,34,250	Rs. 14,76,750
(B)	[Tax Payable on total income of Rs. 50 lakhs (Rs. 12,500 plus Rs. 1,00,000 plus Rs. 12,00,000)] + [Total income in excess of Rs. 50 Lacs]		Rs. 14,12,500
(C)	Marginal Reilef (A)-(B)		Rs. 64,250
(D)	Tax payable (A)-(C)		Rs. 14,12,500
	Add: Health and Education Cess @4%		Rs. 56500
	Tax Liability		Rs. 14,69,000

Case 2: If the total income exceeds Rs. 1 crores

1.	Tax on total income (plus surcharge as applicable)	****	
2.	Tax on (total income of Rs. 1 crores including surcharge as applicable) + (Total Income – Rs.1 crores) or	(****)	(****)
3.	1 (–) 2 = Marginal Relief if positive	****	

2. Marginal relief in case of *Firm/Limited Liability Partnership/Local Authorities/Co-operative societies* ***is available if the total income exceeds Rs. 1 crore.***

1.	Tax on total income (plus surcharge)	****	
2.	Tax on (total income of Rs. 100 Lacs) + (Total Income – Rs. 100 Lacs) or	(****)	(****)
3.	1 (–) 2 = Marginal Relief if positive	****	

3. Marginal relief in case of companies *is available if the total income exceeds Rs. 1 crore*

Case 1: If the total income exceeds Rs 1 crores but upto Rs. 10 crores

1.	Tax on total income (plus surcharge)	****	
2.	Tax on (total income of Rs. 1 crores) + (Total Income – Rs. 1 crores) or	(****)	(****)
3.	1 (–) 2 = Marginal Relief if positive	****	

Case 2: If the total income exceeds Rs. 10 crores

1.	Tax on total income (plus surcharge as applicable)	****	
2.	Tax on (total income of Rs. 10 crores including surcharge as applicable upto 10 crores) + (Total Income – Rs.10 crores) or	(****)	(****)
3.	1 (–) 2 = Marginal Relief if positive	****	

Health and Education Cess

In case of every assessee, the amount of tax after surcharge a shall be increased by health and education cess at the rate 4%.

Average rate of Tax [Section 2(10)]

$$\text{Average Rate of tax} = \frac{\text{Amount of income tax calculated on the total income} \times 100}{\text{Total Income}}$$

Maximum Marginal Rate (MMR) [Section 2(29C)]

MMR is the rate of income tax (including surcharge, if any) applicable in relation to the highest slab of income, specified in the Finance Act for the relevant year, in the case of the following persons: – (a) an individual or (b) an Association of person or body of individuals.

E.g.: MMR for Assessment year 2021-22 is 42.744% [being Tax @ 30% + 37% surcharge (assuming total income > 5 crore) + 4% cess on income tax]

CASE STUDIES

1. Can capital contribution of the individual partners credited to their accounts in the books of the firm be taxed as cash credit in the hands of the firm, where the partners have admitted their capital contribution but failed to explain satisfactorily the source of receipt in their individual hands?

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

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

Issue under consideration: The issue before the High Court was whether the Assessing Officer was justified in treating the capital contribution of partners as income of the firm by invoking section 68?

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

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

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

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

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

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

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

3. Miss Kiara borrowed on Hundi, a sum of Rs.25,000 by way of bearer cheque on 11-09-2018 and repaid the same with interest amounting to Rs.30,000 by account payee cheque on 12-10-2018. The Assessing Officer (AO) wants to treat the amount borrowed as income during the previous year. Is the action of AO valid?

Answer

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

In this case, Miss Kiara has borrowed Rs. 25,000 on Hundi by way of bearer cheque. Therefore, it shall be deemed to be income of Miss Kiara for the previous year 2018-19. 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.

4. MKG Agency is a partnership firm consisting of father and three major sons. The partnership deed provided that after the death of father, the business shall be continued by the sons, subject to the condition that the firm shall pay 20% of the profits to the mother. Father died in March, 2018. In the previous year 2018-19, the reconstituted firm paid Rs. 1 lakh (equivalent to 20% of the profits) to the mother and claimed the amount as deduction from its income. Examine the correctness of the claim of the firm.

Answer

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

Rather, such income stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said amount but it so received for and on behalf of the mother, who possesses the overriding title. Therefore, the amount paid to the mother should be excluded from the income of the firm. This view has been confirmed in *CIT vs. Nariman B. Bharucha & Sons (1981) 130 ITR 863 (Bom)*.

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

Answer

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

6. The Assessing Officer found, during the course of assessment of a firm, that it had paid rent in respect of its business premises amounting to* Rs. *60,000, which was not debited in the books of account for the year ending 31.3.2019. The firm did not explain the source for payment of rent. The Assessing Officer proposes to make an addition of* Rs. *60,000 in the hands of the firm for the assessment year 2021-22. The firm claims that even if the addition is made, the sum of* Rs. *60,000 should be allowed as deduction while computing its business income since it has been expended for purposes of its business. Examine the claim of the firm.

Answer

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

DETERMINATION OF RESIDENTIAL STATUS [SECTION 6]

Total income of an assessee cannot be computed unless the person's residential status in India during the previous year is known. Income earned and received outside India is taxable in India only if the person is resident of India. It means the scope or tax incidence is higher on resident assessee and moreover one can plan his residential status as one of the basic tool of tax planning in the hands of the assessee to reduce his tax burden. Section 6 of the Income-tax Act prescribes the tests to be applied to determine the residential status of all tax payers for the purposes of income-tax. According to the provisions relating to residential status, a person can either be;

(i) Resident in India or

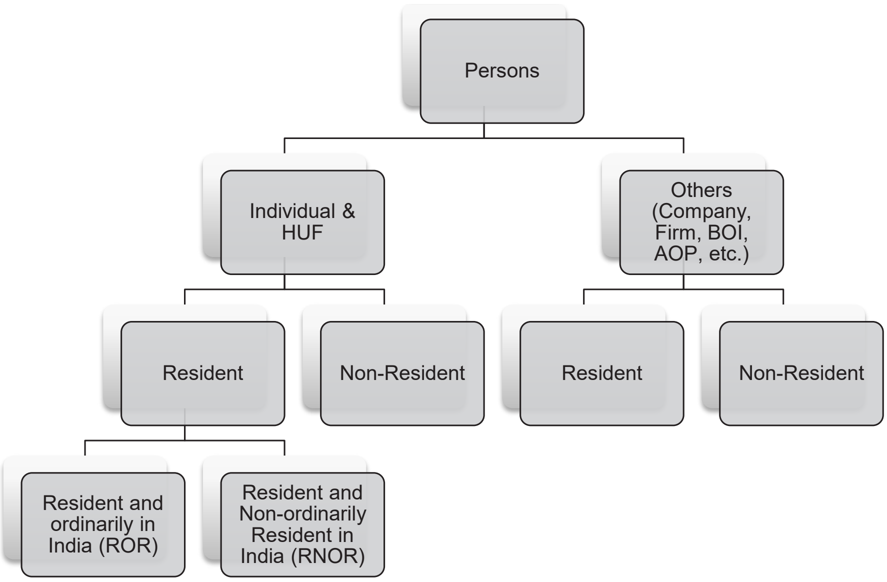
(ii) Non-resident in India

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

(a) Resident and ordinarily resident in India (ROR) or

(b) Resident but not ordinarily resident in India (RNOR or NOR).

Persons other than individual and HUF will be either resident in India or non-resident in India.



1. Residential Status of Individual [Section 6(1) and 6(6)]

Provisions relating to determination of residential status of individuals are summarised as follows:

Resident	If satisfies any one of the two basic conditions.
Non-Resident	If does not satisfy any one of the two basic conditions.
Basic Conditions	1. Stay of Individual in India should be 182 days or more during relevant Previous Year (PY); OR 2. Stay of Individual in India should be 60 days or more during relevant PY and 365 days or more during 4 PYs immediately preceding relevant PY.
Exception to Basic Conditions	In following cases, only 1st Basic condition needs to be checked: 1. Indian Citizen - who comes on a visit to India during relevant PY; or - who is leaving India as a crew member of an Indian Ship during the relevant previous year; or

	- who goes abroad for employment purposes during the relevant previous year. 2. Person of Indian Origin (who himself or his parents or his grandparents were born in undivided India) who comes on a visit to India during relevant PY However, in case of the citizen or person of Indian origin having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year, for the words "sixty days" occurring therein, the words "one hundred and twenty days" had been substituted. **[Amendment vide Finance Act, 2020]**
ROR	If Resident Individual satisfies both the additional conditions.
RNOR	If Resident Individual does not satisfy both the additional conditions.
Additional Conditions	1. Individual should be resident (by satisfying any of the two basic conditions or first basic condition, if falls in exception to basic conditions) in at least 2 PYs out of 10 PYs immediately preceding relevant PY; and 2. Stay of Individual in India should be 730 days or more during 7 PYs immediately preceding relevant PY.

Steps to be followed for determination of Residential status of a Person:

Step 1: Check whether an Individual falls under any exception to basic conditions.

Step 2: If yes, check only first basic condition, otherwise check both the basic conditions. If he satisfies any one of the basic conditions (only first in case of exception), then he would be resident in India, otherwise he would be Non-resident in India.

Step 3: If an Individual is resident in India, then check whether he is ROR or RNOR.

Step 4: If Individual satisfies both the additional conditions, then he is ROR. Otherwise, he would be RNOR.

Note: Notwithstanding anything contained in clause (1), an individual, being a citizen of India, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year shall be deemed to be resident in India in that previous year, if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature. **[Amendment vide Finance Act, 2020]**

Illustration

Determine the residential status of A for AY 2021-22

A is an Indian Citizen and goes from India to Spain for visit purposes on 27th December, 2020. Prior to this, he had never been out of India.

Solution

Determination of Residential status of A for Previous Year 2020-21 (Assessment Year 2021-22):

In this case, both the basic conditions would be checked as A does not fall under any exception to basic conditions.

Stay of A in India during relevant PY 2020-21 = 1st April, 2020 to 27th December, 2020 i.e. 271 days (30 + 31+ 30 + 31 + 31 + 30 + 31 + 30 + 27).

A is a Resident in India as he satisfies first basic condition by staying in India for more than 182 days during relevant previous year.

Now, it would be checked whether A is ROR or RNOR.

Since A had never been out of India before 27th December, 2020, he would be satisfying both the additional conditions as follows:

Additional Condition 1:

Resident in at least 2 PY out of 10 PYs:

PY	Falls under exception to basic condition	Stay during relevant PY (days)	First Basic Condition	Stay during 4 PY immediately preceding relevant PY	Second basic condition	Residential status
2019-20	No	365	Satisfied	Not required	Not required	Resident
2018-19	No	365	Satisfied	Not required	Not required	Resident

A satisfies 1st additional condition as he is resident in at least 2 PYs out of 10 Pys immediately preceding relevant previous year.

Additional condition 2:

Stay of Individual in India during 7 PY immediately preceding relevant PY:

PY	Stay Period	Days
2019-20	1st April, 2019 to 31st March, 2020	365
2018-19	1st April, 2018 to 31st March, 2019	365
2017-18	1st April, 2017 to 31st March, 2018	366
2016-17	1st April, 2016 to 31st March, 2017	365
2015-16	1st April, 2015 to 31st March, 2016	365
2014-15	1st April, 2014 to 31st March, 2015	365
2013-14	1st April, 2013 to 31st March, 2014	366
	Total	2557

A satisfies 2nd additional condition also as his stay during 7 PYs immediately preceding relevant PY is more than 730 days.

Therefore, A is ROR in India during relevant previous year.

Illustration:

Mr. A,leaves India on 18th April, 2020 and then comes back to India on 9th January, 2021. His stay in India during earlier years is as follows: 2019-20: Nil; 2018-19: 54 days; 2017-18: 162 days. Prior to this, he never went out of India. Determine his residential status.

Solution:

Determination of Residential status of A for Previous Year 2020-21 (Assessment Year 2021-22):

In this case, both the basic conditions would be checked as A does not fall under any exception to basic conditions.

Stay of A in India during relevant PY 2020-21 = 1st April, 2020 to 18th April, 2020 (18 days) and 9th January, 2021 to 31st March, 2021 (23 + 29 + 31 days) = 101 days.

A does not satisfy 1st Basic condition. We will now check 2nd basic condition. His stay during relevant PY is more than 60 days.

Stay during 4 PYs immediately preceding relevant PY:

PY	Stay Period in India	Days
2019-20	Nil	0
2018-19	Given	54
2017-18	Given	162
2016-17	1st April, 2016 to 31st March, 2017	365
	Total	581

A satisfies 2nd basic condition as his stay during relevant PY is more than 60 days and during 4 PYs immediately preceding relevant PY is more than 365 days.

Therefore, A is Resident in India. Now, we will check additional conditions:

Additional Condition 1:

Resident in at least 2 PY out of 10 PYs:

PY	Falls under exception to basic condition	Stay during relevant PY (days)	First Basic Condition	Stay during 4 PY immediately preceding relevant PY (days)	Second basic condition	Residential status
2019-20	No	Nil	Not satisfied	Not required	Not satisfied	Non Resident
2018-19	No	54	Not satisfied	Not required	Not satisfied	Non Resident
2017-18	No	162	Not satisfied	1461 (365 +365 + 365 +366)	Satisfied	Resident
2016-17	No	365	Satisfied	Not required	Not required	Resident

A satisfies 1st additional condition as he is resident in at least 2 PYs out of 10 PYs immediately preceding relevant previous year.

Additional condition 2:

Stay of Individual in India during 7 PY immediately preceding relevant PY:

PY	Stay Period	Days
2019-20	Given	0
2018-19	Given	54
2017-18	Given	162
2016-17	1st April, 2016 to 31st March, 2017	365
2015-16	1st April, 2015 to 31st March, 2016	365
2014-15	1st April, 2014 to 31st March, 2015	365
2013-14	1st April, 2013 to 31st March, 2014	366
	Total	1677

A satisfies 2nd additional condition also as his stay during 7 PYs immediately preceding relevant PY is more than 730 days.

Therefore, A is ROR in India during relevant previous year.

> ***Illustration:***
>
> A is an Indian citizen and is a practising advocate. He leaves India for his case in UK on 9th May, 2020. Determine his residential status.

Solution:

Determination of Residential status of A for Previous Year 2020-21 (Assessment Year 2021-22):

In this case, both the basic conditions would be checked as A does not fall under any exception to basic conditions.

Stay of A in India during PY 2020-21: 1st April, 2020 to 9th May, 2020 : 39 days (30 + 9)

A does not satisfy 1st basic condition as his stay during relevant PY is less than 182 days.

A also does not satisfy 2nd basic condition as his stay during relevant PY is less than 60 days.

Therefore, A is Non Resident in India during relevant previous year.

Solution:

Determination of Residential status of A for Previous Year 2020-21 (Assessment Year 2021-22):

A falls under exception to basic conditions as he goes for employment purposes outside India during relevant previous year. Therefore, in A's case only 1st basic condition would be checked.

Stay of A in India during PY 2020-21: 1st April, 2020 to 18th September, 2020: 171 days (30 + 31 + 30 + 31 + 31 + 18 days)

A does not satisfy first basic condition as his stay during relevant PY is less than 182 days. Therefore, A is Non Resident in India.

Note: Residential status of spouse is irrelevant for determining residential status of Individual.

> ***Illustration:***
>
> A is a foreign citizen. His father was born in Delhi in 1953 and his mother was born in England in 1954. His grandfather was born in Pakistan in 1918. He comes to attend his friends' marriage on 9th December, 2020 and stays in India for 261 days thereafter. Determine his residential status.

Solution:

Determination of Residential status of A for Previous Year 2020-21 (Assessment Year 2021-22):

A falls under exception to basic conditions as he is a Person of Indian origin (as his grandfather was born in undivided India) and he comes on a visit to India during relevant PY. Therefore, in A's case, only 1st basic condition would be checked.

Stay of A in India during PY 2020-21: 9th December, 2020 to 31st March, 2021 : 114 days (23 + 31 + 29 + 31 days)

A does not satisfy first basic condition as his stay during relevant PY is less than 182 days. Therefore, A is Non Resident in India.

2. Residential Status of HUF, Firm, AOP/BOI, Local Authority, AJP

Determining Factor	Control and Management of the affairs of the business (from where major decisions relating to business are taken).
Resident	If Control and Management of the affairs of the business is wholly or partly in India.
Non-Resident	If Control and Management of the affairs of the business is wholly outside India.
ROR in case of HUF	If Karta of Resident HUF satisfies both the additional conditions as applicable in case of an Individual.
Additional Conditions	Karta should be resident in at least 2 PYs out of 10 PYs immediately preceding relevant PY; and Stay of Karta in India should be 730 days or more during 7 PYs immediately preceding relevant PY.

Illustration:

AT & Co. (HUF) decisions are taken from India except 2 decisions which are taken from outside India. Determine residential status of HUF for AY 2021-22 assuming Karta of HUF is (a) ROR in India; (b) RNOR in India and (c) Non-Resident in India.

Solution:

Determination of Residential status of AT & Co. (HUF) for Previous Year 2020-21 (Assessment Year 2021-22):

HUF is resident in India as control and management of its business affairs is partly situated in India (as some of its decisions are taken from India).

Now, it will be checked whether HUF is ROR or RNOR. It would depend upon satisfaction of additional conditions by Karta of HUF. If he satisfies both the additional conditions, then HUF would be ROR in India, otherwise HUF would be RNOR in India.

Case (a): HUF would be ROR in this case as Karta is ROR in India and he must be satisfying both the additional conditions.

Case (b): HUF would be RNOR in this case as Karta is RNOR in India and he would not be satisfying both the additional conditions.

Case (c): HUF in this case could be ROR or RNOR in India. If Karta is non-resident in India, his additional conditions are not yet checked. If he satisfies both the additional conditions, then HUF would be ROR and if he does not satisfy both the additional conditions, then HUF would be RNOR.

Illustration:

AT & Co., a partnership firm is doing its business activities in India. However, meetings of its partners for decision making take place outside India except one, which has taken place in India. Determine Residential status of Partnership firm for AY 2021-22.

Solution:

Determination of Residential status of AT & Co. for Previous Year 2020-21 (Assessment Year 2021-22):

AT & Co., a partnership firm is resident in India as control and management of its business affairs is partly situated in India.

3. Residential status of Company

Indian Company	Always resident in India
Foreign Company	i) Residential status of a foreign company (whose turnover/gross receipts in the previous year is more than Rs 50 crore) depends upon place of effective management "POEM"(Circular No.8/2017, dated February 23, 2017). ii) Residential status of a foreign company (whose turnover/gross receipts in the previous year is less than Rs 50 crore) will always be non-resident in India.
Resident	POEM of the business is situated wholly in India.
Non-Resident	POEM of the business is situated wholly or partly outside India.

From Assessment Year 2020-21 a foreign company (whose turnover/gross receipt in the previous year is more than Rs 50 crore) will be resident in India if its Place Of Effective Management (POEM) during the previous year is in India. For this purpose, the 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 are made.

GUIDING PRINCIPLES FOR DETERMINATION OF PLACE OF EFFECTIVE MANAGEMENT (POEM) OF A COMPANY

'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 guiding principles to be followed for determination of POEM are enumerated as follows:

A company shall be said to be engaged in "active business outside India" if the passive income is not more than 50% of its total income; and

(i) less than 50% of its total assets are situated in India; and

(ii) less than 50% of total number of employees are situated in India or are resident in India; and

(iii) the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

Explanation: For the aforesaid purpose:

	where the majority of its employees work or where its board typically meets;
Passive income	Passive income" of a company shall be aggregate of, income from the transactions where both the purchase and sale of goods is from / to its associated enterprises; and income by way of royalty, dividend, capital gains, interest or rental income; Note: 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.
Senior Management	"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 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

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. 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.

Determination of "POEM" if active business outside India

The place of effective management in case of a company engaged in active business outside India shall be presumed to be outside India if the majority meetings of the board of directors of the company are held outside India. However, it is established that the Board of directors of the company are standing aside and not exercising their powers of management and such powers are being exercised by either the holding company or any other person (s) resident in India, then the place of effective management shall be considered to be in India. For the purpose of determining whether the company is engaged in active business outside India, the average of the data of the previous year and two years prior to that shall be taken into account. In case the company has been in existence for a shorter period, then data of such period shall be considered.

Determination of "POEM" other than those that are engaged in active business outside India

In this case, the determination of POEM would be a two stage process as follows:

First Stage: Identification or ascertaining the person or persons who actually make the key management and commercial decision for conduct of the company's business as a whole.

Second Stage: Determination of place where these decisions are in fact being made.

Note: 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.

Some of the guiding principles for determining the POEM

(a) The location where a company's Board regularly meets and makes decisions may be the company's place of effective management provided, the Board retains and exercises its authority to govern the company; and in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole. Mere formal holding of board meetings at a place would by itself not be conclusive for determination of POEM being located at that place.

Note: 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.

(b) 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.

In situations where the senior management is so decentralised 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.

(c) 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.

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.

If the above factors do not lead to clear identification of POEM then the following secondary factors can be considered:

(i) Place where main and substantial activity of the company is carried out; or

(ii) Place where the accounting records of the company are kept.

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.

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.

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, store keeping and accounts of the company, are located in country X. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 50 employees is of Rs. 5 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of Rs. 3 crore.*

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

Example 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.

Important Notes:

- It must be noted that only an individual or a HUF can be resident, not ordinarily resident or non- resident in India. All other assesses can be either resident or non-resident in India but cannot be not ordinarily resident in the matter of their residential status for all purposes of income tax.
- A person is deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in Undivided India. It may be noted that grandparents include both maternal and paternal grandparents.
- The residential status of the assessee is to be determined each year with reference to the "previous year". The residential status of the assessee may change from year to year. What is essential is the status during the previous year and not in the assessment year. Moreover, the concept of residential status is nothing to do with nationality or domicile of a person. An Indian, who is a citizen of India, can be non-resident for Income Tax purposes, whereas a foreigner can be resident of India for Income Tax purpose.

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 Rs. 10 lakh the A Co. must submit its recommendation to B Co. and B Co. makes the decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the contracts are above Rs. 10 lakh and over past years also the same trend in respect of value contribution of contracts above Rs. 10 lakh is seen.*

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

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

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 Rs. 50 crores or less in a financial year.

SCOPE OF TOTAL INCOME [SECTION 5]

Section 5 provides the scope of the total income of the assessee because the incidence of tax on any person depends upon his residential status. 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.

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

Where tax incidence arises in case of	Resident or Resident & Ordinarily Resident	Resident but not Ordinarily Resident (only Individual or HUF)	Non-Resident
Income received in India (Whether accrued in or outside India)	**TAXABLE**	**TAXABLE**	**TAXABLE**
Income deemed to be received in India (Whether accrued in or outside India)	**TAXABLE**	**TAXABLE**	**TAXABLE**
Income accruing or arising in India (Whether received in India or outside India)	**TAXABLE**	**TAXABLE**	**TAXABLE**
Income deemed to accrue or arise in India (Whether received in India or outside India)	**TAXABLE**	**TAXABLE**	**TAXABLE**
Income received and accrued outside India from a business controlled or a profession set up in India	**TAXABLE**	**TAXABLE**	**NOT TAXABLE**
Income received and accrued outside India from a business controlled from outside India or a profession set up outside India	**TAXABLE**	**NOT TAXABLE**	**NOT TAXABLE**
Income earned and received outside India but later on remitted to India (whether tax incidence arises at the time of remittance)	**NOT TAXABLE**	**NOT TAXABLE**	**NOT TAXABLE**
Agricultural Income in India	**EXEMPT U/S 10(1)**		
Long term capital gain (on securities units on which Securities transaction tax is paid)	**EXEMPT upto 1 lakh**		
Past untaxed profits (of earlier years)	**NOT TAXABLE**		
Remittances (Second receipt) to India	**NOT TAXABLE**		
Gifts from relative (on any occasion) or Gift on marriage from any person(section 56(2) explained under the head income from other sources)	**NOT TAXABLE**		

Note : a. Income is accrued or arise at a place where source of Income is situated. For example, for salary income, source is situated at the place where services are rendered.

b. Gift on birthday from other than relatives (taxable if amount exceeds Rs. 50,000)

INCOME DEEMED TO ACCRUE OR ARISE IN INDIA [SECTION 9]

1. Income from a business connection (in the form of branch office, project office, agent etc.) in India will be deemed to accrue or arise in India. Section 9 applies to all assessees irrespective of their residential

status and place of business [Please refer section 9(1)(i) for detail understanding of business connection in India].

Following are the case laws through which business connection in India is established:-

a) By business connection means a relation between a business carried on by a non-resident which yields profit or gains through some activity in India. If both non resident and resident carry on a business and if the non resident earns income then it can be said that business connection has been established – CIT v. Ashok Jain [2002] 121 Taxman 328 (Delhi) (Mag.).

   Ex :- Mr. A non resident lives in Germany has the business of perfumes and cosmetics entered into agreement with Mr. B of India on the terms that they share profit equally on the goods supplied by him from Germany to be sold in India. Mr. A sends perfume bottles @ 100 per piece, agreed to be sold at Rs. 500 per piece in India. Mr. B sold a total of 1000 pieces the total profits comes out to be Rs 4,00,000 (to be distributed equally), however Mr. B discloses the cost of the perfume as 300 per piece (Rs 100 as cost and 200 as profit share of Mr. A) in that case the profit comes merely Rs 2,00,000 which means Mr.B has benefitted Mr. A from any tax liability. In this way there is business connection of Mr. A in India and he has earned Rs2,00,000 which is liable to be taxed in India irrespective of his residential status.

b) Where the assessee, a non resident, carried on business in readymade garments in Japan and he had an arrangement with a commission agent in India to purchase readymade garments on his behalf and export them to him, the assessee's case was covered by clause (b) of Explanation to Section 9(1)(i) and not by clause (a) thereof and, therefore, the liability of the assessee to pay tax was not arised on any income deemed to accrue or arise from conversion of materials purchased for the purpose of export – CIT v. N.K. Jain [1994] 206 ITR 692/77 Taxman 13 (Delhi).

c) A single transaction between non-resident and a resident in India without any course of dealings such as might fairly be described as business connection, section 9 is not attracted. Therefore there is no question of continuing business relation when a person purchases machinery or other goods abroad and uses them in India and earns profit – CIT v. Fried Krupp Industries [1981] 128 ITR 27 (Mad.)

Exceptions:

– Income from a business connection will be deemed to accrue or arise in India only to the extent of profits attributable to operations in India. Say, if 10% Weightage is given to work in India, then only 10% of the profits would be deemed to accrue or arise in India.

– Purchase of goods by a NR for the purpose of export will not be deemed to be business connection in India;

– Collection of news and views by a news channel or news agency etc. in India will not be deemed to be a business connection in India;

– Shooting of films in India provided: If maker is individual, he should neither be an Indian citizen nor be Resident in India; if maker is Firm/AOP etc., then none of its members/partners should be Indian citizen or Indian resident; if maker is company, then none of its shareholders should be Indian citizen or Indian resident.

2. Income from any property, asset or source of income situated in India[Sec.9(1)(i)].*

   *Example – A Ltd. a non-Indian company, owns a property in Chennai. The property is being given on rent (rent is being 1,000 US dollar per month) to B Ltd. another non-Indian company. Both the companies are foreign company and their agreement is made outside India. Rent will be payable outside India in foreign currency. Rent is accrued outside India as per the agreement.

Here the rent of the property will be deemed to be earned in India as the property is only situated in India.

3. Income from the transfer of any capital asset situated in India*

   *AMENDMENT MADE BY THE FINANCE ACT, 2012 – The Finance Act, 2012 inserted certain clarificatory amendments in the provisions of section 9 to supersede the ruling of Supreme Court in the case of Vodafone International Holdings B.V. Union of India [2012] 204 Taxman 408. The amendments, inter alia. Included insertion of Explanation 5 in section 9(1)(i) with retrospective effect from the assessment year 1962-63. The Explanation 5 clarifies that an asset or capital asset, being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India if the share or interest derives, directly or indirectly, it's value substantially from the assets located in India.

4. Any income under the head 'Salaries' if it is payable for services rendered in India[Sec.9(1)(ii)]*

   *Income taxable under the head "Salaries" payable for services rendered in India is considered as Income earned in India.

   And any salary payable for the rest period or leave period which is preceded and succeeded by services in India, will also be considered as salary earned in India [exception section 9(1)(iii)]. Similarly, if service is given on board of a ship which is outside shores of India, then the salary will not be deemed to have accrued in India – DIT v. Prahlad Vijendra Rao [2011] 198 Taxman 551 (Kar.)

5. Salary payable by the Government to an Indian Citizen for services rendered outside India[Sec.9(1)(iii)]*

   *According to this section if salary is paid to Indian nationals by Indian Government, for the services rendered in foreign country will be deemed to accrue or arise in India. By virtue of section 10(7), any allowances or perquisites paid outside India is, however, fully exempt tax.

6. Dividend paid by an Indian company [Sec.9(1)(iv)]*

   * Any dividend which is being paid by an Indian company outside India is deemed to be accrue or arise in India only. However in case of non-Indian company, dividend shall be deemed to accrue or arise at a place where register of members is kept – Kusumbai D. Mahadevia v. CIT [1963] 47 ITR 214 (Bom.). Considering the following points :-

   a) Dividend [not under section 2(22)(e)] declared, distributed or paid by an Indian company during June 1, 1997 and March 31, 2002 or after March 31, 2003 will not be taxable in the hands of shareholders.

   b) Only section 9(1)(iv) will be considered for dividend paid here – Pfizer Corpn. v. CIT [2003] 129 Taxman 459 (Bom.).

7. Interest payable by [Sec.9(1)(v)]:*

   – Government(Central or State government)

   – Resident except where interest is payable in respect of borrowings used for business or profession outside India or for earning any income from any source outside India;

   – Non-Resident if interest is payable in respect of borrowings used for a business or profession in India.

   *Also the income of a non-resident shall be deemed to accrue or arise in India under clause [(v) or (vi) or (vii)] of section 9(1) and to be included in his total income irrespective of whether the place of business or business connection or services is in India or not.

CASE STUDIES-

A) Mr. X a non-resident has a project in Chennai, for financing the project he has taken a loan Rs 100 crore @12% interest p.a. from Mr. Y who is also a non-resident. Now in the year end the interest receivable (received outside India) of Rs 12 crore (100cr. * 12%=12 cr.) by Mr. Y will be taxable in India because the business connection has been established in India irrespective of Mr. Y's residential status.

B) Mr. A an Indian resident has a Project in Sri-Lanka for which he has taken a loan of Rs 100 crore @12% interest p.a. from Mr. B a non-resident. The interest received in the year end by Mr. B of Rs 12 crore (received outside India) is not taxable in India because the business connection is not established in India.

C) X Ltd. (Govt. of India enterprise) for a project in Sri-Lanka has taken a loan of Rs 100 crore from Mr. Y a non-resident @12% interest payment p.a. The interest payment of Rs 12 crore receivable by Mr. Y(received outside India) will be taxable to Mr. Y in India because the business connection has been established in India as any amount payable by government of India as interest is always taxable in India.

8. Royalty payable by [Section 9(1)(vi)]:

– Government (Central or State government);

– Resident except where it is payable in respect of any right/information/property used for the purpose of a business or profession outside India or earning any income from any source outside India;

– Non-Resident if royalty is payable in respect of any right/information/property used for the purpose of business or profession in India or earning any income from any source in India.

– Note:"Royality" means consideration for –

a. The transfer of all or any rights in respect of the patent, invention, model,design , secret formula or process of trade mark or similar property.

b. The imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process of trade mark or similar property.

c. The use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

d. The imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

e. The use or right to use any industrial, commercial, scientific equipment but not being the amount preferred to in sec. 44BB;

f. The transfer of all or any rights (including the granting of a licence) in respect of any copyright, literacy, artistic or scientific work including films or videos tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for sale, distribution or exhibition of cinematographic films;

g. The running of any services in connection with aforesaid activities.

NOTE :- The Finance Act, 2012 has amended the above provision with retrospective effect from June 1, 1976 as follows –

i) Inserted Explanation 4 to clarify that the transfer of all or any rights in respect of any right, property or information includes transfer of all or any right for use or also the right to use a computer software regardless of the medium of through which such right is transferred.

ii) Inserted Explanation 5 to clarify that consideration in respect of ay right, property or information all are included in royalty, 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 by the payer directly;

c) The location must be in India of such right, property or information.

iii) Inserted Explanation 6 to clarify that the word "Process" includes transmission by satellite, cable, optic fibre or by any other similar technology, irrespective such process is secret or not.

9. Fees for technical services payable by [Section9(1)(vii)]:

– Government (Central or State government);

– Resident except where services are utilised for a business or profession carried on outside India or earning any income from any source outside India; or

Non-Resident if fee is payable in respect of services for a business or profession carried on in India or earning any income from any source in India.*****

*****If a non-resident receives fees for giving technical services from a resident person and the fees is relatable to business carried on by the payer outside India or fees pertains to a source of income located outside India, then the fees is not deemed to accrue or arise in India. And it is equally applicable if he payer of technical fees is contemplating to create a source for earning income outside India though existence of source of income is not yet came – ITO v. Bajaj Hindustan Ltd. [2011] 47 SOT 74 (Mum.).

*****Even when the services are given outside India, it is not relevant for the purpose of section 9(1)(vii); only the place where services are utilised is relevant – Raymond Ltd. v. CIT [2003] 86 ITD 791 (Mum.).

Special points: Following Explanation shall be inserted u/s 9 by the Finance Act, 2020, w.e.f. 1-4-2022:

For the removal of doubts, it is hereby declared that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean:

(a) transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India, as may be prescribed:

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not—

(i) the agreement for such transactions or activities is entered in India; or

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

Following Explanation shall also be inserted u/s 9 by the Finance Act, 2020, w.e.f. 1-4-2021 :

For the removal of doubts, it is hereby declared that the income attributable to the operations carried out in India, shall include income from—

(i) such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;

(ii) sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and

(iii) sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.

DIVERSION OF INCOME V/S APPLICATION OF INCOME

1) Diversion of Income is the process of diverting income before it is actually earned by the assessee. Such amount shall be excluded from the Total Income of the assessee as the income is diverted to someone else before being earned by the assessee. In case of diversion of Income there is an over-riding title of any other person on such income. Here the income before being earned by the assessee reaches such person and hence not chargeable to tax in hands of the assessee.

Example of Diversion of Income: – M/s ABC is a partnership firm in which A and his two sons B & C are partners. The partnership deed provides that after the death of Mr. A, B & 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/ Mother of B & C). After the death of Mr. A, this 20% amount of profit will not be included in the Total Income of Firm M/s ABC.

Reason - This is a case if Diversion of Income and hence it is deductible from its Total Income. This is because the clause mentioned in partnership deed has given an overriding title of the 20% profit to Mrs. D and such income is a precondition for the firm to continue its business. In other words, this 20% profit reaches Mrs. D before it becomes income of the firm and hence it is a case of diversion of Income.

2) Application of Income means spending of Income after it is being earned by the assessee. Such amount shall be included in the total income of the assessee as it is merely application of earned income.

Example of Application of Income: – Mr. A is liable to pay Rs. 10,000/- per month to Ms. B (his ex-wife) as an alimony sum. Mr. A being an employee of Mr. C, instructs him to pay Rs.10,000/- per month out of his salary and disburse the remaining salary to him. This amount of Rs.10,000/- per month is to be included in the Total Income of Mr. A.

Reason - This is a case of Application of Income by Mr. A and not diversion of Income and therefore it will be included in the Total Income of Mr. A. This is because this amount of Rs. 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 from Mr. C before being earned by Mr. A.

Illustration

Details of incomes of Mr. A for the financial year 2020-21 is as follows:

(a) He works in an Indian Company and receives salary in India during the year Rs. 3,60,000.

(b) He has a house in Delhi from which he has earned Income from house property amounting to Rs. 2,70,000. Rental income is received in Japan.

(c) He transfers shares of an Indian company outside India to a Non resident individual and earns a short term capital gain of Rs. 45,000.

(d) He has also earned a long term capital gain of Rs. 72,000 by sale of shares on stock exchange in India, on which securities transaction taxes have been paid.

(e) He has rendered technical services to a company outside India, which has used these services for its business outside India. Income received outside India is Rs. 1,80,000.

(f) Royalty of Rs. 4,50,000 received from providing know-how, which is utilised by a foreign company in India.

(g) Interest received from Government of India is Rs. 18,000.

(h) Past untaxed profits of financial year 2011-12 are Rs. 5,40,000.

(i) He earns and receives rental income of Rs. 9,00,000 outside India. Out of this, Rs. 7,20,000 is remitted to India. Remaining amount is spent for education of the children abroad.

(j) He got married in the current year and has received Rs. 81,000 in cash gift from his friends. He also got a gift on his birthday in June from his wife's father Rs. 27,000. He also gifts worth Rs. 63,000 from his friends on his birthday.

(k) He has also earned an agricultural income in India of Rs. 1,23,300.

(l) He is doing a business in Sri Lanka but it is controlled from Delhi. Income of Rs. 1,80,000 is earned in that business.

(m) He is doing a business in Japan from which he receives an income of Rs. 42,300.

Compute the total income in case of Mr. A for Assessment Year 2021-22 assuming he is (i) Resident and Ordinary Resident; (ii) Resident but not ordinary resident; (iii) Non-resident.

Solution

Computation of Total Income of Mr. A for Assessment Year 2021-22 (Previous Year 2020-21)

Particulars	ROR	RNOR	NR
(a) Salary received in India (Income received in India)	3,60,000	3,60,000	3,60,000
(b) Rent from a house property in Delhi (Income deemed to accrue or arise in India)	2,70,000	2,70,000	2,70,000
(c) Short term capital gain on sale of shares of an Indian company (Income deemed to accrue or arise in India)	45,000	45,000	45,000
(d) Long term capital gain (on STT paid securities) [Exempt upto Rs. 1 lakhs]	-	-	-

(e) Fees for technical services used for purposes outside India (Income accrued or arise outside India)	1,80,000	-	-
(f) Royalty from a foreign company for right used in India (Income deemed to accrue or arise in India)	4,50,000	4,50,000	4,50,000
(g) Interest received from Government of India (Income deemed to accrue or arise in India)	18,000	18,000	18,000
(h) Past untaxed profits of FY 2011-12 (Not taxable in current year)	-	-	-
(i) Rental income outside India (Income accrued or arise outside India) *Note*: Remittance (second receipt) and use of money for education of children is irrelevant.	9,00,000	-	-
(j) Gift on the occasion of marriage (not taxable)	-	-	-
Gift on birthday from relative (not taxable)	-	-	-
Gift on birthday from other than relatives (taxable if amount exceeds Rs. 50,000)	63,000	63,000	63,000
(k) Agricultural income in India [Exempt u/s 10(1)]	-	-	-
(l) Income from business in Sri Lanka controlled from India (Income accrued or arise outside India from a business controlled from India)	1,80,000	1,80,000	-
(m) Income from business in Japan (Income accrued or arise outside India)	42,300	-	-
Total Income	25,71,300	13,86,000	12,06,000

CASE STUDY

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

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

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

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

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

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

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

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

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

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

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

INCOME WHICH DO NOT FROM PART OF TOTAL INCOME

Agricultural Income [Section 10(1)]

Income from agricultural activities performed in India is exempt from tax.

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

As per section 10(2), amount received out of family income, or in case of impartible estate, amount received out of income of family estate by any member of such HUF is exempt from tax. This is allowable only when the payments are made by the HUF to it's members, out of the income of the family or out of the impartible estate belonging to the family.

Share of profit received by a partner from the firm [Section 10(2A)]

As per section 10(2A), share of profit received by a partner from a firm is exempt from tax in the hands of the partner. Further, share of profit received by a partner of LLP from the LLP will be exempt from tax in the hands of such partner. This exemption is limited only to share of profit and does not apply to interest on capital and remuneration received by the partner from the firm/LLP.

Interest to non-residents [Section 10(4)]

As per section 10(4)(i), in the case of a non-resident; any income by way of interest on certain notified securities or bonds (including income by way of premium on the redemption of such bonds) is exempt from tax. As per section 10(4)(ii), in the case of an individual, any income by way of interest on money standing to his credit in a Non-Resident (External) Account in any bank in India in accordance with the Foreign Exchange Management Act, 1999, and the rules made thereunder is exempt from tax. Exemption under section 10(4)(ii) is available only if such individual is a person resident outside India as defined in clause (w) of section 2 of the Foreign Exchange Management Act, 1999 or is a person who has been permitted by the Reserve Bank of India to maintain the aforesaid Account.

Interest on notified savings certificates [Section 10(4B)]

As per section 10(4B), in the case of an individual, being a citizen of India or a person of Indian origin, who is a non-resident, any income by way of interest on notified savings certificates subscribed in convertible foreign exchange) issued before the 1st day of June, 2002 by the Central Government is exempt from tax.

Leave travel concession [Section 10(5)]

An employee can claim exemption under section 10(5) in respect of Leave Travel Concession. Exemption under section 10(5) is available to all employees (i.e. Indian as well as foreign citizens). Exemption is available in respect of value of any travel concession or assistance received or due to the employee from his employer (including former employer) for himself and his family members in connection with his proceeding on leave to any place in India.

Remuneration received by specified diplomats and their staff [Section 10(6)(ii)]

As per section 10(6)(ii), in case of an individual who is not a citizen of India, remuneration received by him as an official (by whatever name called) of an Embassy, High Commission, Legation, Commission, Consulate or Trade Representative of a Foreign State, or member of the staff of any of that official is exempt from tax, if corresponding Indian official in that foreign country enjoys a similar exemption.

Salary of a foreign employee and non-resident member of crew [Section 10(6)(vi), (viii)]

As per section 10(6)(vi), the remuneration received by a foreign national as an employee of a foreign enterprise for services rendered by him during his stay in India is exempt from tax, provided the following conditions are fulfilled: (a) the 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 year ; and (c) such remuneration is not liable to be deducted from the income of the employer.

As per section 10(6)(viii), any salaries received by or due to a non-resident foreign national for services rendered in connection with his employment on a foreign ship where his total stay in India does not exceed in the aggregate a period of 90 days in the year is exempt from tax.

Remuneration of a foreign trainee [Section 10(6)(xi)]

As per section 10(6)(xi), the remuneration received by a foreign trainee as an employee of foreign Government during his stay in India in connection with his training in any establishment or office of, or in any undertaking owned by the Government ; or any company owned by the Central Government, or any State Government or any company which is a subsidiary of a company referred to above or any corporation established by or under a Central, State or Provincial Act or any co-operative society wholly financed by the Central Government, or any State Government Tax, is exempt from tax

Tax paid on behalf of foreign company deriving income by way of royalty or fees for technical services [Section 10(6A)]

Tax paid by Central Government, State Government or an Indian concern on behalf of a foreign company deriving income by way of royalty or fees for technical services in pursuance of an agreement made after March 31, 1976 but before June 1, 2002 will be exempt from tax in the hands of such foreign company provided such agreement is in accordance with the industrial policy of the Indian Government or it is approved by the Central Government.

Tax paid on behalf of foreign company or non-resident in respect of other income [Section 10(6B)]

Tax paid by Central Government, State Government or an Indian concern on behalf of a foreign company or non-resident in respect of any income (not being salary, royalty or fees for technical services) will be exempt from tax in the hands of such foreign company or non-resident if such income is received in pursuance of an agreement entered into before June 1, 2002 by the Central Government with the Government of a foreign State or international organisation or any other related agreement approved by the Central Government.

Tax paid on behalf of foreign Government or foreign enterprise deriving income by way of lease of aircraft or aircraft engine [Section 10(6BB)]

Tax paid by an Indian company, engaged in the business of operation of aircraft, on behalf of foreign Government or foreign enterprise deriving income by way of lease of aircraft or aircraft engine will be exempt from tax in the hands of such foreign Government or foreign enterprise if such lease rental is received under an agreement which is approved by Central Government and entered during the period between 31-3-1997 to 1-4-1999, or after 31-3-2007.

Technical fees received by a notified foreign company [Section 10(6C)]

Section 10(6C) grants exemption from tax in respect of income arising to notified foreign company by way of royalty or fees for technical services received in pursuance of an agreement entered into with that Government for providing services in or outside India in projects connected with security of India.

Allowance/perquisites to Government employee outside India [Section 10(7)]

As per section 10(7), any 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 from tax.

Income of foreign Government employee under co-operative technical assistance programme [Section 10(8)]

As per section 10(8), remuneration received directly or indirectly by an individual, from the foreign Government in connection with a co-operative technical assistance programme and projects in accordance with an agreement entered into by the Central Government and such foreign Government, is exempt from tax. Further, exemption is available in respect of any other income of such an individual which accrues or arises outside India and is not deemed to accrue or arise in India, provided such individual is required to pay income-tax/ social security tax to the foreign Government.

Remuneration or fees received by a non-resident consultant/its foreign employees [Section 10(8A), (8B)]

Under section 10(8A), (a) remuneration or fees received by a consultant directly or indirectly out of the funds made available to an international organisation, under a technical assistance agreement between such organisation and the Government of a foreign State and (b) any other income which accrues or arises to him outside India and is not deemed to accrue or arise in India, in respect of which such consultant is required to pay income-tax/social security tax to the foreign Government of the country of his origin, is exempt from tax.

Consultant means any individual who is either not a citizen of India, or being a citizen of India, is not ordinarily resident in India or any other person who is a non-resident and is engaged by the international organization for rendering technical services in India in accordance with an agreement entered into by the Central Government and the said international organization and the agreement relating to engagement of consultant is approved by the prescribed authority.

Section 10(8B) grants similar exemption to the employee of the above discussed consultant, if such employee is either not a citizen of India or being a citizen of India, is not ordinarily resident in India and the contract of his service is approved by prescribed authority before the commencement of his service.

Income of a family member of an employee serving under co-operative technical assistance programme [Section 10(9)]

As per section 10(9), the income of any member of the family of any such individual as is referred to in section 10(8)/(8A)/(8B) accompanying him to India, which accrues or arises outside India and is not deemed to accrue or arise in India, in respect of which such member is required to pay any income or social security tax to the Government of that foreign State or country of origin of such member, as the case may be, is exempt from tax.

Retrenchment compensation [Section 10(10B)]

As per section 10(10B), compensation received at the time of retrenchment is exempt from tax to the extent of lower of the following: (a) An amount calculated in accordance with the provisions of section 25F(b) of the Industrial Dispute Act, 1947; or (b) Maximum amount specified by the Central Government (Rs. 5,00,000); (c) Actual amount received.

Under the Industrial Dispute Act, a workman is entitled to retrenchment compensation, equal to 15 days' average pay for each completed year of continuous service or any part in excess of six months. Compensation in excess of aforesaid limits is taxable as salary. However, the aforesaid limit is not applicable in cases where compensation is paid under any scheme approved by the Central Government.

Compensation for Bhopal Gas Leak Disaster [Section 10(10BB)]

Compensation [in accordance with Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985] received by victims of Bhopal gas leak disaster is exempt from tax. However, compensation received for any expenditure which is allowed as deduction from taxable income is not exempt.

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

Any amount received from the Central Government or State Government or a Local Authority by an individual or his legal heirs as compensation on account of any disaster is exempt from tax. However, no deduction is available in respect of the amount received or receivable to the extent such individual or his legal heirs has been allowed a deduction under the Act on account of loss or damage caused due to such disaster. Disaster here means any disaster due to any natural or man-made causes or by accident/negligence which results in substantial loss of human life or damage to property or environment and the magnitude of such disaster is beyond coping capacity of community of the affected area.

Payment at the time of voluntary retirement [Section 10(10C)]

As per section 10(10C), any compensation received at the time of voluntary retirement or termination of service is exempt from tax, if the following conditions are satisfied:

- Compensation is received at the time of voluntary retirement or termination (or in the case of an employee of public sector Company, at the time of voluntary separation)
- Compensation is received by an employee of following undertakings- a) public sector company; or

  b) any other company; or c) an authority established under a Central, State or Provincial Act; or d) a local authority; or e) a co-operative society ; or f) a University established or incorporated by or under a Central, State or Provincial Act and an institution declared to be a University under section 3 of the University Grants Commission Act, 1956 (3 of 1956) ; or g) an Indian Institute of Technology within the meaning of clause (g) of section 3 of the Institutes of Technology Act, 1961 (59 of 1961) ; or h) any State Government; or i) the Central Government; or j) Notified institutes having importance throughout India or in any State or States, k) Notified institute of management
- Compensation is received in accordance with the scheme of voluntary retirement/separation, which is

framed in accordance with guidelines prescribed under Rule 2BA of Income-tax Rules, 1962. Maximum amount of exemption is Rs. 5,00,000. Where exemption is allowed to an employee under section 10(10C) for any assessment year, no exemption under this section shall be allowed to him for any other assessment year. With effect from assessment year 2010-11, section 10(10C) has been amended to provide that where any relief has been allowed to assessees under section 89 for any assessment year in respect of any amount received or receivable on his voluntary retirement or termination of service or voluntary separation, no exemption under section 10(10C) shall be allowed to him in relation to such or any other assessment year.

Tax on perquisites paid by the employer [Section 10(10CC)]

Perquisites to employees mean any facility provided by the employer to the employees. There are two types of perquisites, viz., monetary and non-monetary. Value of perquisite is charged to tax in the hands of the employees, however, the employer may at his will pay tax (on behalf of employees) on such perquisites. In such a case, the amount of tax paid on such perquisites by the employer on behalf of the employees will be treated as income of the employees and is charged to tax in his (i.e., in employee’s) hands. However, by virtue of section 10(10CC) tax paid by employer (on behalf of employee) on non-monetary perquisites will be exempt from tax in the hands of employees. Such tax paid by the employer shall not be allowed as a deductible expenditure in the hands of employer under section 40. Section 10(10CC) provides exemption only in respect of tax on nonmonetary perquisites. In other words, this section does not provide exemption in respect of perquisites or tax paid on monetary perquisites.

Reference Case Law: *The assessee, an employee, claimed that the tax paid by the employer on his salary income is not liable to be included in his total income as it is exempt under section 10(10CC). Assessing Officer disallowed the claim. The Tribunal following the Special bench in RBF Rigs Corpn. LIC (RBFRC) v. ACIT (2007) 109 ITD 141 (SB) (Delhi)(Trib.) held that tax borne by the employer on behalf of the employee would constitute a non-monetary payment as such the same is exempt under section 10(10CC).*

Amount paid on life insurance policy [Section 10(10D)]

As per section 10(10D), any amount received under a life insurance policy, including bonus is exempt from tax. Following points should be noted in this regard:

- Exemption is available only in respect of amount received from life insurance policy. Exemption under section 10(10D) is unconditionally available in respect of sum received for a policy which is issued on or before March 31, 2003. However, in respect of policies issued on or after April 1st, 2003, the exemption is available only if the amount of premium paid on such policy in any financial year does not exceed 20% (10% in respect of policy taken on or after 1st April, 2012) of the actual capital sum assured. With effect from 1-4-2013, in respect of policy taken in the name of a person suffering from diseases specified under section 80DDB or in the name of a person suffering from disability specified under section 80U, the limit will be increased to 15% of capital sum assured
- Value of premium agreed to be returned or of any benefit by way of bonus (or otherwise), over and above the sum actually assured, which is received under the policy by any person, shall not be taken into account while calculating the actual capital sum assured
- Amount received on death of the person will continue to be exempt without any condition

Note: No exemption would be available in case of any sum received under section 80DD (3) or under Key man insurance policy.

Payment from account opened in accordance with the Sukanya Samriddhi Account Rules, 2014 [Section 10(11A)]

As per section 10(11A), any payment from an account opened in accordance with the Sukanya Samriddhi Account Rules, 2014 made under the Government Savings Bank Act, 1873 is exempt from tax. In other words, interest and withdrawals from such account will be exempt from tax under section 10(11A).

Payment from the National Pension System Trust to an employee [Section 10(12A)]

Any payment from the National Pension System Trust to an employee on closure of account 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, is exempt from tax.

Partial withdrawal from NPS [Section 10(12B)]

To provide relief to an employee withdrawing partial amount from National Pension System (NPS) Trust. A new clause (12B) is inserted under section 10 with effect from assessment year 2019-20 to provide that the withdrawal from NPS will not be chargeable to tax if the following conditions are satisfied:

1) Amount of withdrawal should not exceed 25% of total contribution made by an employee in NPS.
2) Partial withdrawal should be made in accordance with the terms and conditions specified under the

Pension Fund Regulatory and Development Authority Act, 2013 and the regulations made thereunder.

Payment from approved superannuation fund in specified circumstances and subject to certain limits [Section 10(13)]

Approved superannuation fund means superannuation fund which is approved by the Commissioner of Income-tax. Tax treatment of such fund is as follows:

Employer's contribution is exempt from tax, however, from assessment year 2010-11 employer's contribution in excess of Rs. 1,50,000 per annum is charged to tax as perquisite. Employee's contribution qualifies for deduction under section 80C and interest on accumulated balance is not liable to tax.

Payments made from the fund are exempt from tax under section 10(13) in following cases:

- Payment on death of beneficiary; or
- Payment to employee in lieu of, or in commutation of an annuity on his retirement at or after the specified age or on his becoming incapable prior to such retirement; or
- Payment by way of refund of contributions on the death of a beneficiary; or
- Payment to employee by way of refund of his contributions on leaving the service in connection with which the fund is established otherwise than by retirement at or after a specified age or on his becoming incapacitated prior to such retirement; or Payment to employee by way of transfer to his account under a pension scheme referred to in section 80CCD

Allowances for meeting business expenditure [Section 10(14)]

These allowances are explained in detail in salary chapter.

Interest Incomes [Section 10(15)]

Interest, Redemption Premium, on notified securities, bonds, certificates, deposits etc., are exempt for all assessees.

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

Lease rent of an aircraft or an aircraft engine paid to a foreign Government or to a foreign enterprise by an Indian company, engaged in the business of operation of aircraft is not taxable in the hands of such foreign Government or non-resident concern, if such payment is in pursuance of an agreement (approved by the Central Government) made before April 1, 1997 or after March 31, 1999 but before April 1, 2007. If such agreement is entered into during April 1, 1997 and March 31, 1999 or after March 31, 2007, then exemption under section 10(15A) is not available. However, in such a case, if tax on such payments is borne by the payer, then tax so borne by the payer is exempt in the hands of payee under section 10(6BB), provided agreement is approved by the Central Government.

Educational scholarship [Section 10(16)]

Any amount received as educational scholarship (i.e., scholarship to meet the cost of education is exempt from tax in the hands of recipient).

Daily allowance to a Member of Parliament [Section 10(17)]

Following allowances are exempt from tax in the hands of a Member of Parliament and a Member of State Legislature:

- Daily allowance received by a Member of Parliament or by a Member of State Legislature or by member of any committee thereof.
- Any other allowance received by a Member of Parliament under the Members of Parliament (Constituency Allowance) Rules, 1986.
- Any Constituency allowance received by a Member of State Legislature.

Awards [Section 10(17A)]

Any payment received in pursuance of following (whether paid in cash or in kind) is exempt from tax:

- Any award instituted in the public interest by the Central Government or State Government or by any other body approved by the Central Government in this behalf.
- Any reward by the Central Government or any State Government for such purpose as may be approved by the Central Government in this behalf in the public interest.

Pension to gallantry award winner [Section 10(18)]

Pension received by an individual who was employee of the Central Government or State Government and who has been awarded Param Vir Chakra or Maha Vir Chakra or Vir Chakra or any other notified gallantry award is exempt from tax. Family pension received by any member of such individual is also exempt.

Family pension received by the family members of armed forces [Section 10(19)]

From the assessment year 2005-06, family pension received by the widow or children or nominated heirs, of a member of armed forces (including paramilitary forces) of the Union, is exempt from tax in the hands of such family members, if the death of such member of armed forces has occurred in the course of operational duty in prescribed circumstances and subject to such conditions as may be prescribed.

Income of a news agency [Section 10(22B)]

Any income of a notified news agency, set-up in India solely for collection and distribution of news is exempt from tax provided that the news agency applies its income or accumulates it for application solely for collection and distribution of news and does not distribute its income in any manner to its members.

Income of a professional association [Section 10(23A)]

Any income (other than income from house property and income from rendering any specific service or income by way of interest or dividend on investment) of an professional institution/association is exempt from tax, if the following conditions are satisfied:

- Professional institution is established in India for the purpose of control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or such other notified profession.
- The institution applies its income, or accumulates it for application, solely to the objects for which it is established.
- The institution is approved by the Central Government by general or special order.

Income received on behalf of Regimental Fund [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.

Income of a fund established for welfare of employees [Section 10(23AAA)]

Any income received by any person on behalf of a fund established, for such purpose as may be notified by the Board in Official Gazette, for the welfare of employees or their dependents and of which fund such employees are members, is exempt from tax, if such fund applies or accumulates its income for exclusive application towards its objects, invests its funds in the modes specified in section 11(5) and such fund is approved by the Principal Commissioner or Commissioner in accordance with rule made in this behalf (see rule 16C and Form No. 9).

Income of pension fund [Section 10(23AAB)]

Any income of a fund set-up by the Life Insurance Corporation of India on or after August 1, 1996 or any other insurer to which contribution is made by any person for receiving pension from such fund, and which is approved by the Controller of Insurance or the Insurance Regulatory and Development Authority, is exempt from tax.

Income from Khadi or village industry [Section 10(23B)]

Income of an institution constituted as a public charitable trust or society which is established for the development of khadi and village industries (not for profit purpose) is exempt from tax, if following conditions are satisfied:

1) Income is attributable to the business of production, sale, or marketing, of khadi or products of village industries.
2) Institution applies its income, or accumulates it for application, solely for the development of khadi or village industries or both 3) Institution is approved by the Khadi and Village Industries Commission.

Income from fund or trust or institution or university or other educational institution or hospital or other medical institution [Section 10(23C)]

Any income received by any person on behalf of fund or trust or institution or university or other educational institution or hospital or other medical institution specified in Section 10(23C) of the Income Tax Act, 1961 is exempt from tax subject to certain condition.

Income of mutual fund [Section 10(23D)]

Any income of following mutual funds (subject to provisions of sections 115R to 115T) is exempt from tax:

- A mutual fund registered under the Securities and Exchange Board of India Act or regulation made thereunder.
- A mutual fund set-up by a public-sector bank, or a public financial institution or authorised by RBI (subject to conditions notified by the Central Government).

Income of notified investor protection fund [Section 10(23EA)]

Any income by way of contributions received from recognised stock exchanges and the members thereof, of a notified Investor Protection Fund set up by recognised stock exchanges in India is exempt from tax. Provided that where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part, with a recognised stock exchange, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall accordingly be chargeable to income-tax.

Income of the notified investor protection fund set-up by commodity exchange [Section 10(23EC)]

Any income by way of contributions received from commodity exchanges and the members thereof, of a notified Investor Protection Fund set up by commodity exchanges in India is exempt from tax. Provided that where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part, with a commodity exchange, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall accordingly be chargeable to income-tax.

Income of Investor Protection Fund set by a depository [Section 10(23ED)]

Any income, by way of contributions received from a depository, of notified Investor Protection Fund set up by a depository in accordance with the regulations made under the SEBI Act and Depository Act is exempt from tax. Provided that where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part with a depository, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall, accordingly, be chargeable to income-tax.

Income of a venture capital fund or a venture capital company from investment in a venture capital undertaking [Section 10(23FB)]

Income of a venture capital fund or a venture capital company from investment in a venture capital undertaking is exempt from tax from assessment year 2001-02. However, this exemption is subject to satisfaction of conditions specified in section 10(23FB). These provisions shall not apply in respect of any income of a venture capital company or venture capital fund, being an investment fund specified in clause (a) of the Explanation 1 to section 115UB, of the previous year relevant to the assessment year beginning on or after the 1st day of April, 2016.

Income of an investment fund [Section 10(23FBA)]

Any income of an investment fund other than the income chargeable under the head “Profits and gains of business or profession” is exempt under Section 10(23FBA). “Investment fund” shall have the same meaning assigned to it in clause (a) of the Explanation 1 to section 115UB. Income referred to in section 115UB of a unit holder of an investment fund [Section 10(23FBB)] Any income referred to in section 115UB, 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 "Profits and gains of business or profession" is exempt under section 10(23FBB). "Investment fund" shall have the same meaning assigned to it in clause (a) of the Explanation 1 to section 115UB.

Exemption in respect of certain income of wholly owned subsidiary of Abu Dhabi Investment Authority and Sovereign Wealth Fund [Section 10(23FE)]

In order to promote investment of sovereign wealth fund, including the wholly owned subsidiary of Abu Dhabi Investment Authority (ADIA), An exemption has been provided to any income of a specified person in the nature of dividend, interest or long-term capital gains arising from an investment made by it in India, whether in the form of debt or equity, in a company or enterprise carrying on the business of developing, or operating and maintaining, or developing, operating or maintaining any infrastructure facility as defined in Explanation to clause (i) of sub-section (4) of section 80-IA of the Act or such other business as may be notified by the Central Government in this behalf. In order to be eligible for exemption, the investment is required to be made on or before 31st March, 2024 and is required to be held for at least three years.

For the purpose of this exemption, "specified person" is proposed to be defined to mean,-

(a) a wholly owned subsidiary of the ADIA, which is a resident of the United Arab Emirates (UAE) and which makes investment, directly or indirectly, out of the fund owned by the Government of the United Arab Emirates; and

(b) a sovereign wealth fund which satisfies the following conditions:

   A. It is wholly owned and controlled, directly or indirectly, by Government of a foreign country;

   B. It is set up and regulated under the law of the foreign country;

   C. Its earnings are credited either to the account of the Government of the foreign country or to any other account designated by that Government such that no portion of the earnings inures any benefit to any private person;

   D. Its asset vest in the Government of the foreign country upon dissolution;

   E. It does not undertake any commercial activity whether within or outside India; and

   F. It is notified by the Central Government in the Official Gazette for this purpose.

This amendment will take effect from 1st April, 2021 and will, accordingly, apply in relation to the assessment year 2021-22 and subsequent assessment years.

Income of a registered trade union [Section 10(24)]

Any income chargeable under the head "Income from house property" and "Income from other sources" of a registered union within the meaning of the Indian Trade Union Act, 1926, formed primarily for the purpose of regulating the relation between workmen and employers or between workmen and workmen is exempt from tax. Similar exemption is available to an association of registered unions.

Income of provident fund [Section 10(25)]

Following income is exempt from tax under this section:

- Interest on securities held by a statutory provident fund and any capital gains arising from such securities
- Any income received by the trustee on behalf of a recognised provident fund or an approved superannuation fund or an approved gratuity fund; and
- Any income received by the Board of Trustees on behalf of Deposit-linked Insurance Fund.

Income of the Employees' State Insurance Fund [Section 10(25A)]

Any income of the Employees' State Insurance Fund of the Employees' State Insurance Corporation set-up under the provisions of the Employees' State Insurance Act, 1948 is exempt from tax under section 10(25A).

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

Income of a member of a Scheduled Tribe [as per article 366(25) of the Constitution] is exempt from tax, if following conditions are satisfied:

- Such member resides in any area in the State of Nagaland, Manipur, Tripura, Arunachal Pradesh, Mizoram or district of North Cachar Hills, Mikir Hills, Khasi Hills, Jaintia Hills and Garo Hills or in the Ladakh region of the State of Jammu and Kashmir.
- Such exemption is available in respect of income which accrues/arises from any source in such areas or income by way of dividends/interest on securities arises from any area.

Income of Minor [Section 10(32)]

Under section 64(1A) income of a minor child is clubbed along with the income of his/her parent, subject to certain conditions.

If the income of an individual includes any income of his/her minor child, then such individual can claim exemption (in respect of each minor child) of lower of following amount:

(a) Rs. 1,500 per minor child; or

(b) Amount of income of each minor child (which is clubbed).

Income on Buyback of Shares [Section 10(34A)]

Any income arising to an assessee, being a shareholder, on account of buy back of shares by the company as referred to in section 115QA is exempt from tax.

Income from international sporting event [Section 10(39)]

From the assessment year 2006-07, any specified income of notified person, arising from an international sporting event held in India is exempt from tax, if the event is approved by the international body and is notified by the Central Government and has participation by more than two countries.

Income received as grant by a subsidiary company [Section 10(40)]

Income of any subsidiary company by way of grant or otherwise received from its Indian holding company which is engaged in the business of generation/ transmission/distribution of power is exempt, if such receipt is for settlement of dues in connection with reconstruction or revival of an existing business of power generation. The exemption is available, if the reconstruction or revival is by way of transfer of business to the Indian company notified under section 80 IA(4)(v)(a).

Under section 10(41), any capital gain arising in the above case is not chargeable to tax, if the transfer has taken place before April 1, 2006

Income from transfer of asset of an undertaking engaged in the business of generation, transmission or distribution of power [Section 10(41)]

Income from transfer of capital asset of an undertaking engaged in the business of generation, transmission or distribution of power where such transfer takes place on or before 31.3.2006 and transfer is made to the Indian company as notified u/s 801A.

Income of a body or authority set up by two countries [Section 10(42)]

Any specified income arising to a body or authority which –

- has been established or constituted or appointed under a treaty or an agreement entered into by the Central Government with two or more countries or a convention signed by the Central Government;
- is established or constituted or appointed not for the purposes of profit;
- is notified by the Central Government in the Official Gazette for the purposes of this clause shall be fully exempted.

Reverse Mortgage [Section 10(43)]

Any amount received by an individual as a loan, either in lump-sum or in instalment in a transaction of reverse mortgage referred in clause (xvi) of Section 47 shall be exempted.

New Pension System Trust [Section 10(44)]

Any income received by any person for, or on behalf of the New Pension System Trust established on 27th February, 2008 shall be exempted.

Exemption of Allowance or perquisite to chairman/member of UPSC [Section 10 (45)]

Any allowance or perquisite, as may be notified by the Central Government in the Official Gazette, in this behalf, paid to the chairman or a retired chairman or any other member or retired member of the Union Public Service Commission, shall be exempt.

Note: the exemption has been withdrawn vide Finance Act,2020

Exemption of 'specified income' of certain bodies or authorities [Section 10(46)]

Any specified income arising to a body or authority or Board or Trust or Commission which:

- is constituted or established by or under a Central, State or Provincial Act, or has been constituted by the Central Government or a State Government with the object of regulating or administering an activity for the benefit of general public;
- is not engaged in commercial activity; and
- is specified by the Central Government by notification in the Official Gazette in this behalf, shall be exempt.

The Central Government has the power to notify the nature and extent of the income of the body or authority or Board or Trust or Commission which shall constitute the specified income.

Exemption of Income of notified 'Infrastructure debt fund' [Section 10(47)]

Any income of notified 'infrastructure debt fund', which is set up in accordance with the guidelines as may be prescribed, shall be exempt from income-tax.

Exemption of Income of a foreign company from sale of Crude Oil in India [Section 10 (48)]

Any income of a foreign Co. received in India in Indian currency on account of sale of crude oil to any person in India shall be exempt if the following conditions are satisfied.

- Such Income is in pursuant to an agreement or an arrangement entered into by the Central Govt. or approved by the Central Govt.;

- having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Govt. in this behalf; and
- the foreign company is not engaged in any activity, other than receipt of such income, in India.

Exemption of income of foreign company from sale of leftover stock of crude oil on termination of agreement or arrangement [Section 10(48B)]

Any income of foreign company on account of sale of leftover stock of crude oil from the facility in India after the expiry or on termination of the agreement or the arrangement shall be exempt, in accordance with the terms mentioned therein.

Income accruing or arising to Indian Strategic Petroleum Reserves Limited (ISPRL) [Section 10(48C)]

Any income accruing or arising to Indian Strategic Petroleum Reserves Limited (ISPRL), being a wholly owned subsidiary of Oil Industry Development Board under the Ministry of Petroleum and Natural Gas, as a result of an arrangement for replenishment of crude oil stored in its storage facility in pursuance to directions of the Central Government in this behalf.

This exemption shall be subject to the condition that the crude oil is 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.

This amendment will take effect from 1st April, 2020 and will, accordingly, apply in relation to the assessment year 2020-21 and subsequent assessment years.

Exemption of income of National Financial Holdings Company [Section 10(49)]

Any income of the National Financial Holdings Company, being a company set-up by the Central Government, shall be exempt.

Other important exemptions

1) Section 10AA provides for exemption in respect of income of newly established units in Special Economic Zones

Applicability

This section applies to any undertaking, being the Unit, which fulfils all the following conditions, namely:

(i) it has begun or begins to manufacture or produce articles or things or provide services during the previous year relevant to the assessment year commencing on or after the 1st day of April, 2006 in any Special Economic Zone;

(ii) it is not formed by the splitting up, or the reconstruction, of a business already in existence:

Provided that this condition shall not apply in respect of any undertaking, being the Unit, which is formed as a result of the re-establishment, reconstruction or revival by the assessment of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

(iii) it is not formed by the transfer to a new business, of machinery plant previously used for any purpose.

Deduction

(i) 100% of profits and gains derived from the export, of such articles or things or from services for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and fifty per cent of such profits and gains for further five assessment years and thereafter;

(ii) for the next five consecutive assessment years, so much of the amount not exceeding fifty per cent of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilized for the purposes of the business of the assessee in the manner laid down in sub-section (2).

Calculation of Deduction

Step 1: Calculate the total income of the assessee as per the provisions of the act, but before allowing deduction under section 10AA.

Step 2 : From the amount calculated in Step 1, allow the deduction under section 10AA, which is least of the following;

– Amount calculated under step 1; or

– Amount deductible under section 10AA

Conditions:

a) the amount credited to the Special Economic Zone Re-investment Reserve Account is to be utilised -

(i) for the purpose of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and

(ii) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India;

b) the particulars, as may be specified by the Central Board of Direct Taxes in this behalf, under clause (b) of sub-section (1B) of section 10A have been furnished by the assessee in respect of machinery or plant along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.

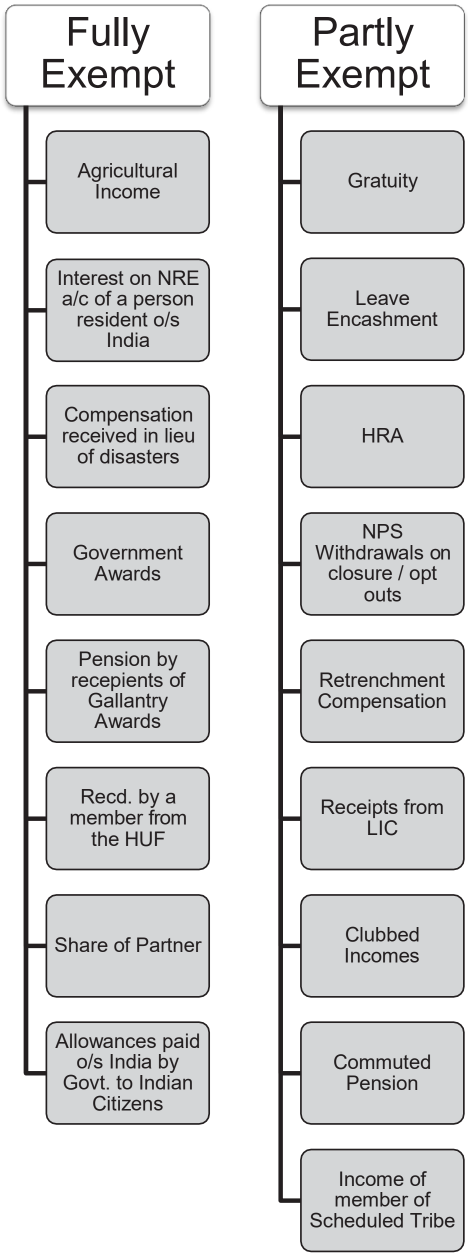
Where any amount credited to the Special Economic Zone Re-investment Reserve Account has been utilised for any purpose other than those referred, the amount so utilised; or has not been utilised before the expiry of the period specified, the amount not so utilised, shall be deemed to be the profits,

(i) in a case referred to in clause (a), in the year in which the amount was so utilised; or

(ii) in a case referred to in clause (b), in the year immediately following the period of three years specified

in sub-clause (i) of clause (a) of sub-section (2), and shall be charged to tax accordingly

SUMMARY CHART



LESSON ROUND UP

– Tax is the financial charge imposed by the Government on income, commodity or activity. Government imposes two types of taxes namely Direct taxes and Indirect taxes. Direct tax is one where burden of tax is directly on the payer. While Indirect tax is paid by the person other than the person who utilizes the product or service.

– The Income tax Act contains the provisions for determination of taxable income, determination of tax liability, procedure for assessment, appeal, penalties and prosecutions.

– Every year a Budget is presented before the parliament by the Finance Minister. One of the important components of the Budget is the Finance Bill. The Bill contains various amendments such as the rates of income tax and other taxes. When the Finance Bill is approved by both the houses of parliament and receives the assent of President, it becomes the Finance Act.

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

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

– Person : Income-tax is charged in respect of the total income of the previous year of every person. Hence, it is important to know the definition of the word person.

– Assessment year means the period of twelve months commencing on 1st April every year.

– Previous year : Income earned in a year is taxable in the next year. The year in which income is earned is known as previous year.

– Computation of income : Income tax is a charge on the assessee’s income. Income Tax law lays down the provisions for computing the taxable income on which tax is to be charged.

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

(i) Resident in India or

(ii) Non-resident in India

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

– Basis of charge : Section 4 of the Act is the charging section which imposes a charge and provides rules for working out the charge so imposed. Section 4 of the Act imposes a charge of tax on the total or taxable income of the assessee. The meaning and scope of the expression of total income is contained in Section 5. The total income of an assessee cannot determined unless we know the residential status in India during the previous year. The scope of total income and consequently the liability to income-tax also depends upon the following facts :

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

TEST YOURSELF

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

SHORT NOTES

(1) Income deemed to be received in India

(2) Income deemed to accrue or arise in India

(3) Residential Status of an Individual

(4) Residential Status of Company

(5) Define the term 'POEM' Place of Effective Management

ELABORATIVE QUESTIONS :

(1) What are the different categories into which the assessees are divided regarding residence and how is the residence of assessees determined for income-tax purposes? Explain.

(2) What tests would you apply to determine the residence of :

(a) a Hindu Undivided family,

(b) a firm,

(c) a limited company,

(d) an individual.

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 2

Computation of Income under the Head of Salary

LESSON OUTLINE

- Introduction
- Impact of Section 115BAC under the head Salary
- Employer-Employee Relationship
- Basis of Charge
- Salary, Perquisites and Profit in lieu of Salary [Section 17]
- Allowances
- Perquisites
- Deduction [Section 16]
- Relief [Section 89]
- Case Study
- LESSON ROUND UP
- TEST YOURSELF

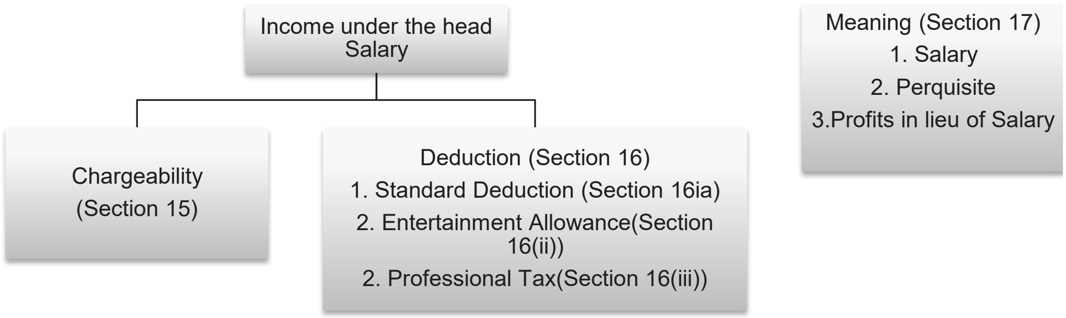
LEARNING OBJECTIVES

The taxability of income of a person depends on the chargeability of such income under the Income tax Act 1961. The total income of an assessee (subject to statutory exemptions) is chargeable under Section 4(1). The scope of the total income, which varies with the residential status, is defined in Section 5. Section 14 enumerates the heads of income under which the income of an assessee will fall. The rules for computing income and the permissible deductions under different heads of income, are dealt in different sections of the Act. The heads of income, along with their corresponding set of sections for the purpose of computation of income, are given below : (A) Salaries (Sections 15 to 17); (B) Income from house property (Sections 22 to 27); (C) Profits and gains of business or profession (Sections 28 to 44D); (D) Capital gains (Sections 45 to 55A); and (E) Income from other sources (Sections 56 to 59).

At the end of this lesson, students will be able to understand how to calculate income under the head salaries, what are the deductions, exemptions available from salaries.

INTRODUCTION

The provisions pertaining to Income under the head "Salaries" are contained in sections 15, 16 and 17.



EMPLOYER-EMPLOYEE RELATIONSHIP

Before an income can become chargeable under the head 'salaries', it is vital that there should exist between the payer and the payee, the relationship of an employer and an employee. As such the existence of "employer-employee" relationship is the "sine-qua- non" for taxing a particular receipt under the head salaries. It does not matter whether the employee is a full time employee or a part-time one. If, for example, an employee works with more than one employer, salaries received from all the employers should be clubbed and brought to charge for the relevant previous years. Once the relationship of employer and employee exists, the income is to be charged under the head "salaries".

Case Study

(a) Katrina, an actress, is employed in Bansali Films, where she is paid a monthly remuneration of Rs. 10 lakh. She acts in various films produced by various producers. The remuneration for acting in such films is directly paid to Chopra Films by the different producers. Is the amount received by Katrina is taxable as a Salary? Will your answer be different if she acts in various films and gets fees from different producers?

Ans: Case 1: In this case, Rs. 10 lakh will constitute salary in the hands of Katrina, since the relationship of employer and employee exists between Bansali Films and Katrina.

Case 2: if Katrina acts in various films and gets fees from different producers, the same income will be chargeable as income from profession since the relationship of employer and employee does not exist between Katrina and the film producers.

Foregoing of Salary v Surrender of Salary

Foregoing of Salary: Once salary accrues, the subsequent waiver by the employee does not absolve him from liability to income-tax. Such waiver is only an application and hence, chargeable to tax.

Surrender of salary: However, if an employee surrenders his salary to the Central Government under section 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered would be exempt while computing his taxable income.

Place of Accrual of Salary

- Section 9(1)(ii), salary earned in India is deemed to accrue or arise in India even if it is paid outside India or it is paid or payable after the contract of employment in India comes to an end.
- If an employee gets pension paid abroad in respect of services rendered in India, the same will be deemed to accrue in India.

- Leave salary paid abroad in respect of leave earned in India is deemed to accrue or arise in India.

For this purpose, **section 9(1)(iii)** provides that salaries payable by the Government to a citizen of India for services outside India shall be deemed to accrue or arise in India. However, by virtue of **section 10(7)**, any allowance or perquisites paid or allowed outside India by the Government to a citizen of India for rendering services outside India will be fully exempt.

Impact of Section 115BAC under the head Salary [Amendment vide Finance Act, 2020]

Finance Act, 2020 has introduced a New Optional Tax System for Individuals and HUFs u/s 115BAC of the Income Tax Act, 1961 w.e.f. AY 21-22 to provide for concessional rate of Slab Rates to be applied on Total Income calculated without claiming specified deductions and exemptions.

Hence, from AY 2021-22 or FY 2021-22, there are two operative tax system –

1. One is the Existing tax system where all the applicable deductions and exemptions are allowed and the tax rates are as per the Slab rates of tax specified in the Finance Act, 2020.
2. The second one is section 115BAC which is a Optional Tax System under which many deductions and exemptions have not been allowed but lower slab tax rates are provided in the section 115BAC itself.

Individual and HUF opting for concessional tax regime under section 115BAC: The deduction under Chapter VI-A other than the provisions of sub-section (2) of section 80CCD or section 80JJAA; not available to the Individual and HUF opting to pay tax under concessional tax regime under section 115BAC of the Income Tax Act, 1961.

Many exemptions & deduction are not allowed under the new tax system. The below chart contains the exemptions and deduction not available under the new system related to Income under the head Salary. Similarly, deductions & exemptions not available under the new tax system and which are related to other heads are provided in other chapters

Sr. No.	Nature of Exemption/Deduction Relating to Head Salaries	New System of Tax u/s 115BAC	Existing system of Tax
A	**RETIREMENT BENEFITS EXEMPTIONS**		
	Leave Salary u/s 10(10AA)	Allowed	Allowed
	Gratuity u/s 10(10)	Allowed	Allowed
	Commutation of Pension u/s 10(10A)	Allowed	Allowed
	Retrenchment Compensation u/s 10(10B)	Allowed	Allowed
	VRS Compensation u/s 10(10C)	Allowed	Allowed
	Leave Travel Concession u/s 10(5)	Not Allowed	Allowed
B	**ALLOWANCES**		
	Exemption u/s 10(13A) and Rule 2A from House Rent Allowance	Not Allowed	Allowed
1.	**Exemption u/s 10(14)(i) and Rule 2BB**		
	Travelling Allowance	Allowed	Allowed
	Conveyance Allowance	Allowed	Allowed
	Daily Allowance	Allowed	Allowed

	Helper Allowance	Not Allowed	Allowed
	Any allowance granted for encouraging the academic, research and training pursuits in educational and research institutions	Not Allowed	Allowed
	Uniform Allowance	Not Allowed	Allowed
2.	**Exemption u/s 10(14)(ii) and Rule 2BB**		
	Children Education Allowance	Not Allowed	Allowed
	Hostel Expenditure Allowance	Not Allowed	Allowed
	Tribal Area Allowance	Not Allowed	Allowed
	Transport Allowance to Handicapped/Deaf/Dumb/ Blind employee	Allowed	Allowed
	Transport Allowance to other than above employees	Not Allowed	Not Allowed
C	**PERQUISITES**		
	Free food and beverage through vouchers provided to the employee upto 50/meal/Tea & snacks	Not Allowed	Allowed
	Other Exemptions from perquisites e.g. Use of Computers, Laptops etc	Allowed	Allowed
D	**DEDUCTIONS U/S 16**		
	Standard Deduction u/s 16(ia)	Not Allowed	Allowed
	Entertainment Allowance u/s 16(ii)	Not Allowed	Allowed
	Professional Tax u/s 16(iii)	Not Allowed	Allowed

Clarification in respect of option under section 115BAC of the Income-tax Act, 1961 [Notification No. 38/2020] Section 115BAC of the Income-tax Act, 1961, inserted by the Finance Act, 2020 w.e.f. the assessment year 2021-22, inter alia, provides that a person, being an individual or a Hindu undivided family having income other than income from business or profession", may exercise option in respect of a previous year to be taxed under the said section 115BAC alongwith his return of income to be furnished under sub-section (1) of section 139 of the Act for each year. The concessional rate provided under section 115BAC of the Act is subject to the condition that the total income shall be computed without specified exemption or deduction, set-off of loss and additional depreciation.

Representations expressing concern regarding tax to be deducted at source (TDS) has been received stating that as the option is required to be exercised at the time of filing of return, the deductor, being an employer, would not know if the person, being an employee, would opt for taxation under section 115BAC of the Act or not. Hence, there is lack of clarity regarding whether the provisions of section 115BAC of the Act are to be considered at the time of deducting tax.

In order to avoid the genuine hardship in such cases, the Board, in exercise of powers conferred under section 119 of the Act, hereby clarifies that an employee, having income other than the income under the head "profit and gains of business or profession" and intending to opt for the concessional rate under section 115BAC of the Act, may intimate the deductor, being his employer, of such intention for each previous year and upon such intimation, the deductor shall compute his total income, and make TDS thereon in accordance with the provisions of section 115BAC of the Act. If such intimation is not made by the employee, the employer shall make TDS without considering the provision of section 115BAC of the Act.

It is also clarified that the intimation so made to the deductor shall be only for the purposes of TDS during the previous year and cannot be modified during that year. However, the intimation would not amount to exercising option in terms of sub-section (5) of section 115BAC of the Act and the person shall be required to do so along with the return to be furnished under sub-section (1) of section 139 of the Act for that previous year. Thus, option at the time of filing of return of income under sub-section (1) of section 139 of the Act could be different from the intimation made by such employee to the employer for that previous year.

Further, in case of a person who has income under the head "profit and gains of business or profession" also, the option for taxation under section 115BAC of the Act once exercised for a previous year at the time of filing of return of income under sub-section (1) of section 139 of the Act cannot be changed for subsequent previous years except in certain circumstances.

Accordingly, the above clarification would apply to such person with a modification that the intimation to the employer in his case for subsequent previous years must not deviate from the option under section 115BAC of the Act once exercised in a previous year.

BASIS OF CHARGE

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. As per Section 15, the income chargeable to income tax under the head salaries would include:

- Any salary due to an employee from an employer or a former employer during the previous year irrespective of the fact whether it is paid or not.
- Any salary paid or allowed to the employee during the previous year by or on behalf of an employer, or former employer, would be taxable under this head even though such amounts are not due to him during the accounting year.
- Arrears of salary paid or allowed to the employee during the previous year by or on behalf of an employer or a former employer would be chargeable to tax during the previous year in cases where such arrears were not charged to tax in any earlier year.

In short, salary is chargeable to tax on DUE OR RECEIPTS BASIS, whichever is earlier.

(i) Due basis – when it is earned even if it is not received in the P.Y. (Accrued)

(ii) Receipt basis – when it is received even if it is not earned in the P.Y. (Advance)

Difference between advance salary and advance against salary

Loan is different from salary. When an employee takes a loan from his employer, which is repayable in certain specified installments, the loan amount cannot be brought to tax as salary of the employee. Similarly, advance against salary is different from advance salary. It is an advance taken by the employee from his employer. This advance is generally adjusted with his salary over a specified time period. It cannot be taxed as salary.

Proforma for computation of income under the head "Salaries"

	Particulars	Amount
(i)	Basic Salary	xxx
(ii)	Fees/Commission	xxx
(iii)	Bonus	xxx

(iv)	Allowances:			
	(a)	Dearness Allowance		xxx
	(b)	House Rent Allowance	xxx	
		Less: Least of the following is exempt		
		HRA actually received	xxx	
		Rent paid (-)10% of salary for the relevant period	xxx	
		50%/40% of salary for the relevant period	xxx	xxx
	(c)	Children Education Allowance	xxx	
		Less: 100 per month per child upto maximum of two children	xxx	xxx
	(d)	Children Hostel Allowance	xxx	
		Less: 300 per month per child upto maximum of two children	xxx	xxx
	(e)	Transport allowance	xxx	
		Less: (3,200 in case of blind or deaf and dumb or orthopedically handicapped employee)	xxx	xxx
	(f)	Entertainment Allowance		xxx
	(g)	Other Allowances		xxx
(v)	Taxable Perquisites			
	(a)	Valuation of rent free accommodation		
		If accommodation owned by the employer		
		(i) Cities having population > 25 lakh 15% of salary (–) rent recovered from employee		
		(ii) Cities having population > 10 lakh < 25 lakh 10% of salary (–) rent recovered from employee		
		(iii) In other cities 7.5% of salary (-) rent recovered from employee		
		If accommodation taken on lease by the employer		
		Lower of the following		
		Rent paid by the employer or		
		15% of salary		
		Less: rent recovered from the employee		xxx
	(b)	Valuation of use of motor car		xxx
	(c)	Any other perquisite		xxx
(vi)	Taxable annuity or uncommuted pension			xxx
(vii)	Taxable Commuted pension			xxx
(viii)	Taxable Gratuity			xxx
(ix)	Leave encashment			xxx
(x)	Leave travel concession/Voluntary retirement compensation/Retrenchment compensation etc.			xxx

(xi)	Professional tax, if paid by the employer	xxx
	Gross Salary	xxx
Less: Standard Deduction (Rs. 50,000 or salary which ever is less)		(xxx)
Less: Entertainment allowance (only for Govt employees)		(xxx)
Less: Professional Tax		(xxx)
	Income under the head salary	xxx

SALARY, PERQUISITE AND PROFITS IN LIEU OF SALARY [SECTION 17]

The meaning of the term 'salary' for purposes of income tax is much wider than what is normally understood. The term 'salary' for the purposes of Income-tax Act, 1961 will include both monetary payments (e.g. basic salary, bonus, commission, allowances etc.) as well as non-monetary facilities (e.g. housing accommodation, medical facility, interest free loans etc).

Section 17(1), defined the term "Salary". It is an inclusive definition and includes monetary as well as non-monetary items.

Definition of Salary [Section 17(1)]

(i) wages,

(ii) any annuity or pension,

(iii) any gratuity,

(iv) any fees, commission, perquisite or profits in lieu of or in addition to any salary or wages,

(v) any advance of salary,

(vi) any payment received in respect of any period of leave not availed by him i.e. leave salary or leave encashment,

(vii) the portion of the annual accretion in any previous year to the balance at the credit of an employee participating in a recognized provident fund to the extent it is taxable and

(viii) transferred balance in recognized provident fund to the extent it is taxable,

(ix) the contribution made by the Central Government or any other employer in the previous year to the account of an employee under a pension scheme referred to in section 80CCD.

Wages

In common parlance, the term "wages" means fixed regular payment earned for work or services. The words "wages", "salary", "basic salary" are used interchangeably. Moreover, the payments in the form of Bonus, Allowances etc. made to the employee are also included within the meaning of salary.

Profits in lieu of Salary

It includes the following:

(i) The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment.

(ii) The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the modification of the terms and conditions of employment. Usually, such compensation is treated as a capital receipt. However, by virtue of this provision, the same is treated as a revenue receipt and is chargeable as salary.

(iii) Any payment due to or received by an assessee from his employer or former employer from a provident or other fund, to the sum allocated by way of bonus on such policy.

(iv) Any sum received by an assessee under a keyman insurance policy including the sum allocated by way of bonus on such policy.

(v) Any amount, whether in lumpsum or otherwise, due to the assessee or received by him, from any person -

(a) before joining employment with that person, or

(b) after cessation of his employment with that person.

(vi) Any other sum received by the employee from the employer

Computation of Salary in the Grade System

An employee may be entitled to receive Salary in grade system. Under this system, the normal annual increments to be given to employee are already fixed in the grade.

For example, if an employee joins the service on 01.06.2010 and is placed in the grade of Rs. 10000-1000-15000-2000-25000 then his salary from 01.06.2010 will be Rs. 10,000 p.m. and thereafter his salary will be Rs. 11000 p.m. w.e.f. 31.05.2011 until it reaches Rs. 15,000 after which it will increase annually by Rs. 2000 until it reaches Rs. 25,000. After that, employee will be placed in another grade.

In certain cases, employee joins in the grade at a salary in between the grade, in that case his salary will annually increase in the aforesaid manner the only difference is that his initial salary would be a different amount than the start of grade. For example, if an employee joins the service in the grade of 10000-1000-15000-2000-25000 on 01.08.2017 at a salary of Rs. 13000, then his salary from 01.08.2017 will be 13000 p.m. and thereafter his salary will be 14000 p.m. w.e.f. 01.08.2018 until it reaches Rs. 15,000 after which it will increase annually by Rs. 2,000 until it reaches Rs. 25,000.

Different forms of salary	Taxability
Basic salary	Taxable.
D.A./pay	Taxable.
Advance salary	Taxable in the year of receipt
Arrears of salary	Taxable in the year of receipt, if not taxed on due basis earlier.
Leave Salary [Section 10(10AA)]	1. Government employees (only Central or State government)- fully exempt from tax. 2. Non-Government employees, exempt from tax to the extent of the least of the following: (a) Cash equivalent of leave salary in respect of the period of earned leave at the credit of employee at the time of retirement (which cannot exceed 30 days' "average salary" for every completed year of service); or (b) 10 months "average salary"; or (c) Amount specified by the Government i.e. Rs. 3,00,000 or (d) Leave encashment actually received at the time of retirement.

	Notes – 1. "Average salary" means average salary drawn during the period of 10 months immediately preceding the retirement. 2. Fraction number of years are completely ignored. If the employee rendered service of 5 years 10 months it will be taken as 5. 3. Leave salary received during the period of service is taxable in all cases. 4. Where an employee has received from his previous employer cash equivalent to his earned leave and also receives from present employer leave encashment, the maximum limit shall be reduced by the amount previously exempted. 5. Leave Encashment paid to legal heirs of the deceased employee at the time of his/her death is not taxable as salary. 6. Meaning of salary: Basic salary, Conditional D.A. and commission based on fixed percentage of turnover.
Salary in lieu of notice	Taxable.
Fees and commission	Taxable.
Bonus	Taxable on receipt basis if not taxed earlier on due basis.
Gratuity	1. Government employee [Section 10(10)(i)] (Central Government or State Government or Local authority but not employees of statutory corporation) – fully exempt from tax. 2. Non-Government employee covered by the POGA 1972 [Section 10(10)(ii)]: Least of the following is exempt and the balance (Amt. Received (–) Amt. Exempted) is taxable : (a) 15 days salary** last drawn for each completed year of service in excess of six month; (b) Rs.20,00,000 (Increased from 10 lacs to 20 lacs by Payment of Gratuity (Amendment) Act, 2018) ; or (c) Gratuity actually received. **** Salary means: Basis salary + DA** 3. Non-Government employee (not covered by POGA) [Section 10(10)(iii)] exempt from tax to the extent of the least of the following: (a) Rs. 20,00,000 (Increased from 10 lacs to 20 lacs by Payment of Gratuity (Amendment) Act, 2018) ; (b) Half month's average salary** for each completed year of service; or (c) Gratuity actually received. ****Salary means**: Basis salary (average of last 10 months) + Dearness allowance (if provided in terms of employment) + commission as a percentage of turnover achieved by the employee.

	Average salary for this purpose is to be calculated on the basis of average salary drawn during the period of 10 months **immediately preceding the month** in which the employee has retired. **IMPORTANT NOTES:** 1. Employees of a seasonal establishment: Instead of 15 days, 7 days salary. 2. Piece rated employee: Daily wages shall be computed on the average of the total wages received by him for a period of three months immediately preceding the retirement. 3. Where an employee receives gratuity from two or more employers in the same previous year, then the exemption shall not exceed the maximum limit of Rs.20 lacs. It is very important to note that this provision is applicable only in case of residual category of employees covered under 10(10)(iii). It means it is not applicable in case of employees covered by Payment of Gratuity Act. 4. Gratuity received by family members after the death of employee:– • If gratuity becomes due during lifetime or at time of retirement of assessee it is taxable in hands of assessee. • If gratuity becomes due and received after death of employee it is not taxable in hands of employee. It is also not taxable in hands of legal heirs as it does not takes partake the character of income in their hands but it is only a part of estate devolving upon them.
Pension	➢ Uncommuted pension is taxable in all cases. ➢ Commuted pension is fully exempt from tax in the case of a Government employee (i.e. an employee of the Central Government, State Government, local authority and statutory corporation). In the case of non-Government employee, commuted pension is exempt to the extent given below – (a) One-third of normal pension is exempt if the employee receives gratuity or (b) One Half of normal pensions is exempt from tax if the employee does not receive gratuity.
Pension under new pension scheme in the case of a Government employee or any other employee joining, on or after January 1, 2004	As per section 80CCD(1) if an individual employed by central government or any other employer on or after 01-01-2004 has paid or deposited any amount in a previous year in his account under a NPS a deduction of such amount not exceeding 10% of his salary is allowed. According to new provision the date of joining the service being on or after 1.1.2004 is not applicable to private sector employees. 1. Employer's contribution is first included in salary then a deduction is available (to the extent 14 per cent of salary) under section 80CCD(2). 2. Employee's contribution is deductible under section 80CCD(1) to the extent of 10 % of salary. 3. When pension is received out of the aforesaid amount, it will be taxable in the year of receipt.

	Employers contribution towards NPS is not considered for monetary ceiling of 1.5 lakh Notes: – • If pension is received from United Nation Organisation (UNO) by its employee or his family members it is not chargeable to tax. • Family pension received by family members of armed forces is fully exempt from tax. • Family pension received by other employee not covered above after death of employee is taxable in hands of recipient under other sources after giving standard deduction of 15000 or 1/3 rd of such pension whichever is lower
Annuity from employer	Taxable as salary.
Annual accretion to the credit balance in RPF	1. Excess of employer's contribution over 12% of salary is taxable. 2. Excess of interest over notified interest is taxable (notified rate of interest is 9.5%)
Retrenchment compensation	**Exempt from tax to the** least of the following is exempt from tax— 1. Amount actually received; 2. Rs.5,00,000; 3. An amount calculated in accordance with Section 25F(b) of the Industrial Disputes Act, 1947 i.e. 15 days average pay** for each completed year of service or part thereof in excess of 6 months. However the aforesaid limit is not applicable in cases where compensation is paid under any scheme approved by the government. **** Average Pay means:** 1. In case of monthly payment- Average of last 3 months. 2. In case of weekly payment- Average of last four completed weeks. 3. In case of daily payment- Average of Last 12 full working days.
Compensation received under voluntary retirement scheme (VRS)	It applies to an employee of the company or the authority, as the case may be, who has completed 10 years of service or completed 40 years of age. 1. Amount Actually received 2. Amount specified by government i.e. Rs. 5 lakh 3. One of the condition is the amount payable on account of voluntary retirement or voluntary separation of the employees does not exceed (a) the amount equivalent to three month's salary for each completed year of service, or (b) the salary at the time of retirement multiplied by the balance months service left before the dated of his retirement on superannuation, whichever is more. Relief section 89 is not available.
Salary from UNO	Not chargeable to tax.

Illustration 1. A is Product (Head) of Z ltd. He retires on November 30, 2020 after service of 25 years and 11

months. At the time of retirement he has been paid Rs. 2, 50,000 as gratuity, although Z Ltd. Is covered by Payment of Gratuity Act 1972. Find gratuity taxable for assessment year 2021-22.

The following additional information is also provided:

1. Salary And Allowances

a.	Basic salary and allowances	Rs. 9,000 per month
b.	Month from which increment is allowed	July
c.	Amount of last increment	Rs. 1,000
d.	Commission (fixed on per month basis)	Rs. 500

2. Besides, he gets 0.5 percent commission on turnover achieved by his department. Turnover for different months is as under:

a.	January 2020	Rs. 80,000
b.	February 2020	Rs. 90,000
c.	March 2020	Rs. 60,000
d.	April 2020 to June 2020	Rs. 4,00,000
e.	July 2020 to October 2020	Rs. 5,00,000
f.	November 2020	Rs. 1,00,000

3. As per service rules, salary and commission becomes due on first day of the next month and paid on the same day.

Solution:

Basic salary from January to June 2020 (Rs. 8000 x 6)	Rs. 48,000
Basic salary from July to October 2020 (Rs. 9000x 4)	Rs. 36,000
Fixed Commission	Nil
0.5% Commission on turnover during January to October 2020	
(0.5% of Rs. 11, 30,000)	Rs. 5,650
Total	Rs. 89,650
Average	Rs. 8,965.50

Computation of exemption under section 10(10) (iii)

Out of Rs. 2, 50,000, the least of following is exempt:

a. Rs. 20,00,000

b. Rs. 134482 [Rs. 8965.50 x26 (15/26)]) or

c. Rs. 2,50,000

Gratuity Amount chargeable to tax is Rs. 115518

ALLOWANCES

Allowance means the fixed sum paid by employer to employee to meet official or personal expenses. Different types of allowances are given to employees by their employers. Generally allowances are given to employees to meet some particular requirements like house rent, expenses on uniform, conveyance etc. Under the Income-tax Act, 1961, allowance is taxable on due or receipt basis, whichever is earlier. Various types of allowances normally in vogue are discussed below :

Allowances		
Fully Taxable	**Partly Taxable**	**Fully Exempt**
(i) Entertainment Allowance (ii) Dearness Allowance (iii) Overtime Allowance (iv) Fixed Medical Allowance (v) City Compensatory Allowance (to meet increased cost of living in cities) (vi) Interim Allowance (vii) Servant Allowance (viii) Project Allowance (ix) Tiffin/Lunch/Dinner (x) Any other cash Allowance (xi) Warden Allowance (xii) Non-practicing Allowance	(i) House Rent Allowance [u/s 10(13A)] (ii) Special Allowances [u/s 10(14)]	(i) Allowances to High Court Judges (ii) Allowance paid by the United Nations Organization. (iii) Compensatory Allowance received by a judge (iv) Sumptuary allowance granted to High Court or Supreme Court Judges (v) Allowance granted to Government employees outside India.

Note: If the assessee opted concessional tax slab under section 115BAC of the Income tax Act, 1961, then assessee is not eligible to claim exemption from any allowances except:

1. Travelling Allowances
2. Daily Allowances
3. Conveyance Allowance
4. Transport Allowance(For blind, handicapped, deaf or dumb employee)

(A) Allowances which are fully taxable

(1) City compensatory allowance: City Compensatory Allowance is normally intended to compensate the employees for the higher cost of living in cities. It is taxable irrespective of the fact whether it is given as compensation for performing his duties in a particular place or under special circumstances.

(2) Entertainment allowance: This allowance is given to employees to meet the expenses towards hospitality in receiving customers etc. The Act gives a deduction towards entertainment allowance only to a Government employee. In the case of government employees (only Central Government and State Government), First included in salary and there after least of following is deductible;

   1. Rs. 5000;
   2. 20 per cent of basic salary; or
   3. Entertainment allowance.

(3) Non government employees (including employees of statutory corporation and local authority): nothing is allowed as deduction

Partially exempt or fully exempt allowances on satisfaction of the prescribed conditions [Section 10(14)]

Certain allowances are exempt upto the amount spent for specified purposes i.e. exemption would be lower of the actual allowance or amount spent for specified purposes –

Allowances prescribed for the purposes of section 10(14)(i)

(a) any allowance granted to meet the cost of travel on tour or on transfer (Travelling Allowance);

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

(b) any allowance, whether granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty;

(c) any allowance granted to meet the expenditure incurred on conveyance in performance of duties of an office or employment of profit (Conveyance Allowance);

(d) any allowance granted to meet the expenditure incurred on a helper where such helper is engaged in the performance of the duties of an office or employment of profit (Helper Allowance);

(e) any allowance granted for encouraging the academic research and training pursuits in educational and research institutions;

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

Certain allowances are exempt upto the amount specified by Government i.e. exemption would be lower of the actual allowance or amount specified by Government.

S. No.	Name of Allowance	Extent to which allowance is exempt
1.	Any Special Compensatory Allowance in the nature of Special Compensatory (Hilly Areas) Allowance or High Altitude Allowance or Uncongenial Climate Allowance or Snow Bound Area Allowance or Avalanche Allowance	Rs. 800 or Rs. 7,000 or Rs. 300 per month depending upon the specified locations
2.	Any Special Compensatory Allowance in the nature of border area allowance or remote locality allowance or difficult area allowance or disturbed area allowance	Rs. 1,300 or Rs. 1,100 or Rs. 1,050 or Rs. 750 or Rs. 300 or Rs. 200 per month depending upon the specified locations.
3.	Special Compensatory (Tribal Areas / Schedule Areas / Agency Areas) Allowance	Rs. 200 per month.
4.	Allowance for transport employees	70% of such allowance upto a maximum of Rs. 10,000 per month.
5.	Children Education Allowance	Rs. 100 per month per child upto a maximum of two children.

6.	Hostel expenditure allowance	Rs. 300 per month per child upto a maximum of two children.
7.	Compensatory Field Area Allowance	Rs. 2,600 per month in specified areas.
8.	Compensatory Modified Field Area Allowance	Rs. 1,000 per month in specified areas.
9.	Transport allowance	Rs. 3200 per month in the case of an employee who is blind or orthopedically handicapped employee with disability of lower extremities or deaf and dump
10.	Underground Allowance would be granted to an employee who is working in uncongenial, unnatural climate in underground mines. This is applicable to whole of India.	Rs. 800 per month

House rent allowance	**Exempt from tax to the extent of the least of the following:** 1. 50 per cent of salary in Delhi Mumbai Kolkata Chennai or 40 per cent of salary in other cases; 2. House rent allowance; or 3. The excess of rent paid over 10 per cent of salary **Taxable HRA** = Actual HRA – Exemption (a) Exemption not available to an assessee who lives in his own house, or in a house for which he has not incurred the expenditure of rent. (b) Salary for this purpose means basic salary, dearness allowance, if provided in terms of employment and commission as a fixed percentage of turnover. (c) Salary determined on due basis. [Explanation (ii) to rule 2A] **Mode of computation of Exemption**: The exemption depends on salary, HRA, rent paid and place where house is taken. If all these factors are same throughout the previous year the exemption should be calculated on "annual" basis otherwise monthly basis. No exemption if employee resides in his own house. Exemption is available even if the house is owned by close relative and for which rent is regularly paid (Bajrang Prasad Ramdharant v. CIT [2013] 60 SOT 66(Ahd.)

(B) Allowances which are fully exempt

(1) Allowance to High Court Judges: Any allowance paid to a Judge of a High Court under section 22A(2) of the High Court Judges (Conditions of Service) Act, 1954 is not taxable.

(2) Allowance received from United Nations Organisation (UNO): Allowance paid by the UNO to its employees is not taxable by virtue of section 2 of the United Nations (Privileges and Immunities) Act, 1947.

(3) Compensatory allowance under Article 222(2) of the Constitution: Compensatory allowance received by judge under Article 222(2) of the Constitution is not taxable since it is neither salary not perquisite.

(4) Sumptuary allowance: Sumptuary allowance given to High Court Judges under section 22C of the High Court Judges (Conditions of Service) Act, 1954 and Supreme Court Judges under section 23B of the Supreme Court Judges (Conditions of Service) Act, 1958 is not chargeable to tax.

(5) Allowances payable outside India [Section 10(7)]

Allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for services rendered outside India are exempt from tax.

Students may remember that in such cases under section 9(1)(iii), the income chargeable under the head 'Salaries' is deemed to accrue in India. The residential status of the recipient will, however, not affect this exemption.

<u>Exemption of specified allowances and perquisites paid to Chairman or a retired Chairman or any other member or retired member of the UPSC [Section 10(45)]</u>

(i) Under the Income-tax Act, 1961, perquisites and allowances received by an employee are taxable under the head "Salaries" unless they are specifically exempted.

(ii) Section 10(45) exempts specified allowances and perquisites received by Chairman or any other member, including retired Chairman/member, of the Union Public Service Commission (UPSC).

(iii) The exemption would be available in respect of such allowances and perquisites as may be notified by the Central Government in this behalf.

(iv) Accordingly, the Central Government has notified the following allowances and perquisites for serving Chairman and members of UPSC, for the purpose of exemption under section 10(45) -

(1) the value of rent free official residence,

(2) the value of conveyance facilities including transport allowance,

(3) the sumptuary allowance and

(4) the value of leave travel concession.

In case of retired Chairman and retired members of UPSC, the following have been notified for exemption under section 10(45):

(i) a sum of maximum Rs.14,000 per month for defraying the service of an orderly and for meeting expenses incurred towards secretarial assistance on contract basis.

(ii) the value of a residential telephone free of cost and the number of free calls to the extent of Rs.1,500 pm (over and above free calls per month allowed by the telephone authorities)

PERQUISITES

Perquisites are the benefits or amenities in cash or in kind, or in money or money's worth and also amenities which are not convertible into money, provided by the employer to the employee whether free of cost or at a concessional rate. Their value, to the extent these go to reduce the expenditure that the employee normally would have otherwise incurred in obtaining these benefits and amenities, is regarded as part of the taxable salary.

Taxable Perquisites: We need to understand the valuation of perquisites. The table appended below, summarises the taxable value of various perquisites in the hands of the employee assessees.

Sl. No.	Perquisite	Category of Employee	Value of perquisites
1	Rent Free Residential Accommodation	Government Employee	Licence Fee determined as per the Government Rules, as reduced by rent actually paid by the employee for unfurnished accommodation. For a furnished accommodation, 10% p.a. of the furniture cost is added to the value obtained above for unfurnished. In case the furniture is hired, the actual hire charges would be added to the value obtained above for unfurnished.
		Non-Government Employee	In case of Unfurnished Accommodation; (a) If the accommodation is owned by the employer, the value would be based on the population, i.e., (i) if in cities having a population of > 25 Lacs (2001 Census) - - 15% of Salary; (ii) if the population is between 10 Lacs up to 25 Lacs – 10% of Salary;
			(iii) else 7.5% of Salary (b) If the accommodation is taken on lease by the employer, the actual value of lease rentals paid by the employer subject to a maximum of 15% of Salary is considered as Value. For a furnished accommodation, 10% p.a. of the furniture cost is added to the value obtained above for unfurnished. In case the furniture is hired, the actual hire charges would be added to the value obtained above for unfurnished. In all cases, any amount recovered from the employee should be reduced to arrive at the taxable value of the perquisite Where the accommodation is provided by the employer in a hotel (except where the employee is provided such accommodation for a period not exceeding in aggregate 15 days on the transfer from one place to another): The perquisites value would be 24% of salary paid or payable for the previous year or the actual charges paid or payable to such hotel, which is lower, for the period during which such accommodation is provided as reduced by the rent, if any, actually paid or payable by the employees.
2	Interest Free / Concessional Loan	All employees	Where the employer grants a loan to an employee, exceeding INR 20000, the interest at the rate charged by SBI, as on the first date of the relevant PY, at maximum outstanding monthly balance as reduced by the Interest actually charged to the employee; would be the taxable value of the perquisite

3	Use of movable assets by employee / any member of his household	All employees	10% p.a. of the actual cost of the asset, if it is owned by the employer OR the actual hire charges incurred by the employer if the asset is hired as reduced by the amount, if any, paid or recovered from the employee for such use would be the taxable value of the perquisite. Note: Use of laptops and computers wouldn't attract taxability as perquisites.
4	Transfer of movable assets	All employees	If Computers / electronic items are transferred, 50% Depreciation p.a. (WDV) for every completed year of usage; if Motor cars are transferred, 20% Depreciation p.a. (WDV) for every completed year of usage; and for all other assets transferred, 10% Depreciation p.a. (WDV) for every completed year of usage would be treated as the taxable value of perquisite net of any amount so recovered from the employee
5	Provision of gas/electricity / water	All employees	The value of benefit to the employee resulting from the supply of gas, electric energy or water for his household consumption shall be determined as the sum equal to the amount paid on that account by the employer to the agency supplying the gas, electric energy or water. Where such supply is made from the sources owned by the employer, without purchasing them from any other outside agency, the value of perquisites would be the manufacturing cost per unit incurred by the employer. Where the employee is paying any amount in respect of such services, the amount so paid shall be deducted from the value so arrived at.
6	Provision of free / concessional educational facilities	All employees	Amount actually expended by the employer net of the amount so recovered. However, if the educational institution is owned by the employer, and free educational facilities are provided to the employee's children, there wouldn't be any perquisite as long as the value of benefit in a month is < INR 1000. Any amount recovered from the employee would be reduced.
7	Credit Card Expenses	All employees	Membership fees / Annual fees incurred by the employer, on a card provided to the employee, would be the taxable value of perquisite net of the amount, if any, recovered from him.
8	Club expenditure	All employees	Cost incurred by the employer at actual, net of recovery from the employee would be the taxable value of perquisite. However, in case the employee enjoys Corporate Membership in a club, the value of benefit wouldn't include the initial membership paid by the Employer to acquire the corporate membership
9	Health Club, Sports, Similar facilities	All employees	No perquisite if provided uniformly by the employer to all employees

10	Sweat Equity	All employees	In case where, on the date of exercising the option, the share of the company is listed on a recognised stock exchange, the fair market value (FMV) would be the average of the opening and closing price of the share on that date on the said stock exchange. If the shares of the company are listed on more than one stock exchange, the FMV would be the average of the opening and closing prices of the share on the recognised stock exchange which records the highest volume of trading in the share. In case on the date of the exercising of the option, if there was no trading in the share, the FMV would be the closing price on the recognised stock exchange, on a date closest to exercising the option, immediately before that date, and if the shares of the company are listed on more than one stock exchange, the FMV would be the closing price of the share on the recognised stock exchange which records the highest volume of trading in the share. In case the shares of the company are not listed on any recognised stock exchange, the FMV would be that as determined by the Merchant Banker on the specified date, i.e., the date of exercising the option or any date earlier not exceeding 180 days prior to the date of exercise of the option.

Motor Cars

The taxable value of use of motor cars are dealt with separately, as it is situational, as under:

Where the Expenses are met by the employer

- ✓ If the Car is owned / hired by the employer; expenses met by the employer & is used by the employee wholly for Official purposes, there is no perquisite.
- ✓ If the Car is owned / hired by the employer; expenses met by the employer & is used by the employee wholly for Personal purposes, the running and maintenance charges / wear & tear / hire charges / driver's salary would be treated as the taxable value of the perquisite net of the amount so recovered from the employee.
- ✓ If the If the Car is owned / hired by the employer; expenses met by the employer & is used by the employee partly for Official and partly for Personal purposes, the taxable value of the perquisite would be based on the cc of the engine, as under:
  - o Up to 1.6 litres, the taxable value of the perquisite would be INR 1800 pm
  - o > 1.6 litres, the taxable value of the perquisite would be INR 2400 pm
  - o If chauffer is also provided, INR 900 pm is to be added to either of the above, depending on the engine capacity
- ✓ If the Car is owned / hired by the employee; expenses met by the employer & is used by the employee wholly for Official purposes, there is no perquisite.
- ✓ If the Car is owned / hired by the employee; expenses met by the employer & is used by the employee wholly for Personal purposes, the actual expenditure so incurred would be treated as the taxable value of the perquisite.
- ✓ If the Car is owned / hired by the employee; expenses met by the employer & is used by the employee

partly for Official and partly for Personal purposes, the taxable value of the perquisite would be the actual expenditure incurred by the employer as reduced by the taxable value of the perquisite determined above basis the engine capacity.

Where the Expenses are met by the employee

- ✓ If the Car is owned / hired by the employer; expenses met by the employee & is used by the employee wholly for Official purposes, there is no perquisite
- ✓ If the Car is owned / hired by the employer; expenses met by the employee & is used by the employee wholly for Personal purposes, the wear & tear / hire charges / driver's salary would be treated as the taxable value of the perquisite
- ✓ If the If the Car is owned / hired by the employer; expenses met by the employee & is used by the employee partly for Official and partly for Personal purposes, the taxable value of the perquisite would be based on the cc of the engine, as under:
  - o Up to 1.6 litres, the taxable value of the perquisite would be INR 600 pm
  - o > 1.6 litres, the taxable value of the perquisite would be INR 900 pm
  - o If chauffer is also provided, INR 900 pm is to be added to either of the above, depending on the engine capacity

Tax-free perquisites (in all cases)

The value of the following perquisites is not to be included in the salary income of an employee:

Medical Facilities:

(a) The value of any Medical facility provided to an employee or his family member in any hospitals, clinics, etc. maintained by the employer.

(b) Reimbursement of expenditure actually incurred by the employee on medical treatment for self or for his family members in any hospitals, dispensaries etc. maintained by the Government or local authority or in a hospital approved under the Central Health Scheme or any similar scheme of the state Government or in a hospital, approved by the chief commissioner having regard to the prescribed guidelines for the purposes of medical treatment of the prescribed diseases or ailments.

(c) Group medical insurance obtained by the employer for his employees (including family members of the employees) or all medical insurance payments made directly or reimbursement of insurance premium to such employees who take such insurance.

(d) Reimbursement of medical expenses actually incurred by the employee up to a maximum of Rs. 15,000 in the aggregate in a year, in a private hospital for his and his family.

(e) Any expenditure incurred or paid by the employer on the medical treatment of the employee or any family member of the employee outside India, the travel and stay abroad of such employee or any family member of such employee or any travel or stay abroad of one attendant who accompanies the patient in connection with such treatment will not be included in perquisites of the employee. However, the travel expenditure shall be excluded from the perquisites only when the employee's gross total income as computed before including the said expenditure does not exceed two lakh rupees and further to such conditions and limits as the Board may prescribe having regard to guidelines, if any, issued by the Reserve Bank of India.

Refreshment:

The value of refreshment provided by the employer during office hours and in office premises is fully exempt

Subsidized lunch or dinner provided by employer is exempt

Recreational facilities:

The value of recreational facilities provided is exempt. However, the facility should not be restricted to a selected few.

Telephone facility provided at the residence of the employee is exempt to the extent of the amount of telephone bills paid by the employer when it is used for official and personal purposes of the employee.

Transport provided by the employer to the employees as a group (and not to any individual or a few employees alone) from their place of residence to the place of work and back in the case of an employer engaged in the business of carriage of goods or passengers, to his employees either free of charge or at a concessional rate. Also from the assessment year 1990-91, conveyance facility provided for the journey between office and residence and back at free of charge or at concessional rate.

Personal accident insurance, i.e. payment of annual premium by employer on personal accident policy effected by him to his employee

Refresher Course: Where the employee attends any refresher course in management and the fees are paid by the employer, the amount spent by employer for the purpose.

Free rations: The value of free rations given to the armed forces personnel.

Computer/laptops provided only for use, ownership is retained by the employer

Rent free houses / conveyance to High Court & Supreme Court Judges

Employers' Contribution to Group Insurance Schemes, to recognised Provident Funds

Annual Premium by employer on policy taken on life of employee

DEDUCTION [SECTION 16]

(I) Standard Deduction [Section 16(ia)]: Standard deduction of Rs. 50,000 (fifty thousand) or the amount of the salary, whichever is less w.e.f. Assessment Year 2021-22.

(II) Entertainment Allowance [Section 16(ii)]: Deduction of the least of the following shall be allowed to Government Employees only;

- 20% of basic salary;
- Rs.5000
- Actual allowance

(III) Professional Tax [Section 16(iii)]: Deduction is allowed in the year of payment. If paid by employer, then first include in salary as a perquisite and then a deduction shall be allowed.

Note: The deduction u/s 16(ia), 16(ii), 16(iii) not available for assessee opted for section 115BAC of the Income Tax Act, 1961]

RELIEF [SECTION 89]

(1) On account of arrears of salary or advance salary: Where by reason of any portion of an assessee's salary being paid in arrears or in advance or by reason of his having received in any one financial year, salary for more than twelve months or a payment of profit in lieu of salary under section 17(3), his income is assessed at a rate higher than that at which it would otherwise have been assessed, the Assessing Officer shall, on an application made to him in this behalf, grant such relief as prescribed. The procedure for computing the relief is given in Rule 21A.

(2) On account of family pension: Similar tax relief is extended to assessees who receive arrears of family pension as defined in the Explanation to clause (iia) of section 57.

"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.

No relief at the time of Voluntary retirement or termination of service: No relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or a scheme of voluntary separation (in the case of a public sector company), if exemption under section 10(10C) in respect of such compensation received on voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee in respect of the same assessment year or any other assessment year.

Illustration 1:

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

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

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

Solution:

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

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

(a) the actual amount received (Rs. 900 × 12) = Rs.10,800

(b) excess of the actual rent paid by the assessee over 10% of his salary

= Rent Paid - 10% of salary for the relevant period

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

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

= 40% of [(Rs. 3,000+ Rs. 600) × 12] = Rs.17,280

Note: For the purpose of exemption under section 10(13A), salary includes dearness allowance only when the terms of employment so provide, but excludes all other allowances and perquisites.

Illustration 2:

Ruchira, an employee of a management consultancy firm, was sent to UK in connection with a project of the firm's client for two months in the previous year. In addition to her salary, the firm paid per diem allowance for the period when she worked in UK to meet expenses on boarding and lodging. Tax was not deducted at source from such allowance by the employer. Ruchira did not include such allowance in computation of her taxable salary for the relevant assessment year. In course of assessment of Ruchira under section 143(3), the Assessing Officer sent a notice to her asking him to explain why the per diem allowance received by her should not be charged to tax? Ruchira has sought your advice.

Solution:

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

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

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

Illustration 3:

Mr. E is a Finance Manager in ABC Ltd. The company has provided him with rent-free unfurnished accommodation in Mumbai. He gives you the following particulars:

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

Even though the company allotted the house to him on 1.4.2020, he occupied the same only from 1.11.2020. Calculate the taxable value of the perquisite for A.Y. 2021-22.

Solution:

Value of the rent free unfurnished accommodation

= 15% of salary for the relevant period

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

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

Note: Since, Mr. E occupies the house only from 1.11.2020, we have to include the salary due to him only in respect of months during which he has occupied the accommodation. Hence salary for 5 months (i.e. from 1.11.2020 to 31.03.2021) will be considered.

CASE STUDY

1. Ranjit has taken an interest-free loan of Rs. 10 lacs from his company. The amount is utilized by him for purchasing a house on 30-06-2018. The house is self-occupied. As per the scheme of the company, loan would be recovered in 40 equal monthly instalments recoverable immediately after the completion of 18th month from the date of purchase. Assuming the SBI lending rate of similar loan on 1.4.2019 was 9.75%. Calculate the perquisite value of such loan in the hands of Ranjit for the assessment year 2021-22. Is it possible to get deduction of perquisite value of interest under section 24(b)? Does it make any difference, if the house is given on rent?

Solution

First instalment will be due on 1st January, 2020. Amount of instalment will be:

Rs. 10,00,000 ÷ 40 = Rs. 25,000.

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

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

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

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

Answer

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

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

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

3. Examine the correctness or otherwise of the following case in the context of provisions contained in the Income-tax Act, 1961 relevant/applicable for the assessment year 2021-22:

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

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

Answer

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

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

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

4. Can the limit of Rs. 1,000 per month per child be allowed as standard deduction, while computing the perquisite value of free or concessional education facility provided to the employee by the employer?

Solution

CIT (TDS) v. Director, Delhi Public School (2011) 202 Taxman 318 (Punj. & Har.) As per the provisions of Rule 3(5) of the Income-tax Rules, 1962, in case an educational institution is maintained and owned by the employer and free or concessional education facility is provided to the employees' household in such institution, then, the cost of education in a similar institution in or near the locality shall be taken to be the value of perquisite in the hands of the employee. In case the cost of such education or the value of benefit does not exceed

Rs. 1,000 per month per child, the perquisite value shall be taken to be Nil.

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

<u>**High Court's Decision**</u>**:** The Punjab and Haryana High Court, in the above case, held that on a plain reading of Rule 3(5), it flows that, in case the value of perquisite for free/concessional educational facility arising to an employee **exceeds Rs. 1,000 per month per child, the whole perquisite shall be taxable in the hands of the employee and no standard deduction of**

Rs. 1,000 per month per child can be provided from the same. It is only in case the perquisite value is less than Rs. 1,000 per month per child, the perquisite value shall be nil. Therefore,

Rs. 1,000 per month per child is not a standard deduction to be provided while calculating such a perquisite.

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

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

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

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

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

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

LESSON ROUND UP

– Basis of Charge: As per section 15, salary is taxable on due or receipt basis whichever is earlier. Under Section 15 the income chargeable to income tax under the head salaries would include any salary due to an employee from an employer or a former employer during the previous year irrespective of the fact whether it is paid or not.

- Different forms of salary:

  (A) Basic Salary: Basic salary is taxable in the hands of an employee.

  (B) Allowance: An allowance is defined as a fixed amount of money given periodically in addition to the salary for the purpose of meeting some specific requirements connected with the service rendered by the employee or by way of compensation for some unusual conditions of employment. It is taxable on due/accrued basis whether it is paid in addition to the salary or in lieu thereon.

  (C) Perquisites: The term "perquisites" includes all benefits and amenities provided by the employer to the employee in addition to salary and wages either in cash or in kind which are convertible into money. These benefits or amenities may be provided either voluntarily or under service contract. For income-tax purposes, the perquisites are of three types:

    (i) Tax-free perquisites

    (ii) Taxable perquisites

    (iii) Perquisites taxable under specified cases.

– Valuation of perquisites: The basic principles governing valuation of perquisites are as follows:

– The valuation is done on the basis of their value to the employee and not the employer's cost for providing the same - Wilkins v. Rogerson (1963) 49 ITR 395 (CA).

– The value of perquisite is included in the salary income only if the perquisite is actually provided to the employee.

– Perquisite which is not actually enjoyed by the employee (though the terms of employment provide for the same) cannot be valued and taxed in the employee's hands. Therefore, where the employee waives his right of perquisite, he cannot be taxed thereon.

- Allowable deductions under the head Salaries: The following amounts shall be deducted in order to arrive at the chargeable income under the head "Salaries".

  (A) Standard deduction: Rs. 50,000 or Salary Income whichever is less

  (B) Entertainment allowance

  (C) Tax on employment or Professional Tax

TEST YOURSELF

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

SHORT NOTES

1. Profit in lieu of salary
2. Entertainment Allowance
3. Leave Travel Concession

DISTINGUISH BETWEEN

1. Statutory provident fund' and 'public provident fund'.
2. House Rent Allowance and Rent Free Accommodation.
3. Allowances and Perquisites.

PRACTICAL QUESTIONS

1. Aniket is an employee of ABC Ltd. He was appointed on 1st March, 2020 at a scale of 50000 – 5000 – 70000. He is paid DA (which form part of retirement benefits) @ 15% of Basic Pay and Bonus equivalent to 2 months' salary at end of FY. He contributes 18% of his Basic + DA to a recognised provident fund, and the contribution is matched by the employer.

   He is provided rent free accommodation, hired by the employer, @ 25000 pm. He is also provided the following benefits / amenities:

   (a) Medical Treatment of his dependant spouse INR 40000

   (b) Monthly salary to housekeeper INR 4000

   (c) Telephone Allowance INR 1200 pm

   (d) Gift Voucher of INR 4500 on account of his marriage anniversary

   (e) Medical Insurance Premium for Aniket, paid by his employer INR 15000

   (f) Motor Car owned and driven by Aniket, and engine capacity within 1.6 L; used partly for official and partly for personal purposes. Running & maintenance expenses borne by the employer INR 36,600/-.

   (g) Lunch during office hours valued at INR 2200/-.

He was also allotted 2000 sweat equity shares in September 2020. The shares were allotted @ INR 227 per share against the FMV of INR 377 per share as on the date of exercise of the Option.

Compute the Salary Chargeable to tax assuming Aniket has not opted for Section 115BAC of the Act.

2. Anand is entitled to get a pension of Rs. 600 per month from a private company. He gets three-fifth of the pension commuted and received Rs. 36,000. He did not receive gratuity. The taxable portion of commuted value of pension is –

3. Sneha is an employee in a private company. In the previous year she received salary Rs.1,80,000 and entertainment allowance Rs.12,000. She spent Rs.6,000 on entertainment. Under section 16(ii), she is entitled to deduction of -

4. Interest-free loan to an employee, where the amount of loan does not exceed any one of the following, shall be treated as the tax-free perquisite in all cases under section 17(2) -

5. The maximum exemption in respect of transport allowance granted to an employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty shall be -

Answers:

1. Rs. 13,62,918
2. Rs. 6000
3. Nil
4. Rs. 20000
5. Nil

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 3

Computation of Income under the Head of House Property [Section 22 to 27]

LESSON OUTLINE

- Introduction
- Impact of Section 115BAC under the head House Property
- Basis of Charge [Section 22]
- Property held as stock in trade
- Taxation of Income from house properties situated outside India
- Disputed Ownership
- Treatment of Composite Rent
- Cases where Income from House Property exempt from tax
- Deemed Ownership [Section 27]
- How to compute income from House Property
- Determination of Annual Value [Section 23]
- Municipal Taxes
- Computation of Income from House Property for different categories of property
- Deduction [Section 24]
- Taxability of Recovery of Unrealised Rent & Arrears of Rent received
- Inadmissible Deduction
- Treatment of Income from co-owned property [Section 26]
- Treatment of Income from House Property owned by a partnership firm
- Case Study
- LESSON ROUND UP
- TEST YOURSELF

LEARNING OBJECTIVES

The provisions for computation of Income from house property are covered under sections 22 to 27. This chapter deals with the provisions for computation of Income from house property. Section 22 is the charging section that identifies the basis of charge wherein the annual value is prescribed as the basis for computation of Income from House Property. The process of computation of "Income from House Property" starts with the determination of annual value of the property.

The concept of annual value and the method of determination are laid down in section 23. The admissible deductions available from house property are mentioned in section 24.

At the end of this lesson, students will be able to understand the conditions to be satisfied for income to be chargeable under the head house property, how to determine the annual value of different type of house properties, admissible deductions and inadmissible deductions from annual value, tax treatment of unrealized rent, who are deemed owners, what is meant by co-ownership and what is its tax treatment etc.

KEY SECTIONS

SECTION	PARTICULARS	
22	Income from House Property (Charging Section - Basis of Charge)	
23	Annual value of House Property	
24	Deductions from income from House Property	
25	Amounts not deductible from income from House Property	
25A	Special provision for arrears of rent and unrealized rent received subsequently	
26	Property owned by Co-owners	
27	"Owner of house property", "annual charge", etc., defined. (Deemed Owner)	
KEY RULES		
INCOME-TAX RULES, 1962		
Rule	Particulars	Read with
4	Unrealized rent	Section 23

INTRODUCTION

Income from house property is one of the important heads of income under the Income Tax Act. The tax payers have been, in particular, keen to know about the exemptions and deductions available to them on repayment of interest and principal of the loan obtained to purchase the house property, if that house property is let out or self-occupied. The amount of interest on borrowed capital of the current year is available under the head house property further repayment of principal is available under section 8oC to Individuals and Hindu Undivided Families. Tax levied under section 22 is based on Principle of Mutuality i.e. tax on income from house property and it is not a tax on house property.

Impact of Section 115BAC under the head House Property [Amendment vide Finance Act, 2020]

Finance Act, 2020 has introduced a New Optional Tax System for Individuals and HUFs u/s 115BAC of the Income Tax Act, 1961 w.e.f. A/Y 21-22 to provide for concessional rate of Slab Rates to be applied on Total Income calculated without claiming specified deductions and exemptions.

Hence, from AY 2021-22 or FY 2020-21, there are two operative tax system –

1. One is the Existing tax system where all the applicable deductions and exemptions are allowed and the tax rates are as per the Slab rates of tax specified in the Finance Act, 2020.
2. The second one is section 115BAC which is an Optional Tax System and under which many deductions and exemptions have not been allowed but lower slab tax rates are provided in the section 115BAC itself.

Individual and HUF opting for concessional tax regime under section 115BAC: The deduction under Chapter VI-A other than the provisions of sub-section (2) of section 80CCD or section 80JJAA; not available to the Individual and HUF opting to pay tax under concessional tax regime under section 115BAC of the Income Tax Act, 1961.

Many exemptions & deduction are not allowed under the new tax system. The below chart contains the exemptions and deduction not available under the new system related to Income under the head house property. Similarly, deductions & exemptions not available under the new tax system and which are related to other heads are provided in other chapters.

Sr. No.	Nature of Exemption/Deduction Relating to Head House Property	New System of Tax u/s 115BAC	Existing system of Tax
1.	Deduction of Municipal tax from GAV	Allowed	Allowed
2.	Standard Deduction u/s 24(a) from NAV	Allowed	Allowed
3.	Interest Deduction u/s 24(b) from NAV		
	(a) Let out properties u/s 23(1)	Allowed	Allowed
	(b) Self residential Property u/s 23(2)	Not Allowed	Allowed
	(c) Property which is stock in trade u/s 23(5)	Allowed	Allowed
4.	Set off of brought forward House Property losses & brought forward Depreciation from Current year House Property Income	Not Allowed if related to disallowed deduction & exemptions	Allowed

5.	Set off current year House Property loss from other heads	Not Allowed	Allowed

BASIS OF CHARGE [SECTION 22]

If all the following three conditions are satisfied then the property income will be chargeable to tax under the head Income from House Property.

1. Property should consist of any BUILDING* or land appurtenant (means land connected with the building like garden, garage etc.) thereto.

   ***Building** means a permanent structure made of bricks, stones, concrete etc. and which has a foundation, walls and doors . It does not include temporary structures.

2. Assessee must be the owner of the property.

   Notes:

   - Assessee need not to be a Registered owner.
   - Ownership includes both leasehold and freehold rights and also includes deemed ownership. [Section 27]
   - Assessee must be owner of the property during the previous year. It is not material whether he is the owner in the Assessment Year.
   - If the title of the ownership of the property is under dispute in a court of law, the decision as to who will be the owner chargeable to income-tax under section 22 will be of the Income-tax Department till the court gives its decision to the suit filed in respect of such property.

3. The property should not be used by the owner for the purpose of any business or profession carried on by him, the profit of which is chargeable to tax. The income earned by an assessee engaged in the business of letting out of properties on rent would also be taxable as business income and not as income from house property [Rayala Corporation (P) Ltd. v. Asstt. CIT (SC) (2016) 386 ITR 500].

If all the above three conditions are satisfied then the property income will be chargeable to tax under the head Income from House Property.

Points to remember:

1. Income from subletting of house property will be taxable under the head “Income from other Sources”.
2. Income from vacant plot is taxable under the head “Income from other Sources”.
3. Income from display of advertisement on the roof of building will be taxable under the head income from other sources and not under the head house property because section 22 conditions are not satisfied.

Exceptions

- Income from letting out a vacant land is chargeable to tax under the head “**Income From Other Sources**”
- Income earned by an assessee who is engaged in the business of letting out properties on rent, would be chargeable to tax under the head “**Profits / Gains from Business / Profession**”

PROPERTY HELD AS A STOCK IN TRADE [SECTION 23(5)]

Property constitutes stock in trade of the business, then income is to be charged only under the head "Income from House Property", till the time they are unsold.

Where the property consisting of any building or land appurtenant thereto is held as stock-in-trade and the property or **any part of the property is not let during the whole or any part of the previous year**, the annual value of such property or part of the property, for the period up to 1 year from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, shall be taken to be *nil*.

Exceptions: If the letting out is supplementary to the main business, then rental income is taxable as Business Income. Deductions or allowances from such income have to calculated as relating to PGBP and not relating to House Property.

TAXATION OF INCOME FROM PROPERTIES SITUATED OUTSIDE INDIA

Income from properties situated outside India is liable for taxation in India if -

1. The owner of the property is resident in India; or
2. The owner of the property is non-resident or not ordinarily resident in India and the income from such property is received in India.

Note:

- The municipal taxes paid outside India shall be deductible **if such taxes have been actually paid by the assessee during the previous year**.
- The annual value of such property would be computed as if the property is situated in India.

DISPUTED OWNERSHIP

- If title of ownership of a house property is under dispute in a court of law, the decision about who is owner rests with department.
- Assessment cannot be postponed due to mere dispute regarding the title of property.
- Generally the person who is in receipt of income or person who enjoys possession of house property as owner, though his claim is disputed, is assessable to tax u/s 22.

TREATMENT OF COMPOSITE RENT

Meaning of Composite Rent:

- Composite rent means the rent charged not only for the property to be let out but also for the other facilities like furniture, Lift, Security, Power Back-up etc.

Tax Treatment of Composite Rent

1. **Composite letting separable**:
   - Where composite rent is rent of letting out of building and letting out of other assets and two letting are separable i.e. letting out of one is acceptable to the other party without letting out of the other,
     - ✓ **The sum which is attributable to property is to be assessed in form of annual value u/s 22** and
     - ✓ **The sum which is attributable to other charges is assessed under PGBP or Other sources**.

Note:

Rent received from paying guest is taxable under the head 'Income from other sources'.

2. **Composite letting not separable:**

   ✓ Where composite rent is rent of letting out of building and letting out of other assets and two letting are **not separable**, then

   ✓ The income will be assessable **either under PGBP or Income from other sources** even if the composite rent is segregable. (i.e. if sum receivable for the two lettings is fixed separately)

CASES WHERE INCOME FROM HOUSE PROPERTY IS EXEMPT FROM TAX

Sl. No.	Section	Particulars
1	10(1) read with section. 2(1A)(c)	Income from any farm house forming part of agricultural income.
2	10(19A)	Annual value of any one palace in the occupation of an ex-ruler. (*If the ex-ruler has a house property which partly let out and partly self occupied, then only* ***the self occupied part of the house property shall be exempted***)
3	10(20)	Income from house property of a local authority.
4	10(21)	Income from house property of an approved scientific research association.
5	10(23B)	Institution for development of khadi and village industries.
6	10(23BB)	Khadi and Village Industries Board.
7	10(23BBA)	A body or Authority for administering religious or charitable trusts or endowments
8	10(23C)	Property income of universities, educational institutions, etc.
9	10(24)	Property income of any registered trade union.
10	10(26B)	Statutory Corporation or an institution/ Association financed by the government for promoting the interest of members of SC or ST
11	10(27)	Co-operative Society for promoting the interest of the members of SC or ST
12	11	Income from house property held for charitable or religious purpose.
13	13A	Property income of any political party.
14	22	Property used for own business or profession
15	23(2)	Two self-occupied property of an individual/HUF

DEEMED OWNER [SECTION 27]

In certain cases the legal ownership may vest with one person whereas the taxability is cast on another person who is deemed to be the owner.

1. An individual who transfers otherwise than for adequate consideration any house property;

   a. to his or her spouse (not being a transfer in connection with an agreement to live apart) or

   b. to a minor child (not being a married daughter);

2. The holder of an impartible estate (**i.e. Deemed owner of all the properties comprised in the estate**)

[*Impartible estate means a property which is not legally divisible*]

3. A member of a Co-operative society, Company or other Association of persons to whom a building or a part or leased under a house building scheme of the society, company or association;

4. A person who is allowed to take or retain possession of any building or part thereof in part performance of nature referred to in section 53A of the Transfer of Property Act, 1882;

   This would include cases where the –

   (i) possession of property has been handed over to the buyer

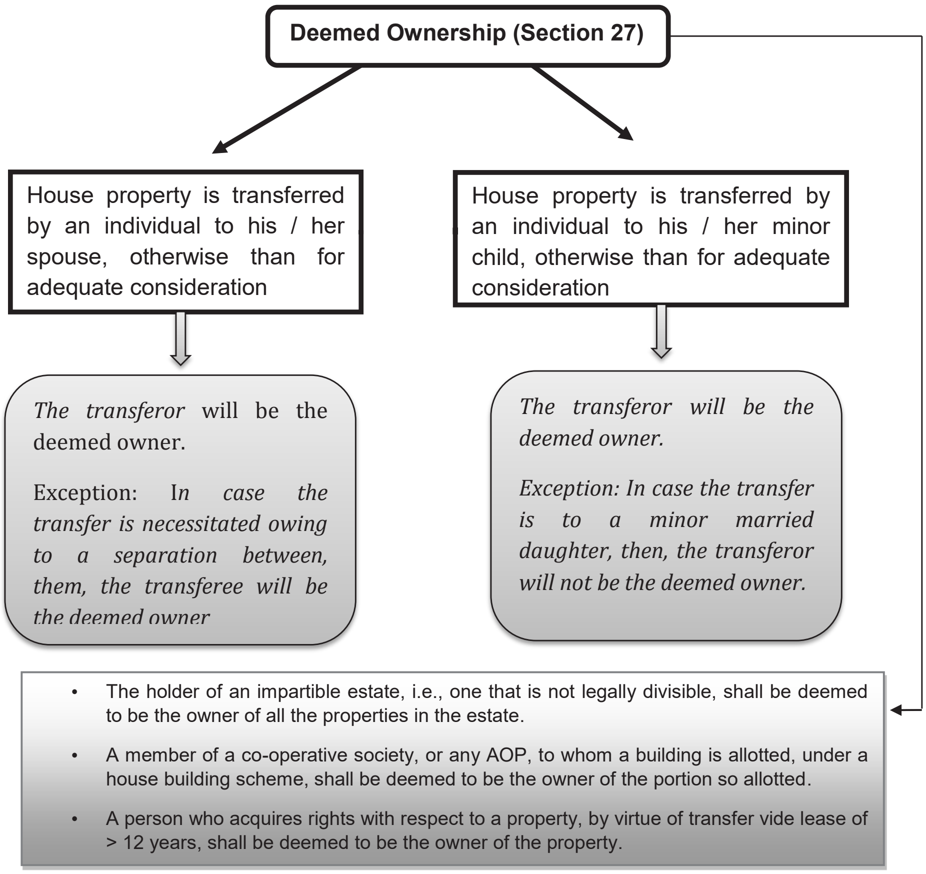
   (ii) sale consideration has been paid or promised to be paid to the seller by the buyer sale deed has not been executed in favour of the buyer, although certain other documents like power of attorney/ agreement to sell/will etc. have been executed.

5. A person who acquires any rights (excluding any rights by way of lease from month to month or for a period of one year) 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 of such property by way of sale or exchange or lease for a term of not less than twelve years.).

IMPORTANT ISSUES

a) House property is owned by the assessee, but it is used by the firm in which he is a partner, and he not derived any benefit from the firm. It is deemed that the partner is using the property for his own business, and hence not taxable under "income from House Property".

b) When property is owned by HUF, but used by the firm in which all the members are partners, income will be assessed in the hands of HUF as House Property.



Annual value how determined [Section 23]	
Section 23(1)	Let out properties
Section 23(2)(a)	Self-occupied property (i.e. purposes of his own residence)
Section 23(2)(b)	Property not actually occupied by the owner (by reason of the fact that owing to his employment, business or profession carried on at any other place)
Section 23(3)	Partly let out and partly self occupied property
Section 23(4)	Deemed to be let out property

HOW TO COMPUTE INCOME FROM HOUSE PROPERTY

Particulars		Let Out/Deemed to be let out
Gross Annual Value (GAV)		xxxx
Less: Property taxes paid to local authority		(xxxx)
Net Annual Value (NAV)		xxxx
Less: Deductions u/s. 24		
a) 30% of the net annual value	**xxxx**	
b) Interest on capital borrowed (loans) paid or payable	**xxxx**	(xxxx)
Income from house property(computed)		Xxxx

DETERMINATION OF ANNUAL VALUE [SECTION 23]

This involves following steps:

Step 1- Determination of Expected Rent

Fair Rent	xxx
Municipal Valuation	xxx
(a or b) whichever is higher	xxx
Standard Rent	xxx
(c or d)whichever is less is Expected Rent [ER]	xxx

Note: 1

Fair Rent or Notional rent

- It can be determined on the basis of rent fetched by similar property in the same or similar locality.

Municipal Valuation:

- For collecting municipal taxes, local authorities make a periodical survey of all building in their jurisdiction. Such valuation may be taken as a strong evidence representing the earning capacity of a building.

Standard Rent under Rent Control Acts:

- Standard rent is the maximum rent which a person can legally recover from his tenant under Rent Control Act.
- **Reasonable Expected Rent cannot exceed Standard Rent but can be lower than Standard Rent.**

Step 2-Determination of Rent actually received or receivable:(De-facto rent of the property)

It is calculated as follows:-

Rent of the previous year (or that part of the previous year) for which the property is available for letting out	****
Less: Unrealised rent if few conditions are satisfied**	(****)
Rent Received or receivable before deducting loss due to vacancy	****
Less: Loss due to vacancy	(****)
Rent received or receivable after loss due to vacancy	****

If actual rent received or receivable after LDV is higher than ERR, then **GAV= ARR(-) UR(-) LDV**

But if ARR after deducting UR and LDV is less than ER, then Step 3

Step 3-

1. If ARR after deducting UR and LDV is less than ER, due to loss due to vacancy only, then: GAV= ARR(-) UR(-)LDV
2. If ARR after deducting UR and LDV is less than ER, due to vacancy and other factors, then: GAV= ER(-) LDV
3. If ARR after deducting UR and LDV is less than ER, due to other factors, then: GAV= ER

Note: 1

Treatment of unrealized rent [Explanation to section 23(1)] and Rule 4 of INCOME-TAX RULES, 1962

The Actual rent received/receivable should not include any amount of rent which is not capable of being realised. However the conditions prescribed in Rule 4 should be satisfied. They are

- the tenancy is bona fide;
- the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;
- the defaulting tenant is not in occupation of any other property of the assessee;
- the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

Step 4 From the GAV as computed above deduct Municipal tax paid by the owner during the previous year. The balance will be the Net Annual Value (NAV), which as per the Income-tax Act is the annual value.

MUNICIPAL TAXES [PROPERTY TAXES]

Municipal tax includes services related tax like Water tax and Sewerage Tax levied by any local authority in respect of any house property to the extent to which such taxes are borne and paid by the owner, and include enhanced municipal tax finally determined on appeal and payable by assessee - **Clive Buildings Cola Ltd. v. CIT (1989) 44 Taxman 160.** Property taxes are allowable as deduction from the GAV subject to the following two conditions:

i. It should be borne by the assessee & actually PAID during the previous year.
ii. It can be claimed as deduction only in respect of let-out or deemed to be let- out properties.
iii. Deduction is allowed in the year of payment only. (**i.e. Municipal tax paid in advance is not allowed as deduction**)

Where the tax on property is enhanced with retrospective effect by municipal or local authorities and the enhanced tax relating to the prior year is demanded during the assessment year, the entire demand is deductible in the assessment year **[C.I.T. v. L. Kuppu Swamy Chettiar (1981) 132 ITR 416 (Mad.)].**

Even where the property is situated outside the country taxes levied by local authority is that country are deductible is deciding the annual value of the property. **[CIT v. R Venugopala Riddiar (1965) 58 ITR 439 (Mad.)]**

COMPUTATION OF "INCOME FROM HOUSE PROPERTY" FOR DIFFERENT CATEGORIES OF PROPERTY

(I) PROPERTY LET OUT THROUGHOUT THE PREVIOUS YEAR

Particulars		Amount
Computation of GAV		
Step 1	Compute ER	
	ER = Higher of MV and FR, but restricted to SR	
Step 2	Compute Actual rent received/receivable	
	Actual rent received/receivable less unrealized rent as per Rule 4	
Step 3	Compare ER and Actual rent received/receivable	
Step 4	GAV is the higher of ER and Actual rent received/ receivable	
Gross Annual Value (GAV)		A
Less:	Municipal taxes (paid by the owner during the previous year)	B
Net Annual Value (NAV) = (A-B)		C
Less:	Deductions u/s 24	
	(a) 30% of NAV	D
	(b) Interest on borrowed capital (actual without any ceiling limit)	E
Income from house property (C-D-E)		F

Illustration 1 :

Mr. X is the owner of three houses, which are all let out and not governed by the Rent Control Act. From the following particulars find out the gross annual value in each case:

Particulars	I	II	III
Municipal Value	**30,000**	**20,000**	**35,000**
Actual (De facto) Rent	**32,000**	**28,000**	**30,000**
Fair Rent	**36,000**	**24,000**	**32,000**

Solution:

Gross Annual Value (GAV): Higher of Expected or Actual Rent **Expected Rent:** Higher of Municipal Valuation or Fair Rent

House I: Rs. 36,000

House II: Rs.24,000

House III: Rs. 35,000

Actual Rent (given) GAV:

House I: Rs. 36,000 House II: Rs. 28,000 House III: Rs. 35,000

Illustration 2:

Mr. X is the owner of four houses, which are all let out and are covered by the Rent Control Act. From the following particulars find out the gross annual value in each case, giving reasons for your answer:

Particulars	I	II	III	IV
Municipal Value	30,000	26,000	35,000	30,000
Actual (De Facto) Rent	40,000	30,000	32,000	32,000
Fair Rent	36,000	28,000	30,000	36,000
Standard Rent	30,000	35,000	36,000	40,000

Solution:

As all the houses are covered by the Rent Control Act, their gross annual value will be higher of expected Rent or Actual Rent. Expected Rent Shall be higher of Municipal Value or Fair rent but subject to Standard Rent:

Particulars	I	II	III	IV
Expected Rent	30,000	28,000	35,000	36,000
Actual (De Facto) Rent	40,000	30,000	32,000	32,000
G.A.V.	40,000	30,000	35,000	36,000

Annual letting value of self occupied property, subject to Rent Control Act is to be fixed on basis of standard rent and not on basis of open market **Tilak Raj v. CIT (1989) 45 Taxman 279/178 ITR 327 (Punj. & Har.).**

In determining annual value salary paid to caretaker cannot be taken into account

CIT v. Smt. Sreelekha Banerjee (1989) 45 Taxman 358/179 ITR 46 (Cal.).

Loss relating to self occupied house property could be set off against income from other sources **CIT v. K.K. Dhanda (HUF) (1989) 45 Taxman 346/178 ITR 602 (Punj. & Har.).**

Illustration 3:

Anirudh has a property whose municipal valuation is Rs. 1,30,000 p.a. The fair rent is Rs. 1,10,000 p.a. and the standard rent fixed by the Rent Control Act is Rs. 1,20,000 p.a. The property was let out for a rent of Rs. 11,000 p.m. throughout the previous year. Unrealised rent was Rs. 11,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @10% of municipal valuation. Interest on borrowed capital was Rs. 40,000 for the year. Compute the income from house property of Anirudh for A.Y. 2021-22. Mr. Anirudh has not opted for Section 115BAC of the Income Tax Act, 1961

Solution:

Computation of Income from house property of Mr. Anirudh for A.Y. 2021-22

Particulars	Amount in Rs.	
Computation of GAV		
Step 1 Compute ER		
ER = Higher of MV of Rs. 1,30,000 p.a. and FR of Rs. 1,10,000 p.a., but restricted to SR of Rs. 1,20,000 p.a.	1,20,000	
Step 2 Compute actual rent received/receivable		
Actual rent received/receivable less unrealized rent as per Rule 4 = Rs. 1,32,000 – Rs. 11,000	1,21,000	
Step 3 Compare ER of Rs. 1,20,000 and Actual rent received/ receivable of Rs. 1,21,000.		
Step 4 GAV is the higher of ER and Actual rent received/receivable	1,21,000	
Gross Annual Value (GAV)		1,21,000
Less: Municipal taxes (paid by the owner during the previous year) = 10% of Rs.1,30,000		(13,000)
Net Annual Value (NAV)		1,08,000
Less: Deductions under section 24		
(a) 30% of NAV	32,400	
(b) Interest on borrowed capital (actual without any ceiling limit)	40,000	72,400
Income from house property		**35,600**

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

Particulars		Amount
Computation of GAV		
Step 1	Compute ER	
ER = Higher of MV and FR, but restricted to SR		
Step 2	Compute Actual rent received/receivable	
Actual rent received/receivable for let out period less unrealized rent as per Rule 4		
Step 3	Compare ER and Actual rent received/receivable computed for the let-out period	
Step 4	If Actual rent is lower than ER owing to vacancy, then Actual rent is the GAV.	
	If Actual rent is lower than ER due to other reasons, then ER is the GAV.	

	However, in spite of vacancy, if the actual rent is higher than the ER, then Actual rent is the GAV.		
Gross Annual Value (GAV)			A
Less: Municipal taxes (paid by the owner during the previous year)			B
Net Annual Value (NAV) = (A-B)			C
Less: Deductions under section 24			
(a) 30% of NAV		D	
(b) Interest on borrowed capital (actual without any ceiling limit)		E	
Income from house property (C-D-E)			

Illustration 4:

Mr. Ganesh has a property whose municipal valuation is Rs. 2,50,000 p.a. The fair rent is Rs. 2,00,000 p.a. and the standard rent fixed by the Rent Control Act is Rs. 2,10,000 p.a. The property was let out for a rent of Rs. 20,000 p.m. However, the tenant vacated the property on 31.1.2021. Unrealised rent was Rs. 20,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @8% of municipal valuation. Interest on borrowed capital was Rs. 65,000 for the year. Compute the income from house property of Ganesh for A.Y. 2021-22 assuming Mr. Ganesh has not opted for Section 115BAC of the Income Tax Act, 1961.

Solution:

Computation of Income from house property of Ganesh for A.Y. 2021-22

Particulars	**Amount in Rs.**	
Computation of GAV		
Step 1 Compute ER		
ER = Higher of MV of Rs. 2,50,000 p.a. and FR of Rs. 2,00,000 p.a., but restricted to SR of Rs. 2,10,000 p.a.	2,10,000	
Step 2 Compute Actual rent received/receivable		
Actual rent received/receivable for let out period **Less** unrealized rent as per Rule 4 = Rs. 2,00,000 – Rs. 20,000	1,80,000	
Step 3 Compare ER and Actual rent received/receivable		
Step 4 In this case the actual rent of Rs. 1,80,000 is lower than ER of Rs. 2,10,000 owing to vacancy, since, had the property not been vacant the actual rent would have been Rs. 2,20,000 (Rs. 1,80,000 + Rs. 40,000). Therefore, actual rent is the GAV.	1,80,000	
Gross Annual Value (GAV)		1,80,000
Less: Municipal taxes (paid by the owner during the previous year) = 8% of Rs. 2,50,000		(20,000)
Net Annual Value (NAV)		1,60,000
Less: Deductions under section 24		

(a) 30% of NAV = 30% of Rs. 1,60,000	48,000	
(b) Interest on borrowed capital (actual without any ceiling limit)	65,000	(1,13,000)
Income from house property		47,000

(III) SELF-OCCUPIED PROPERTY

Particulars		Amount
Annual value under section 23(2)		Nil
Less:	Deduction under section 24	
	Interest on borrowed capital (i) Interest on loan taken for acquisition or construction of house on or after 1.4.99 and same was completed within 5 years from the end of the financial year in which capital was borrowed, interest or aggregate interest paid or payable subject to a maximum of Rs. 2,00,000 (including apportioned pre-construction interest). (ii) In case of loan for acquisition or construction taken prior to 1.4.99 or loan taken for repair, renovation or reconstruction at any point of time, interest or aggregate interest paid or payable subject to a maximum of Rs. 30,000. Aggregate of the amounts of deduction under (i) & (ii) shall not exceed Rs. 2,00,000 [Inserted by Finance (No. 1) Act, 2019]	E
Income from house property		-E

Pre-construction period and Interest		
Meaning	**Start**	**Date of Borrowing**
	End	A. March 31 immediately prior to the year of completion of construction B. Date of repayment **A or B whichever is earlier**
Tax Treatment	Pre-construction period interest is allowed as deduction **in equal installments for the said previous year and for each of the four immediately succeeding previous years. (i.e. 5 equal instalments from the year of completion of construction.)**	
Point of consideration	• Interest paid on "**new loan**", which is taken to repay subsequent to the capital borrowed, for the purpose of repayment of such capital shall be allowed as deduction.	

Note: The Deduction of Rs. 30,000 / Rs. 2,00,000 with respect to Interest paid on borrowed capital u/s 24(b) not allowed in case of Self occupied Property, if assessee opted for section 115BAC of the Income Tax Act, 1961.

IV HOUSE PROPERTY LET-OUT FOR PART OF THE YEAR AND SELF-OCCUPIED FOR PART OF THE YEAR

Particulars		Amount
Computation of GAV		
Step 1	Compute ER for the whole year	

	ER = Higher of MV and FR, but restricted to SR		
Step 2	Compute Actual rent received/receivable		
	Actual rent received/receivable for the period let out less unrealized rent as per Rule 4		
Step 3	Compare ER for the whole year with the actual rent received/receivable for the let out period		
Step 4	GAV is the higher of ER computed for the whole year and Actual rent received/ receivable computed for the let-out period		
Gross Annual Value (GAV)			**A**
Less:	Municipal taxes (paid by the owner during the previous year)		**B**
Net Annual Value (NAV) = (A-B)			**C**
Less:	Deductions under section 24		
	(a) 30% of NAV	D	
	(b) Interest on borrowed capital (actual without any ceiling limit)	E	
Income from house property (C-D-E)			**F**

Illustration 5:

M is the owner of a house. The municipal value of the house is Rs. 40,000. He paid Rs. 8,000 as local taxes during the year. He was using this house for his residential purposes but let out w.e.f. 1.1.2020 @ Rs. 4,000 p.m. Compute the net annual value of the house.

Solution:

PARTICULARS	AMOUNT Rs.
Annual rent or municipal valuation (whichever is higher)	48,000
Less : Local taxes	8,000
Net annual value of the house (No benefit shall be given for self occupied period as the house did not remain vacant during the previous year)	40,000
Note: If fair rent is not given, then assume actual rent as fair rent.	

Illustration 6:

(i.e. No vacancy but there is unrealized rent)

Mr. A owns two houses. The expected rent of the house one is Rs. 65,000. This house was let out for Rs. 7,500

But the rent for the months of February and March, 2021 could not be realized.

The expected rent of another house is Rs. 1,50,000. This house was let out for Rs.12,000 p.m. But the rent for the last three months could not be realized.

In the both cases, Mr. A fulfills the conditions of Rule 4. You are required to compute the Gross Annual Value of both the houses.

Solution:

Particulars	House I	House II
Expected Rent	65,000	1,50,000
Annual Rent	90,000	144000
Unrealized Rent	15,000	36,000
Computation of Gross Annual Value		
Step 1: Expected Rent	65,000	1,50,000
Step 2: Actual Rent (After deducting unrealized rent) if higher than Expected Rent then Actual rent otherwise Expected rent	75,000	1,50,000
Step 3: Applicable only in case of vacancy	N.A.	N.A.
Gross Annual Value	**75,000**	**1,50,000**

Illustration 7:

(There is vacancy but no unrealized rent)

Find out the gross annual value in the case of the following properties for the Assessment Year 2021-22

Rs. in thousands

Particulars	P	Q	R	S
Expected Rent	70	55	85	125
Rent Per Month (if let out)	7	5	8	8
Let out period (in months)	11	0	9	10
Vacancy (in months)	1	12	3	2

Further all the rent were realized for the year by the assessee.

Solution:

Calculation of Gross Annual Value of Mr. X for A.Y. 2021-22

	P	Q	R	S
Annual Rent (If let out for 12 months)	84	60	96	96
Loss due to vacancy	7	60	24	16
Unrealized rent	Nil	Nil	Nil	Nil
Actual Rent (for let out period)	77	Nil	72	88
Calculation of Gross Annual Value				
Step 1: Expected Rent	70	55	85	125
Step 2: If actual rent is more than Expected Rent than Actual rent otherwise expected Rent	77	N.A.	N.A.	N.A.
Step 3: If property remain vacant then decline due to vacancy shall be considered	77	0	72	109
Gross annual value	77	0	72	109

Illustration 8:

(Vacancy and unrealized rent both exist)

Mr. X is the owner of a house property. He lets this property during the previous year 2020-21 for Rs. 7,000 p.m. The house was occupied from 1.4.2018 to 31.1.2021. From 1.2.2021, it remained vacant. Mr. X fails to realize Rs.. 10,000 from the tenant. The Expected rent of the house is Rs. 82,000 p.a. Calculate the Gross Annual Value of the house.

Solution:

Particulars	Amount Rs.
Expected Rent	82,000
Annual Rent (Actual for the whole year - 7000 x 12)	84,000
Actual Rent (7,000 x 10)	70,000
Unrealized rent	10,000
Realized rent (Rs. 70,000 - 10,000)	60,000
Loss Due to vacancy (7,000 x 2)	14,000
Decline due to vacancy (82,000 - 14,000) but not less than actual rent received	68,000
Calculation of Gross Annual Value	
Step 1: Expected Rent	82,000
Step 2: If actual rent is more than expected rent than actual rent otherwise expected rent	N.A.
Step 3: Decline due to vacancy in Expected Rent (i.e. Expected Rent minus Loss due to vacancy but not less than actual rent received)	68,000
Gross Annual Value	68,000

V. More than Two Self Occupied Property [Section 23(4)]

1. If the assessee owns more than two house property as self-occupied property (SOP); then any two of the property at the option of the assessee shall be treated as "Self- occupied property, and the other property shall be deemed to be let out.
2. Assessee can choose an option which will yield lower taxable income.
3. In the case of a deemed let-out property, the nature of which is self-occupied property or unoccupied property, the income shall be similar to that of let-out property but subject to certain modifications i.e. Fair rent has to be adopted as gross annual value. The question of considering actual rent received or receivable does not arise.
4. No adjustment arises on account of property remaining vacant or on account of unrealizable rent.

Special Point:

- If a house property has two or more independent residential units, one of which is self occupied for own residential purposes and other units are let out or used for own business then, valuation of each unit will be determined separately.
- Loss from one House Property will be set off first against income from another house property in the current year. If any loss remains after set off then, during that year it will be set off from any other heads

of income subject to maximum Rs.2,00,000/-. If still any loss remains then it will be carry forward to next year and in the next year it will be available for set off only from income from house property and not from any other heads of income. Loss can be carry forward for a total period of 8 Years.

Note: The Deduction of Rs. 30,000 / Rs. 2,00,000 with respect to Interest paid on borrowed capital u/s 24(b) not allowed in case of Self occupied Property, if assessee opted for section 115BAC of the Income Tax Act, 1961.

Illustration 9:

Mr. Ganesh has two houses, both of which are self-occupied. The particulars of the houses for the P.Y. 2020-21 are as under:

Particulars	House I	House II	House III
Municipal valuation p.a.	1,00,000	1,50,000	2,00,000
Fair rent p.a.	75,000	1,75,000	1,90,000
Standard rent p.a.	90,000	1,60,000	1,80,000
Date of completion	31.3.1999	31.3.2001	1.4.2010
Municipal taxes paid during the year	12%	8%	10%
Interest on money borrowed for repair of property during the current year	-	55,000	40,000

Compute Ganesh's income from house property for A.Y. 2021-22 and suggest which house should be opted by Ganesh to be assessed as self-occupied so that his tax liability is minimum. Assuming Mr. Ganesh has not opted for Section 115BAC of the Income Tax Act, 1961.

Solution:

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

Particulars	Amount in Rs.		
	House I	House II	House III
Gross Annual Value (GAV) ER is the GAV of house property ER = Higher of MV and FR, but restricted to SR	90,000	1,60,000	1,80,000
Less: Municipal taxes (paid by the owner during the previous year)	12,000	12,000	20,000
Net Annual Value (NAV)	78,000	1,48,000	1,60,000
Less: Deductions under section 24			
(a) 30% of NAV	23,400	44,400	48,000
(b) Interest on borrowed capital	NIL	55,000	40,000
Income from house property	54,600	48,600	72,000

OPTION 1 (House I & II – self-occupied and House III – deemed to be let out)

Particulars	Amount in Rs.
House I & II (Self-occupied) (interest deduction restricted to Rs. 30,000)	(30,000)
House III (Deemed to be let out)	72,000
Income from house property	42,000

If House I & II is opted to be self-occupied, the income from house property shall be Rs.42,000

OPTION 2 (House I & III – self-occupied & House II –deemed to be let out)

Particulars	Amount in Rs.
House I & III (Self-occupied) (interest deduction restricted to Rs. 30,000)	(30,000)
House II (Deemed to be let out)	48,600
Income from house property	18,600

If House I & III is opted to be self-occupied, the income from house property shall be Rs.18,600

OPTION 3 (House II & III– self-occupied & House I –deemed to be let out)

Particulars	Amount in Rs.
House I (Deemed to be let-out)	54,600
House II & III (Self-occupied) (interest deduction restricted to Rs. 30,000)	(30,000)
Income from house property	24,600

Since Option 2 is more beneficial, Ganesh should opt to treat House 1 & III as self-occupied and House II as deemed to be let out. His income from house property would be Rs. 18,600 for the A.Y. 2021-22.

VI. Annual value building as Stock In Trade [Section 23(5)]

- Where property consisting of any building or land appurtenant thereto
- is held as stock-in-trade and
- property or any part of the property
- is not let during whole or any part of the p/y,
- Annual value of such property or part of the property,
- for period up to 2 year [Substituted by Finance (No.1) Act, 2019 from the end of F/Y
- in which certificate of completion of construction of the property
- is obtained from the competent authority,
- Shall be taken to be NIL

DEDUCTIONS [SECTION 24]

LET-OUT PROPERTY	SELF-OCCUPIED PROPERTY
STANDARD DEDUCTION U/S 24(a) • Deduction @ 30% flat deduction on the Net Annual Value; • This deduction is allowed even if no expenditure is incurred by the assessee.	**STANDARD DEDUCTION U/S 24(a)** • This deduction is not available for self-occupied property
INTEREST ON BORROWED CAPITAL [Section 24 (b)] a) Interest Payable on loans borrowed for the purpose of acquisition, construction, renovation, repairing or reconstruction can be claimed as deduction. b) Interest relating to the year of completion of construction can be fully claimed in that year irrespective of the date of completion. c) Pre-Construction Interest: Interest accrued during the construction period preceding the year of completion of construction can be accumulated and claimed as deduction over a period of 5 years in equal installments commencing from the year of completion of construction. d) Any subsequent loan borrowed to repay the original loan shall also be entitled to the same treatment as the original loan. Where a person acquires a property and pays only part of the sale consideration, interest payable on the unpaid purchase price qualifies for deduction in the computation of income from such Property. e) Deduction under section 24(b) for interest is available on accrual basis. Therefore interest accrued but not paid during the year can also be claimed as deduction.	**INTEREST ON BORROWED CAPITAL [Section 24 (b)]** a) Deduction shall be allowed upto Rs.2,00,000: CONDITIONS: 1. Loan borrowed on or after 01-04-99. 2. Loan taken only for acquisition/ construction of house property 3. If property is constructed then it should be complete before 5 year from the end of the financial year in which loan is borrowed then. OR b) Deduction shall be allowed upto Rs.30,000 in the following cases: 1. If the conditions specified in (a) above are not satisfied
f) Interest on unpaid interest is not deductible. g) Brokerage or commission paid for acquiring the loan will not be allowed as deduction	2. Loan borrowed for repair, renovation etc. 3. Capital borrowed before 1.04.1999 for any purpose or 4. Construction of house not completed within 5 years from the end of the financial year in which loan is borrowed.

Note: The Deduction of Rs. 30,000 / Rs. 2,00,000 with respect to Interest paid on borrowed capital u/s 24(b) not allowed in case of Self occupied Property, if assessee opted for section 115BAC of the Income Tax Act, 1961 assuming Mr. P has not opted for Section 115BAC of the Income Tax Act, 1961..

Illustration 10:

P, an individual, borrowed Rs. 20,00,000 for repair of his self-occupied house property and paid interest of Rs. 1,60,000 thereon during the financial year 2020-21. What is the amount of interest allowable as deduction under section 24 for the assessment year 2021-22. Assuming Mr. P. has not opted for Section 115BAC of the Income Tax Act, 1961?

Solution:

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

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

TAXABILITY OF RECOVERY OF UNREALISED RENT & ARREARS OF RENT RECEIVED

(i) Unrealised rent is deducted from actual rent in determination of annual value under section 23, subject to fulfillment of conditions under Rule 4. Subsequently, when the amount is realised it gets taxed under section 25A in the year of receipt.

(ii) If the assessee has increased the rent payable by the tenant and the same has been in dispute and later on the assessee receives the increase in rent as arrears, such arrears is assessable under section 25A.

	Unrealized rent [Section 25A]	Arrears of rent [Section 25A]
(a)	Taxable in the hands of the assessee whether he is the owner of that property or not.	Taxable in the hands of the assessee whether he is the owner of that property or not.
(b)	Taxable as income of the previous year in which he recovers the unrealized rent.	Taxable as income of the year in which he receives the arrears of rent.
(c)	30% of the unrealized rent deduction shall be allowed. (i.e. 70% is taxable)	30% of the amount of arrears shall be allowed as deduction. (i.e. 70% is taxable)

Illustration 11:

Nikhil has a property whose Municipal Valuation is INR 500,000 pa. The Fair Rent of the property is INR 400,000 pa and the Standard Rent fixed by Rent Control Act is 450,000 pa. The property was let out for a Rent of INR 35000 pm and the tenant vacated the same on 31st January 2021. Unrealised Rent was INR 35000 and the conditions are fulfilled with respect to the same. He paid municipal taxes worth INR 15000 during the PY and the Interest on Loan was INR 60000. Please exhibit the computation and advise the income from house property. [Assuming assessee has not opted for Section 115BAC of the Income Tax Act, 1961].

Solution:

Computation of GAV	INR	INR
ER		4,50,000
Higher of:		
1) Fair Rent	4,00,000	
2) Municipal Value	5,00,000	
Limited to Standard Rent	4,50,000	
Actual rent received/receivable	3,50,000	

Less: Unrealised Rent	(35,000)	
		3,15,000
GAV		4,50,000
Less: Municipal Taxes paid by the owner during the PY		15,000
NAV		4,35,000
Less: Deductions u/s 24		
30% NAV	(1,30,500)	
Interest on borrowed capital	(60,000)	
		(1,90,500)
Income from House Property		2,44,500

Illustration 12:

Smt. Shanti Devi has a house property in Kolkata. The Municipal Valuation for the same is INR 10,00,000. The Fair Rental for the property is INR 750,000. The Standard Rent per the Rent Control Act is INR 800,000. She let out the property until 30th Nov'20 for a monthly rent of Rs. 75,000 per month. Thereafter, the tenant vacated the property and she used the house for self-occupation. Rent for the months of Oct & Nov 20 couldn't be realised despite all efforts, and all the conditions for unrealised rent were satisfied. She paid Municipal Taxes @ 12% during the year. She also paid Interest of INR 25,000 during the year for amount borrowed for repairs. Compute the Income from House Property for AY 2021-22 assuming assessee has not opted for Section 115BAC of the Income Tax Act, 1961

Solution:

Computation of GAV ER Higher of:	INR	INR
1) Fair Rent	7,50,000	
2) Municipal Value Limited to Standard Rent	10,00,000	 8,00,000
Annual Rent	6,00,000	
Less: Unrealised Rent	1,50,000	
		4,50,000
GAV (partly let out and partly self occupied)		8,00,000
Less: Municipal Taxes paid by the owner during the PY		1,20,000
Net Annual Value (NAV)		6,80,000
Less: Deductions u/s 24		
30% NAV	2,04,000	
Interest on borrowed capital	25,000	2,29,000
Income from House Property		4,51,000

INADMISSIBLE DEDUCTIONS [SECTION 25]

Interest chargeable under this Act which is payable outside India shall not be deducted if –

a) tax has not been paid or deducted from such interest and

b) there is no person in India who may be treated as an agent under section163.

TREATMENT OF INCOME FROM CO-OWNED PROPERTY [SECTION 26]

(i) **Where property is owned by two or more persons, whose shares are definite and ascertainable**,

- then share of each owner in the income of property will be taxed in his individual assessment according to nature of occupancy
- if the property is self-occupied, then the part of self-occupancy is applicable to each co-owner individually, and they are entitled for deduction u/s 24 independently.

(ii) **Where property is owned by two or more persons, whose shares are not definite:**

- income from house property will be determined and charged to tax in the capacity of an AOP.

TREATMENT OF INCOME FROM PROPERTY OWNED BY A PARTNERSHIP FIRM

(i) Where an immovable property or properties is included in the assets of a firm, the income from such property should be assessed in the hands of the firm only.

(ii) Hence, the property income cannot be assessed as income of the individual partner in respect of his share in the firm.

Illustration 13:

Two sisters, Seema and Rashmi, are co-owners of a house property, with 50% share each in the property. The property was constructed prior to 1st April 1999. The property has 7 equal units and is situated in Bangalore. During the FY 2020-21, each co-owner occupied one unit each and the balance were let out @ a rental of INR 20000 per unit per month. The Municipal Valuation (MV) was INR 7,00,000 and the Municipal Taxes were @ 10% of the MV. Interest payable on loan taken for construction was INR 400,000. One of the let-out units was vacant for 6 months in the year. Compute the Income from House Property for each of the sisters.

Solutions:

Computation of GAV Estimated Rent Higher of:	INR	INR
1) Fair Rent	-	
2) Municipal Value (700000 x 5/7)		5,00,000
Annual Rent	12,00,000	
Less: Unrealised Rent	(1,20,000)	
		10,80,000
GAV (partly let out and partly self occupied)		10,80,000
Less: Municipal Taxes paid by the owner during the PY		(50,000)

NAV		10,30,000
Less: Deductions u/s 24		
30% NAV	(3,09,000)	
Interest on borrowed capital (Rs.400000 x 5/7)	(2,85,714)	
		(5,94,714)
Income from House Property		4,35,286
Share of each Co-owner		2,17,643
Loss from House Property (self occupied portions)		-30,000
Income from House Property (each co-owner)		1,87,643

Notes:

1) Observe that the computation has been done for the 5 let out and 2 self-occupied portions separately and commensurately
2) Note that the Interest on Borrowed Capital for let out proportions is fully allowable as deduction without any cap
3) Note that the AV for the Self Occupied Portion is NIL and the Interest on Borrowed Capital is restricted to INR 30,000 for each co-owner
4) Assuming Assessee has not opted for Section 115BAC of the Income Tax Act, 1961.

Illustration 14:

Mr. X is the owner of four houses. The following particulars are available:

	House 1	House 2	House 3	House 4
Municipal valuation	16,000	20,000	24,000	5,600
Rent (Actual)	—	14,000	20,000	6,800
Municipal taxes	400	1,000	1,200	300
Repairs and collection charges	200	2,500	1,040	460
Interest on mortgage	—	—	—	1,000
Ground rent	—	100	—	60
Fire premium	140	—	200	—
Annual charges	—	—	360	—

House No. 1 is self-occupied.

House No. 2 is let out for business, construction was completed on 1.3.91 and consists of two residential units. House No. 3 is 3/4 used for own business 1/4 let out to the manager of the business.

House No. 4 is let out for residential purposes.

His other income is Rs. 30,000. Find out the income of X from house property for the assessment year 2021-22.

Solution:

House No. 1

	Rs.
Municipal valuation	16,000
Annual value deemed to be	NIL

House No. 2

Gross Annual Value	20,000
Less: Municipal taxes	1,000
Net annual value	19,000
Less: 30% of Net Annual Value	5,700
Income from house property	13,300

House No. 3

Since the house is used for own business, the income from this house is not taxable under the head 'Income from house property' but will be assessed under 'Profit and gains of business or profession'. 1/4 of the house occupied by the Manager is presumed to be incidental to the business and hence not assessable under the head 'Income from house property'.

House No. 4

Gross Annual Value	6,800
Less: Municipal taxes	300
Net annual Value	6,500
Less: 30% of Net Annual Value	1,950
Income from house property	4,550

Income from House Property: Rs. NIL + Rs. 13,300 + Rs. 4,550 = Rs. 17,850. It is presumed that House No. 4 has not been mortgaged for purposes of acquiring or repairs on the house property.

Illustration 15:

Mr. Lal is the owner of a house property. Its municipal valuation is Rs. 80,000. It has been let out for Rs. 1,20,000 p.a. The local taxes payable by the owner amount to Rs. 16,000 but as per agreement between the tenant and the landlord, the tenant has paid the amount direct to the municipality. The landlord, however, bears the following expenses on tenant's amenities:

Extension of water connection	3,000
Water charges	1,500
Lift maintenance	1,500
Salary of gardener	1,800
Lighting of stairs	1,200
Maintenance of swimming pool	750

The landlord claims the following deductions:

Repairs and Collection charges	7,500
Land revenue paid	1,500

Compute the taxable income from the house property for the assessment year 2021-22.

Solution:

Computation of income from house property for the assessment year 2021-22

Gross annual value: to be higher of the following:

(a) Municipal valuation Rs. 80,000 or

(b) De facto rent (1,20,000 less value of amenities)

(c) Rent Received: 1,20,000

Less: Value of the amenities provided by the assessee:

(i)	Extension of water connection not deductible as it is capital expenditure	
(ii)	Water Charges	Nil
(iii)	Lift maintenance	1500
(iv)	Salary of gardener	1,800
(v)	Lighting of stairs	1,200
(vi)	Maintenance of swimming pool	750
	Total	(6,750)

Gross Annual Value	1,13,250
Less: Local tax	(Nil)
No deduction is permissible as the taxes have been paid by the tenant	
Net Annual Value	1,13,250
Less: Standard deduction from net annual value:	
30% of Net Annual Value	(33,975)
Income from house property	79,275

Illustration 16:

For the assessment year 2021-22 Sonu submits the following information:

Income from business (speculative)	Rs. 40,000	
Property Income	House I (Rs.)	House II (Rs.)
Municipal valuation	35,000	80,000
Rent received	38,000	68,000
Municipal taxes paid by tenant	3,000	4,000
Repairs paid by tenant	500	18,000
Land revenue paid	2,000	16,000
Insurance premium paid	500	2,000

Interest on borrowed capital for payment of municipal tax of house property	200	400
Nature of occupation	Let out for residence	Let out for business
Date of completion of construction	1.4.1996	1.7.1994

Determine the taxable income of Sonu for the assessment year 2021-22.

Solution:

Computation of Taxable Income of Sonu for Assessment Year 2021-22

House I		**Amount (Rs.)**
Gross Annual Value		38000
Less: Municipal Taxes - not deductible since paid by tenant		NIL
Net Annual Value		38000
Less: 30% of Net Annual Value		(11,400)
Taxable Income	Total	26,600
House II		
Gross Annual Value		80000
Less: Taxes - not deductible, paid by tenant		NIL
Net Annual Value		80,000
Less: 30% of Net Annual Value		(24,000)
Taxable Income	Total	56,000

Total Income = Rs. 26,600 + Rs. 56,000 + Rs. 40,000 = Rs. 1,22,600.

Note: Interest on borrowed capital for payment of municipal tax is not allowed as deduction under Section 24 of the Act.

Tax Planning consideration in case of Income from House Property

Tax Payer should consider following points for tax planning in case of Income from House Property

- Nature, Purpose and type of house property.
- Deductions available under section 24 (Home Loan Interest Rs. 30000 / Rs. 200000)
- Exemptions availability. (i.e. cases where income from house property is exempt from tax)
- Stamp duty and registration charges and other expenses related directly to the transfer are also allowed as a deduction under Section 80C, subject to a maximum deduction.
- The joint owners, who are also co-borrowers of a self-occupied house property, can claim a deduction on interest on the home loan up to Rs 2 lakh each.
- Inadmissible deductions under section 25.

CASE STUDY

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

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

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

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

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

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

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

2. Would income from letting out of properties by a company, whose main object as per its memorandum of association is to acquire and let out properties, be taxable as its business income or income from house property, considering the fact that the entire income of the company as per its return of income was only from letting out of properties?

Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673 (SC)

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

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

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

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

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

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

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

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

CIT v. Hariprasad Bhojnagarwala (2012) (Guj.)

The Gujarat High Court observed that a firm, which is a fictional entity, cannot physically reside in a house property and therefore a firm cannot claim the benefit of this provision, which is available to an individual owner who can actually occupy the house. However, the HUF is a group of individuals related to each other i.e., a family comprising of a group of natural persons. The said family can reside in the house, which belongs to the HUF. Since a HUF cannot consist of artificial persons, it cannot be said to be a fictional entity.

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

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

Facts of the case: The assessee had received interest-free deposit in respect of shops given on rent. The Assessing Officer added to the assessee's income notional interest on the interest free deposit at the rate of 18 per cent simple interest per annum on the ground that by accepting the interest free deposit, a benefit had accrued to the assessee which was chargeable to tax under section 28(iv).

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

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

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

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

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

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

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

(i) beyond the said period; or

(ii) not eligible for such exemption even during the said period due to non-fulfilment of the stated condition, would be taxable under the same head of income i.e., "Income from house property".

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

[6] Can interest paid by builder for delay in providing or delivering of flats be admissible under section24 of Income Tax?

Akash and Ambar Trust V CIT [2004]268ITR93/140

Facts of the case: Business of the appellant is to construct flats and sell at profit. Interest has been paid by the appellant in pursuance of an agreement entered into. The appellant was paid advance money as price of the flat deliverable within a stipulated period; later appellant had to pay interest to allottee as the flat could not be delivered during the stipulated period as per agreement.

Issue of Case: Appellant is of contention that the amount paid to the Assessee for purchase of the flat was utilized for construction of the flat and has to be treated as capital borrowed by the Assessee for construction of the flat and, therefore, the interest paid thereon is liable to be deducted under Section 24(1)(vi).

High Court's Observations & Decision: High Court observed that interest paid could not be treated as Interest paid on capital borrowed for the construction of flats. It is further observed that under section 24 deduction of amount of interest payable on capital is allowed only when properly has been constructed on the said borrowed capital. In the present facts apparently the Assessee did not construct the flat on borrowed capital. In addition to that amount so paid by the Assessee to the purchaser was not interest payable on any borrowed capital with which the construction of the said flat was made. Actually it was payment made by the Assessee to the purchaser on his failure to deliver the flat within the stipulated time. Hence, even if it is termed as interest, is in the nature of penalty or liquidated damages, in respect of which deduction is not permissible under Section 24(1)(vi) of the Income-tax Act, 1961.

[7] Can notional interest on security deposit be included in Annual Letting Value (ALV) and assessed as Income from house property ?

CIT v. K. Streetlite Electric Corporation

Facts of the case: The Assessee has earned rental income by letting out the facilities of factory, land, building and offices, etc. Assessing Officer has noticed that the Assessee had taken interest-free security of from two parties, to whom the assets were leased out and the Assessee has stated a very low rental income of as the annual letting value (ALV) in respect of those properties. Moreover, AO has sent SCN stating interest at 18% per annum on the interest-free security.

High Court's Observations & Decision: It was observed that security deposit was a sham device to avoid tax and had no real basis with the actual rent that was received by the assessee. According to section 23(1)(b), where the property is actually let out, the actual amount of rent received or receivable shall form part of the income from house property. To supplement that, notional interest that may accrue on the security deposit would not form part of income from house property as held by the Bombay High Court in CIT v. J.K. Investors (Bombay) Ltd. (2001) 248 ITR 723(Bom). However, where payment of the security deposit is to circumvent the real rent, the same shall fall within its ambit as income from house property. Hence, it was held hat notional interest on security deposit would be treated to be included in the ALV as there is no provision in the agreement to increase in rent from year to year. However, interest rate would be 9 per cent, instead of 18 per cent, on the security amount would be just to meet the ends of justice and the same will be treated as taxable income of the assessee under the head "Income from house property" relating to the land and building.

[8] Whether interest charged by the bank on the amount borrowed by the assessee from it for raising construction was to be allowed or not?

Naman Kumar vs CIT [2014]

Here in the above cited case, income of the assessee under the head "income from house property" is to be computed for the purpose of income tax after making certain deductions as are envisaged in Section 24 of the Act. Section 24(1)(vi) of the Act stipulates that amount of interest payable on capital borrowed, interalia, for construction of the property yielding income, is an admissible deduction. It thus is evident that only interest payable on such borrowed capital is to be deducted while computing income chargeable to income tax under the head 'income from house property". It would be stated that interest paid on interest levied by the bank, because of non-payment of installments of borrowed capital to the bank, does not qualify for an admissible deduction.

LESSON ROUND UP

– Charging Section: Section 22 of the Act provides that the annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him, the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head Income from House Property".

– Deemed Owner: As per section 27, the following persons though not the legal owners of a property are deemed to be the owners for the purposes of sections 22 to 26:

(a) Transfer to a spouse or minor child

(b) Holder of an impartible estate

(c) Member of a co-operative society

(d) Person in possession of a property

(e) Person having right in a property for a period not less than 12 years

– The measure of charging income-tax under this head is the annual value of the property, i.e., the inherent capacity of a building to yield income. The expression 'annual value' has been defined in Section 23(1) of the Income-tax Act as, the annual value of any property shall be deemed to be:

o the sum for which the property might reasonably be expected to let from year to year; or

o where the property or any part of the property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable; or

o where the property or any part of the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (a), the amount so received or receivable.

– Gross annual value shall be higher of

(a) Expected Rent

(b) Actual rent received or receivable.

The higher of Municipal value and fair rental value shall be Expected rent. However, expected rent shall not exceed the Standard rent.

– Net annual value shall be computed in the following manner:

  Determine the Gross Annual Value

  Deduct municipal tax actually paid by the owner during the previous year from the Gross Annual Value.

– Deduction from Annual Value (Section 24): W.e.f. Assessment Year 2002-03, income chargeable under the head "Income from house property" shall be computed after making the following deductions, namely:

  o Standard deduction: a sum equal to 30% of the annual value;

  o Interest on borrowed capital: where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital. The interest on borrowed money pertaining to pre-construction period is available in 5 equal installments commencing from the previous year in which house is acquired or constructed. For this purpose the pre-construction period means the period commencing on the date of borrowing and ending on 31st March immediately prior to the date of completion of construction/ date of acquisition or date of repayment of loan, whichever is earlier. Interest for current year is deductible upto Rs. 30,000/ Rs. 2,00,000 as the case may be.

TEST YOURSELF

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

ELABORATIVE QUESTIONS

1. What is the meaning of 'Owner of House Property' under Section 27 of the Income-tax Act, 1961?
2. What is 'annual value' of house property? How is it computed?
3. In computing the income from house property what deductions are allowed from the net annual value?
4. What is the basis of computation of income from House property? How would you arrive at the net annual value of a house occupied by an assessee for his own residence?
5. How would you deal with the following while calculating the income under 'Income from house property':

   (a) Annual Charge.

   (b) Vacancy Allowance.

   (c) Unrealised Rent.

   (d) Income from house property situated in a foreign country.

DISTINGUISH BETWEEN

1. Gross Annual Value and Annual Value
2. Deemed owners and Actual owners
3. Standard Rent and Expected Rent
4. Fair Rent and Annual Rent

PRACTICAL QUESTIONS

1. A HUF owns a property which has been let out to a firm carrying on business. HUF is a partner of the

firm through its karta. No rent has been charged by the HUF from the Firm for the use of premises. The AO, however, taxed the family on the notional income property based on municipal valuation. Is this decision justified?

2. Mr. Anil revived a sum of Rs. 360000 (Rs. 120000 p.a.) on 1.7.2020 by way of arrears for the last three years as the govt. department (tenant) enhanced the rate of rent with retrospective effect. Will the sum of Rs. 360000 be taxable in the AY 2021-22? Can it be speared for the last three years?

3. X, an individual, borrowed Rs. 20,00,000 for the repair of his self occupied house property and paid interest Rs. 170000 thereon during the financial year 2020-21. What is the amount of interest allowable as deduction under section 24 for the AY 2021-22. Assuming assessee has not opted for Section 115BAC of the Income Tax Act, 1961?

4. Compute the Net Annual Value of the House Property for AY 2021-22

   Mr. A (ROR) in India during the FY 2020-21. He owns a house property in UK which has been let out at EURO 10000 p.m. The municipal taxes paid is EURO 8000 during 2020-21. The value of 1 EURO in Indian Rupees taken at Rs. 82.50.

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 4

Computation of Income – Profits and Gains from Business and Profession

LESSON OUTLINE

- Incomes Chargeable under the head Business or Profession (Section 28)
- Computation of Income from Business or Profession (Section 29)
- Expenses allowed as Deduction [Section 30 to Section 37(1)]
- Expenses not allowed as Deduction (Section 40(a)/Section 40(b)/Section 40A(2)/Section 40A(3) etc)
- Deemed Incomes chargeable under the head Business or Profession (Section 41)
- Maintenance of Accounts for Business or Profession (Section 44AA)
- Compulsory Audit of Accounts (Section 44AB)
- Computation of Income on Presumptive basis (Section 44AD/Section 44AE/Section 44ADA)
- Question for Practice
- LESSON ROUND UP
- TEST YOURSELF

LEARNING OBJECTIVES

The provisions for computation of Income from Business or Profession are applicable for Persons who are not in employment and earn income being their own masters. There are many deductions allowed to such persons from their Income but there also many conditions for allow ability of the same.

At the end of this lesson, students will be able to understand:

- What incomes are chargeable under the head Business or Profession.
- Determine the expenses which are admissible/inadmissible while computing the Income from Business or Profession.
- Analyse when are certain receipts deemed to be Income chargeable to tax under this head.
- Determine Deductions allowable on actual payment basis.
- Know which Assessee's are required to compulsorily maintain Books of Accounts.
- Determine when is Audit of Accounts compulsory.
- Determine who are the Assessee's to whom provisions of presumptive tax apply

KEY SECTIONS COVERED IN THIS CHAPTER

Section 28	Basis of Charge
Section 29	Computation of Business Income
Section 30	Building used for business
Section 31	Plant & Machinery, Furniture &Fixtures used for business
Section 32	Depreciation
Section 32AC	Investment in new plant & machinery
Section 35	Scientific research
Section 35(2AA)	Weighted deduction for cont. to national laboratory etc
Section 35(2AB)	Company assessee, In house scientific research
Section 35AD	Deduction for specified business
Section 35CCA	Expenditure on Rural devp. programmes
Section 35CCC	Expenditure on Agricultural extension project
Section 35CCD	Expenditure on Skill Development Project
Section 35D	Amortization of preliminary expenses
Section 35DDA	Amortization of expenditure in case of VRS
Section 36	Allowable deductions
Section 37(1)	General deductions
Section 37(2B)	Expenditure to political party
Section 38(2)	Building/Plant/Machinery/Furniture not exclusively for business
Section 40(a)	Deductions not allowable
Section 40A(2)	Expenditure to specified persons
Section 40A(3)	Payment other than by account payee cheque
Section 40A(7)	Disallowance for provision for gratuity
Section 40A(9)	Contribution to non statutory funds
Section 40A(13)	No deduction of marked to market loss
Section 41	Deemed profits chargeable to tax
Section 43(1)	Actual cost
Section 43B	Certain deductions on Actual Payment Basis
Section 43AA	Taxation of foreign exchange fluctuation
Section 43CA	Consideration of real estate transactions
Section 43CB	Computation of income from construction and service contracts

Section 44AA	Books of account
Section 44AB	Audit of accounts
Section 44AD/AE/ADA	Deemed business incomes

CHARGEABILITY [SECTION 28]

Following Incomes are chargeable under “Profit and Gains from Business and Profession”

a) **Profit of any Business or Profession** *carried by assessee* **at any time** during Previous Year

b) **Partner of a Firm** : Any Interest, Salary, Bonus, Commission, or any type of remuneration due / received from Firm.

c) **Compensation due or received [section 28(ii)]**

- For Termination/Modification of agreement for managing a Company.
- For Termination/modification of terms of Agency.
- For Vesting in Government, management of any property/business under any law.
- ***From any person, by whatever name called, at or in connection with the termination or the modification of the terms and conditions, of any contract relating to his business[Finance Act,2018]***

d) **Non-Compete fees & Exclusivity rights :** Any sum received/receivable in Cash or kind under an agreement for :

- Not carrying out any activity in relation to any business ***or***,
- Not sharing any know-how, patent, copyright etc., and any similar right.
- Information or techniques likely to assist in the manufacture or processing of goods or provision for service.

e) **Benefits/Perquisites** in cash or kind arising from carrying on business or profession

f) Sum received under **Keyman Insurance Policy** including bonus on such policy

g) **Export Incentives** like

- Sale of Import license.
- Cash assistance against Export.
- Duty drawback of Customs/Excise.
- Profit on transfer of duty entitlement pass book scheme/duty free replenishment certificate

h) Income derived by trade, professional or similar association from **Specific services** performed for its members.

i) Any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if expenditure on such capital asset has been allowed as a deduction u/s 35AD

j) The fair market value of inventory as on the date on which it is converted into, or treated as, a capital asset determined in the prescribed manner. [Section 28(via)]

Special Points :

1. **Section 2(13) : Business** includes any **Trade**, **Commerce** or manufacture or any **Adventure or concern** in the nature of trade, commerce or manufacture. ***Even a single and isolated transaction can be held to be capable of falling in the definition of business. [CIT v Prabhu Dayal (1971) 82 ITR 804(SC)]***

   Definition of Business in section 2(13) is not exhaustive – The definition of the term business in section 2(13) is not exhaustive, it covers every facet of an occupation carried on by a person with a view to earning profits.

   Note: production of goods from raw material, buying and selling of goods to make profits and providing services to others are different form of "business". profit arising there from are, therefore, chargeable to tax under the head"profits and gains from business or profession. The term business" is a word of wide import and in fiscal statutes it must construed in a broad rather than a restricted sense – Mazagaon Dock Ltd. v. CIT [1958] 34 ITR 368 (SC)

   Significance of Profit Motive: Though profit motive is one of the primary requisites of business, it is not an essential ingredient of business for instance, mutual concerns and societies do carry on business,but they seldom have profit motive- General Family Pension Fund v. CIT [1946] 14 ITR 488 (Cal).

   Control and Profit Motives are two crucial tests: if there is neither control over the actual conduct of the day-to day business nor is there any direct nexus (connection or series of connections) with the profits or losses of a business, there can be no question of a business or profession carried on by the assesee in terms of section 28 and the case, therefore, must fall within the ambit of section 56 as income from other sources-CIT v. S.K. Sahana & Sons Ltd.[1987] 33 Taxman 62(Pat).

2. **Section 2(29BA) : Manufacture means A change in non-living physical object or article resulting in transformation of object or article into a New and Distinct object or article having a different name, character or use bringing into existence of a new object or article with a Different chemical composition or integral structure, which is capable as such of being sold or supplied.**

   Business include trade -In the view of section 2(13) business interalia include trade . therefore it is mandatory to deal with it separately. Shah, J., observed in the state of Punjab v. Bajaj electricals Ltd [1968] 70 ITR 730 (SC) that trade in its primary meaning is the exchanging of goods for goods or goods for money ; in its secondary meaning it is repeated activity in the nature of business carried on with purpose of making profit, the activity being manual or mercantile, as distinguished from the liberal arts or learned professions or agriculture.

3. **Section 2(36) : Profession** includes vocation.

4. **Illegal Business :** From Income Tax point of view, even profits of illegal business are taxable under Business or Profession.

5. **Speculation Business :** Where speculative transaction carried on by an assessee is of such a nature as to constitute a business, such speculation business shall be deemed to be distinct & separate from any business. **[Explanation to Section 28]**

6. **Business Loss :** Business Income includes business losses provided they are of revenue nature, real losses & are incidental to carrying on business***. [CIT v K.T.M.S Mahmood (1969)74 ITR 100 (Mad), CIT v Mysore Sugar Co. Ltd. (1962) 46 ITR 649 (SC), CIT v. Abdullabhai Abdulkadar (1961) 41 ITR 545 (SC)]***

METHOD OF ACCOUNTING [SECTION 145]

Section 145(1) : Income under head **Business or Profession &** Income under head **Other Sources** is to be calculated on basis of **Cash or Mercantile basis** of accounting **regularly employed** by the assessee.

Section 145(2) : The Central Government may notify in Official 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.

Section 145(3) : Where the **AO is not satisfied** about the

- **correctness or completeness** of the accounts of assessee, or
- where the **method of accounting** have not been regularly followed by the assessee or
- income has not been computed in accordance with the standards notified
- the AO may make an **assessment u/s 144**

Special point :

Accordingly, the Central Government had, vide *Notification No. S.O.892(E) dated 31.3.2015*, in exercise of the powers conferred by section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by all assessees, following the mercantile system of accounting, for the purposes of computation of income chargeable to income -tax under the head

Profit and gains of business or profession" or "Income from other sources". This notification was to come into force with effect from 1st April, 2015, to be applicable from A.Y. 2016-17

However, the Central Government has, vide *Notification No. S.O.3078(E) dated 29.9.2016*, rescinded *Notification No.S.O.892(E) dated 31.3.2015*. Simultaneously, vide *Notification No. S.O.3079(E) dated 29.9.2016*, the Central Government has notified ten new ICDSs to be applicable from A.Y.2017-18.

The newly notified ICDSs have to be followed by all assessee (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

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

METHOD OF ACCOUNTING IN CERTAIN CASES [SECTION 145A]

For the purpose of determining the income chargeable under the head "Profits and gains of business or profession", –

(i) the valuation of inventory shall be made at lower of actual cost or net realisable value computed in accordance with the income computation and disclosure standards notified u/s 145(2);

(ii) the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation;

(iii) the inventory being 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 in accordance with the income computation and disclosure standards notified u/s 145(2);

(iv) the inventory being securities other than those referred to in clause (iii), shall be valued at lower of actual cost or net realisable value in accordance with the income computation and disclosure standards notified under u/s 145(2) :

Provided that the inventory being securities held by a scheduled bank or public financial institution shall be valued in accordance with the income computation and disclosure standards notified u/s 145(2) after taking into account the extant guidelines issued by the Reserve Bank of India in this regard :

Provided further that the comparison of actual cost and net realisable value of securities shall be made category-wise.

Explanation 1 : For the purposes of this section, any tax, duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment.

TAXATION OF CERTAIN INCOMES [SECTION 145B]

(1) Notwithstanding anything to the contrary contained in section 145, the interest received by an assessee on any compensation or on enhanced compensation, as the case may be, shall be deemed to be the income of the previous year in which it is received (however, it is taxable under section 56 under the head"Income From Other Sources").

(2) Any claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.

(3) The income referred to in sub-clause (xviii) of clause (24) of section 2 shall be deemed to be the income of the previous year in which it is received, if not charged to income-tax in any earlier previous year.

COMPUTATION OF INCOME FROM PROFITS AND GAINS OF BUSINESS OR PROFESSION [SECTION 29]

The income referred to in section 28 shall be computed in accordance with the provisions contained in sections 30 to 43D.

RENT, REPAIRS, TAXES & INSURANCE FOR BUILDINGS [SECTION 30]

In respect of rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession, the following deductions shall be allowed –

(a) where the premises are occupied by the assessee –

(i) as a tenant, the rent paid for such premises ; and further if he has undertaken to bear the cost of repairs to the premises, the amount paid on account of such repairs ;

(ii) otherwise than as a tenant, the amount paid by him on account of current repairs to the premises ;

(b) any sums paid on account of land revenue, local rates or municipal taxes subject to the provision of section 43B ;

(c) the amount of any premium paid in respect of insurance against risk of damage or destruction of the premises.

Explanation : For the removal of doubts, it is hereby declared that the amount paid on account of the cost of repairs referred to in sub-clause (*i*), and the amount paid on account of current repairs referred to in sub-clause (*ii*), of clause (*a*), shall not include any expenditure in the nature of capital expenditure.

NOTE: (i) *Partly used for Business purposes* – where only a part of the business premises taken on rent is used and occupied by the assesee as his dwelling house, a proportion of rent attributable towards the use of premises as dwelling house is not allowed as deduction.

(ii) *Rent V. Premium* – Section 105 of the transfer of property act makes a distinction between the two terms i.e.; rent and premium, while the amount paid for obtaining a lease is "premium", money paid periodically or at some specified occasion is "rent ". The consideration for lease may consist of rent and /or premium amount allowed as deduction under this section is rent for premises taken on lease; such premium is generally regarded as capital expenditure. If, however, premium merely consist of advance payment of rent, it would be allowed as deduction in the relevant years.

REPAIRS AND INSURANCE OF MACHINERY, PLANT AND FURNITURE [SECTION 31]

In respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession, the following deductions shall be allowed –

(*i*) the amount paid on account of current repairs thereto ;

(*ii*) the amount of any premium paid in respect of insurance against risk of damage or destruction thereof.

(*iii*) In order to avail deduction,it is mandatory that plant,machinery,or furniture must be utilized for the purpose of assessee's business during the previous year. It is however not necessary that these assets should be used throughout the previous year - CIT v. National Syndicate [1961] 41 ITR 225(SC).

Explanation : For the removal of doubts, it is hereby declared that the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.

DEPRECIATION [SECTION 32]

Depreciation under the Income Tax Act is a deduction allowed for the decline or loss in the real value of a tangible or intangible asset, due to physical wear, tear and decay, and is generally limited to losses or decline in value which cannot be restored by current repairs and maintenance.

Depreciation shall be allowed if all the following conditions are satisfied :

1. **Specified Assets** : Only the following types of assets are eligible for Depreciation.
   - Tangible Assets : Building, Machinery, Plant or Furniture.
   - Intangible Assets : Know-how, patent, copyright, trademark, licence, franchise or other rights
2. **Purpose** : The specified assets should be used for **Business or Profession** of assessee.
3. **Ownership** : The specified assets can be ***Wholly* or *partly*** owned by assessee during the previous year.

   Note : (i) Registered ownership is not mandatory- it is not mandatory that the assesee should be registered owner of the asset. Exclusion possession rights, to exclude others from the enjoyment of the asset, full control over the assets or premises, right to retain possession and defend the same are but some of the characteristics of the ownership which would entitle a person to claim the depreciation allowance under section 32 - *Mysore Minerals Ltd v. CIT* [1999] 106 Taxman 166 (SC).

   (ii) *Property of Partnership Firm* : the partnership firm is entitled to claim depreciation only on immoveable assets brought by partners as their capital contribution,even if such assets are not registered in the name of the partnership firm under the Transfer of Property Act.

   (iii) *Property Taken on Hire Purchase*: in the case of hire- purchase the rentals paid by the hire-purchaser enable him to claim depreciation on the assets. Thus in hire purchase contract the economic ownership rests with the hire-purchaser not the lessor. A circlular of the board issued in 1943 governs the tax treatment in such cases. The hire vendor will only enter the financial transaction in the books of the accounts and show only the interest part of the instalment as taxable income. this situation is prevailing notwithstanding the fact that under the civil law the ownership does not pass to the hire-purchaser until the last instalment is received.

   (iv) *Depreciation on Fractional Ownership:* After the amendment in section 32(1) by the Finance (No.2) Act, 1996, depreciation is admissible even in respect of fractional ownership of an asset.

   (v) *Purchase of Shares* : when the shares of a real estate company is purchased by the assessee and by the virtue of these shares, he become the absolute owner of such flat,so as result of this it is entitled to claim depreciation on such flat – *Deepak Fertilisers & Petrochemicals Corpn. Ltd. v. CIT* [2008] 117 TTJ (Mum.) 752.
4. **Basis of Depreciation** : Depreciation shall be calculated as per below formula :

   [Rate of Depreciation **] X [WDV** of the **Block Of Asset as on last day of the P/Y]**

   Block of Asset [Section 2(11)]

   - Group of assets falling within a class of assets
   - Comprising of Tangible assets and Intangible assets
   - In respect of which same percentage of depreciation is prescribed.

Written Down Value (WDV) [Section 43(6)]

WDV of block of assets at the beginning of relevant P/Y	**A**
Add : Actual Cost of asset belonging to that block acquired during P/Y	B
Less : **Money Received/Receivable** on assets sold, discarded, demolished or destroyed during previous year including Scrap Value	**C**
WDV of the block of asset as on the last day relevant P/Y	A+B-C

Special points: (i) Where the income of an assessee is derived in ***Part from Agriculture & in Part from P/G/B/P***, for computing WDV, the total amount of depreciation shall be computed as if the entire income is derived from the business of the assessee under the head P/G/B/P.

(ii) the resulting amount is the written down value of the block of the asset on March 31, 2019 relevant for the A/Y 2019-20

(iii) one may determine WDV for the other assessment year on similiar basis.

(iv) value to be reduced from the block of the asset shall be the actual sale consideration received and not the fair market value of the asset transferred - *CIT v. Cable Corportion of India Ltd.* [2011] 201 Taxman 339 (Bom.).

(v) even in case of asset acquired before the previous year where in past no depreciation was computed, actually

RATES OF DEPRECIATION

TYPES OF ASSETS	% Depreciation
Building :	
– Residential buildings other than hotels and boarding houses	5 %
– Non Residential[it covers hotels and boarding houses]	10 %
– Temporary Structure*	40 %
Furniture & Fittings including Electrical Fittings	10%
Plant & Machinery :	
– Books owned by Professional	40%
– Books owned for Library business	40%
– Air & Water Pollution control equipments	40%
– Renewal energy device	40%
– Computer including computer software	40%
– Aero planes	40%
– Life saving Medical Equipment	40%
– Motor car, buses, lorries etc used for hire	30%
– Ships/Speed boats	20%
– Oil wells	15%
– General rate of other machinery	15%
Intangible Assets :	25%

Note: As per the landmark judgment of **CIT V/s Annamalai Finance Ltd.** (Madras HC) It is the end use of the specified asset which is relevant for determining the percentage of depreciation. For example in case of business of leasing out vehicle, if lessee is using the vehicle for running them on hire, depreciation shall be allowable at Higher rate of 30% instead of 15% to the lessor.

Special Points :

1. **Plant** Includes Ships, Vehicles, Books, Scientific Apparatus & Surgical Equipment used for business or profession and does not include Tea Bushes, Live Stock, Building or furniture & fixtures.
2. Building includes Roads, Bridges, Wells, Tube wells.
3. Residential Building means a building in which atleast 2/3rd of the built-up area is used for residential purposes.
4. Wind mills/Related Equipment/Generator or pump driven by wind mills installed w.e.f. 1/4/2014 : 40% Otherwise : 15%
5. a* building acquired on or after september 1, 2002 for installing plant and machinary forming the part of water supply project or water supply project or water treatment system and which is put to use for the purchase of business of providing infrastructure facilities under the clause(i) of sub -section (4) of section 80-IA;

   b. temporary erections such as wooden structures
6. **Case laws on depreciation**

   a) Depreciation is allowed on construction of any land/building taken on lease. [CIT v Noida toll bridge Co.Ltd (2013) 213 Taxmann 333(All.)]

   b) Depreciation is allowed on assets taken on hire purchase

   [CIT v General Industries Corporation (1985) 155 ITR 430 (Delhi)]

   c) Depreciation at the rate of 10 % is available in respect of hotel building even if the building is also used for providing residence of the employees, letting out to the bank and shops - CIT v. Sangu Chakra Hotels (P) Ltd.[2007]161 Taxman 257(Mad). landscaping done by the assesee in its hotel building is to be considering as building -CIT v. Hotel Excelsior Ltd. [2011] 141 TTJ (Delhi)248.

Illustration 1 : Compute depreciation for Assessment year 2021-22

Machinery A 15% WDV as on 1/04/20	Rs. 1,00,000
Machinery B 15% acquired on 15/04/20	Rs. 50,000
Machinery C 15% acquired on 30/09/20	Rs. 60,000

Machinery A sold on 20/05/20 for Rs. 40,000 & Machinery C sold on 11/12/20 for Rs. 40,000.

Solution : Closing block = Rs.1,00,000+Rs.50,000+Rs.60,000-Rs.40,000 -Rs.40,000 = Rs.1,30,000

Depreciation = 15% of Rs.1,30,000 = Rs.19,500

Depreciation Restricted to 50% [Proviso to section 32(1)]

- Where assets **acquired** during previous year
- and **put to use** for less than 180 days in **that** previous year
- Then depreciation on that asset **restricted to 50%** of normal rate
- for **that previous year** only

Special point : Use includes actual as well as passive use(kept ready to use) **[CIT v. Geo Tech Construction Corpn. (2000) 244 ITR 452/112 Taxmann 373 (Ker.)]**

Illustration 2 : Compute depreciation for Assessment year 2021-22

Machinery A : 15% WDV as on 01/04/20 :	Rs. 1,00,000
Machinery B : 15% acquired on 15/04/20 :	Rs. 50,000

& Put to use on 18/12/2020

Solution : Closing block = Rs.1,00,000 + Rs.50,000 = Rs.1,50,000

Depreciation = 15% of Rs.1,00,000 + 7.5% of Rs.50,000 = Rs.18,750

Additional Depreciation [Section 32(iia)]

a. **General Case :**

- Assessee engaged in the business of **manufacture or production** of **any article or thing** or (with effect from the assessment year 2013-14) **"In business of Generation, Transmission or Distribution of power**
- **New Machinery or plant** acquired and installed after March 31, 2005 (other than ships & aircraft)
- **it must be an eligible plant and machinary**

b. **Specific case :**

- Assessee, sets up an undertaking for manufacture or production of any article or thing,
- On or after the 1st day of April, 2015 but before 01/04/2020
- In any notified backward area,
- In Andhra Pradesh or Bihar or Telangana or West Bengal,
- Acquires and installs any new machinery or plant (other than ships and aircraft)
- for the purposes of the said undertaking
- during 1/4/15 and 31/3/2020 in the said backward area

c. **Conditions to be satisfied :**

i. Plant & Machinery should not be used by any person in India or outside India before the date of installation by assessee.

ii. Plant & Machinery not installed in **office premises** or in **residential accommodation** including a guest house.

iii. Plant & Machinery should not be an **office appliance** or road transport vehicle.

iv. **Whole of actual cost** of Plant & Machinery **not allowed as deduction** under P/G/B/P of any one previous year.

d. **Quantum of Increased Depreciation**

General case : 20% for the Previous Year in which conditions are satisfied

(If acquired and put to use for less than 180 days then **10% &** ***balance 10% next year*** *)*

Special case : 35% for the Previous Year in which in case of notified backward areas of respective states

(If acquired and put to use for less than 180 days then 17.5% & balance 17.5% next year)

Special point : 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]

e. **the term "manufacture" or "production", "article" and "things" have been interpreted in many judicial pronouncements and according to the judgment, a taxpayers which are engaged in the following kind of activities are not eligible fo the additional depreciation-**

- cooking food in Hotel-Indian Hotels Co. Ltd v. ITO [2000]112 taxman 46 (SC)
- construction of dam, building or contract for civil engineering - CIT v. Buildmet (P.) Ltd. [1993] 204 ITR 413 (SC), CIT v. N.C Budhraja & co.[1993] 204 ITR 412(SC)
- Cutting and polishing raw diamonds - CIT v. Gem India Manufacturing Co. [2001] 249 ITR 307 (SC)
- incubate of eggs - CIT v. Venkateswara Hatcheries (P) Ltd. [1999] 237 ITR 174 (SC)
- compressing piling for building - CIT v. Pressure Piling Co. (I) (P.) Ltd. [1993) 204 ITR 412 (SC)

Note: If an individual or HUF opts to be taxed as per the new alternative regime under section 115BAC he / it will not be entitled to claim deduction of additional depreciation. ***[As Amended by Finance Act, 2020]***

Illustration 3 : (Additional Depreciation) : Mr. X is engaged in the business of manufacture. During the previous year 19-20, he submits the following information :

Machinery	**Block**
Rate of Depreciation	**15%**
WDV of block as on 01/04/20	2,00,000
New Machinery acquired on 15/04/20	1,00,000
New Machinery put to use	20/05/20
Sale of Old Machinery in opening Block on 15/12/20	50,000

Compute depreciation for A/Y 2021-22.Assuming all conditions for availing additional depreciation are satisfied

Solution : Closing WDV = Rs.2,00,000 +Rs.1,00,000 -Rs.50,000 = Rs.2,50,000

Normal depreciation = 15% of Rs.2,50,000 = Rs.37,500

Additional Depreciation = 20% of Rs.1,00,000 = Rs.20,000

Proportionate Depreciation [Proviso to section 32(1)]

- In case of succession of ***Partnership Firm/Sole proprietary firm*** by a **Company** u/s **47** or
- ***Conversion of Private Company or Unlisted Public Company*** *into a* ***Limited Liability Partnership u/s 47***
- ***Amalgamation*** **u/s 2(IB)** or ***De merger u/s 2(19AA)*** or
- Other cases of ***Succession otherwise on death***
  - Depreciation allowable for the P/Y in which the above succession takes place
  - Shall be apportioned between the ***Predecessor*** & **Successor**
  - On the basis of Number of **days the assets used** by them during that P/Y.

Illustration 4 : A Sole Proprietary concern, whose WDV of block of asset as on 01-04-2020 carrying 15% rate of depreciation is Rs.3,00,000, purchased another asset of same block on 15/10/20 for Rs.1,00,000. The said concern is succeeded by the company on 1/11/20. Compute depreciation available to Proprietary concern and to the company for A/Y 2021-22.

Solution : Computation of Depreciation for A/Y 2021-22

Assuming no Amalgamation has taken place

Particulars	**Amount (Rs.)**
Opening WDV	3,00,000
Add : Actual cost of asset	1,00,000
Less : Sale of Asset	NIL
Closing WDV	4,00,000
Depreciation	
Opening block 3,00,000 x15%	45,000
New Asset 1,00,000 x 15% x ½	7,500

Apportionment of depreciation between sole proprietary concern & company on the basis of number of days asset used by each during Previous Year

Particulars	**Sole proprietary concern**	**Company**
Number of days opening block used in p/y Apportionment of depreciation of opening block	1/4/2020 to 31/10/20 = 214 days 45,000 x 214/365 = 26,384	1/11/2020 to 31/3/2021 = 151 days 45,000 x 151/365 =18,616
Number of days new asset used in p/y Apportionment of depreciation of opening block	15/10/20 to 31/10/20 = 17 days 7,500 x 17/168 = 759	1/11/2020 to 31/3/2021 = 151 days 7,500 x 151/168 = 6,741
Total depreciation	26,384 + 759 = 27,143	18,616 + 6,741 = 25,357

Short Term Capital Gain for Block Assets [Section 50]

Whenever a depreciable asset of block is sold, the Sales consideration is Subtracted from WDV of the block to which such asset belongs.

CASE 1	CASE 2
1**. All Assets** of block are transferred during P/Y 2. Block **Ceases to exist** & **no depreciation** shall be provided for that P/Y 3. Closing WDV/balance is **Short term capital Gain (in case of negative balance) or Loss (in case of positive balance) Refer illustration 5**	1. **Some Assets** of block are transferred during P/Y & Sale proceeds of assets transferred > (Opening W.D.V + Actual cost of new assets acquired during the relevant previous year of the same block) 2. Block **will Exist at NIL value &no depreciation** shall be provided for that P/Y 3. Closing WDV/ balance is Short term capital gain. **Refer illustration 6**

Illustration 5 : WDV block of machinery (consisting of machinery X & Y) (Depreciation 15%) as on 01-04-20 is Rs.3,00,000. Another Machinery Z acquired on 30/09/20 for Rs.1,00,000.

All the three Machinery are sold on 20/12/20. Determine tax treatment for assessment year 2021-22 assuming

A) All Machinery sold for Rs.2,50,000

B) All Machinery sold for Rs.6,50,000

Solution :

A) Block cease to exist, STCL u/s 50 = Rs.3,00,000 + Rs.1,00,000 – Rs.2,50,000 = Rs.1,50,000

B) Block cease to exist, STCG u/s 50 = Rs.3,00,000 + Rs.1,00,000 – Rs.6,50,000 = Rs.2,50,000

Illustration 6 : WDV block of machinery (consisting of machinery X & Y) (Depreciation 15%) as on 01-04-20 is Rs.3,00,000. Another Machinery Z acquired on 30/09/20 for Rs.1,00,000. Machinery X is sold on 20/12/20. Determine tax treatment for assessment year 2021-22 assuming

A) Sold for Rs.1,50,000

B) Sold for Rs.5,00,000

Solution :

A) Closing WDV = Rs.3,00,000 +Rs.1,00,000 - Rs.1,50,000 = Rs.2,50,000. Depreciation @ 15% of Rs.2,50,000=Rs.37,500

B) Block exist at Nil Value, STCG u/s 50 = Rs.3,00,000 + Rs.1,00,000 – Rs.5,00,000 = Rs.1,00,000

Depreciation for Undertaking engaged in generation or generation & distribution of power [Section 32(1)]

Such undertaking has the option either to claim depreciation

- On W.D.V basis on block of assets **or**
- On S.L.M basis on the **actual Cost of assets**
- Such option has to be exercised before furnishing ROI for the assessment year in which undertaking starts to generate power. (*Once such option is exercised it will be final and later on cannot be changed)*

Tax treatment on Sale of assets by such undertaking

- ***Depreciation Claimed and provided*** *on* ***WDV basis : Treatment as done in block of Asset***
- ***Depreciation Claimed and provided*** *on* ***SLM basis :***

Step 1 : Find out **Opening Value** as on 1/4/2020 (Cost of asset less depreciation claimed in prior p/y)

Step 2 :

Sale price < Opening value	**Sale Price > Opening value**
Loss is **Terminal Depreciation** allowed as deduction in the P/Y of sale.	**Deemed Business Income (Balancing Charge)** **= Selling price or Deduction Claimed, less taxable u/s 41(2)** in P/Y of sale **:** Capital Gain = Selling price > Cost *Short term or long term depending upon period of holding*

Illustration 7 : X Ltd is power generating unit .On 15th December, 2019, it purchases an asset for Rs.4,00,000 on which it is charging depreciation on straight line method @ 20%. The asset is sold on 20/06/2020. Determine tax treatment for AY 2021-22 if asset is sold for a) 3,00,000 b) 3,80,000 c) 4,20,000

Solution : Tax treatment for A/Y 2021-22

Particulars	Case 1	Case 2	Case 3
Opening value as on 1/4/2020 (Cost – depreciation of p/y 2019/20) i.e. Rs.4,00,000 – 10% of Rs.4,00,000 (used for < 180 days)	Rs.3,60,000	Rs.3,60,000	Rs.3,60,000
Selling price	Rs.3,00,000	Rs.3,80,000	Rs.4,20,000
Gain/Loss	Loss Rs.60,000	Gain Rs.20,000	Gain Rs.60,000
Balancing charge taxable under PGBP u/s 41(2)	Nil	Rs.20,000	Rs.40,000
Capital Gains	Nil	Nil	STCG Rs.20,000
Terminal depreciation as deduction from PGBP	Rs.60,000	Nil	Nil

Actual Cost [Section 43(1)]

Means actual cost of the asset to the assessee reduced by that portion of the cost, which is met directly or indirectly by any other person or authority.

If assessee incurred any expenditure for acquisition of any asset or part for which payment or aggregate of payments made to a person in a day, otherwise than by A/C payee cheque drawn on bank or A/C payee bank draft or use of ECS through bank account, or through such other electronic mode as may be prescribed (inserted by Finance (No.2) Act, 2019 exceeds Rs.10,000, such expenditure shall not be included in actual cost.

Explanations to section 43(1)	Notional Actual Cost
Asset ceases to be used for Scientific research & now to be used for B/P of the Assessee.	Actual Cost to Assessee ***Less :*** Deduction claimed u/s.35
Where a capital asset referred in section 28(via) is used for the purposes of business or profession	**fair market value which has been taken into account for the purposes of section 28(via)**
Asset belonging to other person is gifted or inherited by the Assessee	Actual cost to other person ***Less :*** Deduction allowed to previous owner as if only asset in block
Asset belonging to other person, used for the purpose of his business or profession is transferred to Assessee and AO is satisfied that transfer is to reduce Income tax liability	Amount determined by AO with prior approval of Joint Commissioner
Building belonging to assessee brought into B&P during P/Y	Actual cost ***Less*** Depreciation allowable as if building used for Business/profession since its acquisition.

Interest paid or payable for acquiring an asset	Will not be added to actual cost after asset first put to use.
Where an asset is acquired on which Excise, Custom Duty is repayable	Actual cost reduced by Excise, Custom Duty repayable
Where portion of cost of an asset met by Central Government, State Government, Authority or other person	
→ If Subsidy, Grant etc., is *directly related* to the asset	Actual cost reduced by value of subsidy
→ If Subsidy, Grant etc., is *not directly* related to an asset but a consolidated sum	Actual cost reduced by proportionate amount of subsidy.
Capital asset on which deduction has been allowed u/s 35AD	NIL

Note: Interest paid before the commencement of the production on amounts borrowed by the assessee for acquisition and installation of the plant and machinery shall form part of the actual cost u/s 43(1), as decided by the **Supreme Court in Challapalli Sugars Limited Vs CIT.**

MISCELLANEOUS ISSUES OF DEPRECIATION

1. Is it mandatory to claim depreciation : *Explanation to Section 32 :* Depreciation provisions shall apply whether or not the assessee has claimed deduction for depreciation.

2. Carry forward and set off of unabsorbed depreciation [Section 32(2)]

a) Deduct current year depreciation from current year income under P/G/B/P.

b) If current year P/G/B/P is insufficient deduct balance depreciation from other head of income for same previous year.[Except income under the head “Salaries”]

c) Even if incomes under other heads insufficient, it is *unabsorbed depreciation* which will be carried forward for **any number** of assessment years by the same assessee.

d) In the next assessment years,b/f unabsorbed depreciation will be added to current year depreciation and again step 1 to step 4 will be followed

However, if B/F losses are also there in a previous year along with B/F unabsorbed depreciation, then priority of set off shall be as follows

- 1st setoff current year depreciation
- Then setoff brought forward losses
- Then setoff unabsorbed depreciation

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.

Special point :

1. The business or profession of which depreciation was computed need not be carried on in the previous year in which b/f depreciation is set off.

2. Depreciation can be c/f only by the **same assessee** i.e. Assessee who has claimed the deduction for depreciation and the assessee who wants to carry forward the depreciation must be the same.

Exceptions to 2nd point :

a) Firm succeeded by a company u/s 47

b) Proprietary concern succeeded by a Company u/s 47

c) Amalgamation or Demerger

Illustration 8 : Mr. X furnishes the following particulars of his Income for previous year 2020-21. Determine Mr. X Total Income for A/Y 2021-22

Particulars	Rs.
Depreciation	85,000
Business Income before depreciation	10,000
Income under head House Property	5,000
Income under head Capital Gains	15,000
Income under head Other sources	10,000
Income under head Salary	10,000

Solution :

Total Income for A/Y 2021-22

Heads of Income	Amount (Rs.)
Income under head Salary	10,000
Income under head House Property	5,000 – depreciation 5,000 = Nil
Income from Business	10,000 – depreciation 10,000 = Nil
Income under head Capital Gains	15,000 – depreciation 15,000 = Nil
Income under head Other sources	10,000 - depreciation 10,000 = Nil
Gross Total Income/Total Income	10,000
Unabsorbed deprecation C/F to subsequent years	45,000

Illustration 9 : Mr. X furnishes the following particulars of his Income for previous year 2020-21. Determine Mr.X Total Income for A/Y 2021-22

Particulars	Rs.
Depreciation	65,000
Business Income before depreciation	1,00,000
B/f Business Loss	30,000

B/f Depreciation	45,000
Income under head Capital Gains	10,000
Income under head Other sources	5,000

Solution :

Heads of Income	**Amount (Rs.)**
Income from Business	1,00,000-Current year depreciation 65,000 – B/F loss 30,000 – B/F depreciation 5000 = Nil
Income under head Capital Gains	10,000 – B/f depreciation 10,000 = Nil
Income under head Other sources	5,000 – B/f depreciation 5,000 = Nil
Gross Total Income/Total Income	NIL
Unabsorbed deprecation C/F to subsequent years	25,000

Asset not exclusively used for Business or Profession [Section 38(2)]

- Where Building, Machinery, Plant or Furniture
- **Not exclusively** used for Business or Profession
- Then deduction **u/s. 30, 31, 32**
- Shall be restricted to such **fair proportion** as AO may determine for purpose of business or profession.

Illustration 10 : Mr. X Purchased a car on 15/05/19 for Rs.5,00,000. Compute the depreciation for Assessment year 2021-22 assuming :

a) Car is only item in the block and

b) 40% of car is used for personal purpose

c) Rate of depreciation eligible for car is 15%

Solution :

Particulars	**P/Y 19-20 (Rs.)**	**P/Y 20-21 (Rs.)**
Opening WDV	Nil	5,00,000 – 45,000 = 4,55,000
Add : Purchase of Car	5,00,000	Nil
Less : Sale	Nil	Nil
Closing WDV	5,00,000	4,55,000
Depreciation @ 15%	75,000	68,250
Less : disallowed u/s 38(2) 40% of Total depreciation	30,000	27,300
Allowable depreciation	**45,000**	**40,950**

INVESTMENT ALLOWANCE FOR NEW PLANT & MACHINERY IN BACKWARD AREA [SECTION 32 AD]

Assessee	Assessee, sets up an undertaking for manufacture or production of any article or thing, on or after the 1st day of April, 2015 in any notified backward area, in Andhra Pradesh or Bihar or Telangana or West Bengal
Investment	Acquires and installs any new asset for the purposes of the said undertaking during 1/4/15 and 31/3/2020 in backward area
Deduction	15% of actual cost of such new asset in previous year in which such new asset is installed
New Asset	New plant or machinery (other than ship or aircraft) Excluding : (i) Plant or Machinery which before its installation by assessee was used either within or outside India by any other person (ii) Plant or Machinery installed in any office premises or any residential accommodation, including guest house (iii) Office appliances including computers or computer software (iv) Any vehicle or (v) Plant or Machinery, whole of actual cost allowed as deduction (whether by way of depreciation/otherwise) in computing income of Business/Profession of any p/y
New Asset sold	■ If any new asset acquired and installed ■ sold or otherwise transferred, ■ except under amalgamation or demerger or reorganisation of business u/s 47, ■ within 5 year from date of its installation, ■ Amount of deduction on such new asset ■ shall be deemed to be income of business or profession ■ of p/y of sale or otherwise transfer, ■ in addition to taxability of gains, arising on account of transfer of such new asset. ✓ If new asset is sold or transferred under amalgamation or demerger or reorganisation of business u/s 47 ✓ within 5 years from date of its installation, ✓ Above provisions shall apply ✓ to Amalgamated company or resulting company or successor, ✓ as they would have applied to amalgamating company or demerged company or predecessor referred u/s 47

Note : If an individual or HUF opts to be taxed as per the new alternative regime under section 115BAC he/it will not be entitled to claim deduction of investment in new plant and machinery in notified backward areas. ***[As Amended by Finance Act, 2020]***

Illustration 11 : X ltd sets up an undertaking in a notified backward area in Andhra Pradesh for manufacturing. For this purpose, it purchased new plant and machinery (Rate of normal depreciation : 15%, Opening WDV 10 crores) as follows :

Plant	**Actual cost (Rs. crore)**	**Date of purchase**	**Date of installation**	**Date when put to use**
A	**20**	**15/4/2019**	**20/5/2019**	**25/5/2019**

Find out normal depreciation, additional depreciation & investment allowance assuming all the conditions have been fulfilled for claiming above benefits

Solution :

Particulars	**Amount (Rs.)**
Normal depreciation : 15% of Closing WDV	15% of (10 + 20 =30 crores) = 4.5 crore
Additional Depreciation : 35% of Actual Cost	35% of 20 crore = 7 crore
Investment Allowance : 15% of Actual cost	15% of 20 crore = 3 crore

DEDUCTION FOR BUSINESS OF TEA/COFFEE/RUBBER/EXPLORATION [SECTION 33AB/ABA]

Section		**Tea/coffee/rubber Development Account [Section 33AB]**	**Site Restoration Fund [Section 33ABA]**
1	Assessee	Growing and Manufacturing Tea or Coffee or Rubber **in India**	Prospecting or Extraction or production of Petroleum or Natural Gas or both **in India**
2	Conditions	Deposit with NABARD ***or*** Deposit Account under scheme framed by Tea/Coffee/Rubber board with the previous approval of the Central Government within 6 months from end of Previous Year **or** before due date of furnishing Return, **Whichever is earlier**	Deposit in State Bank of India in a special Account under scheme framed by Ministry of Petroleum & Natural Gas **or** In a site restoration account opened as per the scheme of above ministry ***before end of previous year*** And the account of the assessee should be audited.
3	Deduction	Amount deposited under point 2 ***or*** **40%** profits of such business computed under the head "P/G/B/P" before 33AB, ***whichever is less***	Amount deposited under point 2 ***or*** **20%** profits of such business computed under the head "P/G/B/P" before 33ABA, ***whichever is less***

Special Point : Applicable for both Sections

1.	**Restriction on utilization of Amount deposited**	Amount withdrawn to be **utilised in accordance** with **scheme specified**. However, amount withdrawn for the purchase of following shall be deemed to be Business income. i. Plant & Machinery to be installed in Office or Residence, ii. Office appliance (other than computer), iii. Plant & Machinery, whole of cost allowed as deduction under Business in one year iv. Plant & Machinery for manufacturing an article specified in **XI Schedule.**

2.	**Withdrawal of Deduction**	Amount withdrawn not utilised for, 1. Specified purposes, **amount that is not utilised** shall be **Business Income of that P/Y.** 2. Asset sold before 8 years from end of previous year in which acquired, deduction claimed w.r.t cost of asset, **Business Income of P/Y of sale**.
3.	**CA Report**	Accounts audited by CA & report attach with Return of Income

Note:

1. The audit report is to be furnished at least one month prior to the due date for furnishing the return of income under section 139(1). ***[As Amended by Finance Act, 2020]***
2. If an individual or HUF opts to be taxed as per the new alternative regime under section 115BAC he/it will not be entitled to claim deduction on account of Tea/ Coffee/Rubber development account and on account of Site Restoration fund. ***[As Amended by Finance Act, 2020]***

Illustration 12 : X ltd is engaged in the business of growing and manufacturing tea in India. It has derived a Total Income from such business of Rs.100 lakhs for previous year 31.3.2021.The said income is computed before allowing deduction u/s33AB.The company has deposited 30 lakhs with NABARD on 24.5.2021 for claiming deduction u/s 33AB.The company has brought forward business losses of 6 lakh. Compute Taxable Income of X ltd.

Solution : Computation of Total Income of X Ltd for A/Y 2021-22

Particulars	Amount in lakhs (Rs.)
Income under head Business Income before deduction u/s 33AB Less : Deduction u/s 33AB 40% of 100 lakh or 30 lakhs, Less : Income after deduction	 100 30 70
(Rule 8) 40% taxable 60% exempt i.e. 60% 70 lakh = 42 lakh	**40% of 70 = 28**
Less B.F loss	6
Gross Total Income	**22**

EXPENDITURE ON SCIENTIFIC RESEARCH [SECTION 35]

The term scientific research means any activities for the augmentation of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries.

Scientific research carried out by assessee i.e. In-house Scientific Research (**has to be related to Assessee Business)**			
Pre commencement (3 years prior to date of commencement of Business)		**Post commencement** (On or after date of commencement)	
Revenue expenditure **Section 35(1)(i)**	**Capital Expenditure** **Section 35(1)(iv)**	**Revenue Expenditure** **Section 35(1)(i)**	**Capital Expenditure** **Section 35(1)(iv)**
Salary of Research Staff & **Purchase of Material** for scientific Research only	Any Capital expenditure **except Land**	**All** Revenue Expenditure	Any Capital expenditure **except Land**
Deduction in P/Y of commencement	Deduction in P/Y of commencement	**Deduction in P/Y in which incurred**	**Deduction in P/Y in which incurred**

Expenses on purchase of cabs and buses which are used to transport employees engaged in scientific research. [CIT v Smith Kline & French (India) Ltd.(1994)77 Taxmann 153(Kar)]

Special Points : Applicable for Pre commencement revenue expenditure only

1. Salary **does not include perquisites**
2. Such revenue expenditure has to be certified by **prescribed authority***

*prescribed authority shall be the director General (income tax exemptions) in concurrence with the secretary, department of scientific and industrial research,government of India. when the question relates to any activity under the clause(ii) and (iii) of section 35(1), it shall referred by the board to the central government shall be final.

Illustration 13 : Mr. X is engaged in paper business and commenced production of paper on 1^{st} December, 2020. He has incurred the following expenditure on scientific research.

1. Salary of research staff from 1^{st} December 2017 to 30^{th} November, 2020 : Rs.60,000 (out of which Rs.20,000 certified by prescribed authority)
2. Purchase of research material from 1^{st} December, 2017 to 30^{th} November, 2020 : Rs.30,000 (out of which Rs.25,000 certified by prescribed authority)
3. Rent paid for building in which research carried out from 01/12/17 to 30/11/20 : Rs.36,000 & from 1^{st} Dec 20 to 31^{st} Jan 21 : Rs.4,000
4. On 15^{th} Feb, 21, the company purchases a plot of land for Rs. 6,00,000. Later on a Laboratory building is constructed (cost of Construction : Rs.2,70,000 & Date of Completion 25^{th} March 21) to do in house scientific research.

   Compute deduction u/s 35 for A/Y 2021-22.

Solution :

Computation of Deduction u/s 35 for A/Y 2021-22

Type of Expenditure	**Amount (Rs.)**
Salary of research staff	20,000
Purchase of research material	25,000
Rent paid for building	4,000
Purchases of plot of land	Not allowed
Construction of Laboratory building	2,70,000
Total	**3,19,000**

Calculation of Deduction u/s 35

1. Revenue expenditure on scientific research is **100% allowed** as deduction irrespective of profits.
2. Capital expenditure on scientific research are allowed as deduction **subject to availability of profit**.
3. Set off & Carry forward **same as unabsorbed depreciation**

Section 35 (2AB)

- Company Assessee *(Engaged in Manufacture of any article except specified under XI schedule)*
- Incurred expenditure (**Except on Land & Building**) on **in house** scientific research **approved by prescribed authority**
- **Weighted deduction of 150 % of such expenditure will be allowed (A/Y 2013-14 to 2021-22)[100% w.e.f.A/Y 21-22, but not on weighted deduction]**
- **Payee company cannot claim weighted deduction under the section 35(2AB): for purpose avoiding mutiple claims,it has been provided that the payee company approved under the provision of section 35(2)(iia) will not be entitled to claim weighted deduction under section 35(2AB). Deduction upto 100% of the sum spent as revenue expenditure or capital expenditure on scientific research, which is available under section 35(1), will continue to be allowed.**

Contributions/Donations for Research to Approved Associations

(Related or Unrelated to Assessee business)

Section 35(1)(ii)	**Section 35(1)(iii)**	**Section 35 (2AA)**	**Section 35(1)(iia)**
Approved Research association/ University /College for scientific research	Approved Research association /University, Institution for Social science or statistical research	National Laboratory or University or IIT for approved Scientific Research Programme	Indian company having main object of scientific research & development & approved by prescribed authority
150% of amount paid allowed **WEF A/Y 21/22 : 100%**	***100%*** of amount paid allowed	***150%*** of amount paid allowed **WEF A/Y 21/22 : 100%**	**100%** of amount paid allowed

Special point : Deduction u/s 35 **shall not be disallowed** if subsequent to payment, approval of such association, institution, etc is withdrawn.

CASE STUDY : Where the assessee himself carries on scientific research and for the purpose of it incurred any revenue expenditure during the relevant previous year, deduction will be allowed for such expenditure, however it must related to the business of the assessee. in this case, expenditure on material purchased for such research and development will be allowed as deduction under section 35, regardless of the fact that whether material is consumed during the relevant previous year or held as closing stock – Balaji Amines Ltd. v. CIT [2015] 153 ITD 20 (Pune).

Provided that every notification on account of payment to outside agencies under section 35(1)(ii), (iia), (iii) in respect of the research association, university, college or other institution, issued on or before the date on which Section 35(1) has come into force, shall be deemed to have been withdrawn unless such outside agency makes an intimation in such form and manner, as may be prescribed, to the prescribed income-tax authority by 31.08.2020 and subject to such intimation the notification shall be valid for a period of five consecutive assessment years beginning with the assessment year commencing on or after the 1st day of April, 2021. ***[As Amended by Finance Act, 2020]***

Provided further these outside agencies (Donee) under section 35(1)(ii), (iia), (iii) are not entitled to deduction under section 35(1) unless they prepare and deliver the Statement of donation receipts by Donee to cross check claim of donation by Donor for such period as may be prescribed to the said prescribed income-tax authority in such form, verified in such manner and within such time, as may be prescribed. And furnishes a certificate to the donor, specifying the amount of donation within such time from the date of receipt of sum. **[As Amended by Finance Act, 2020]**

Note:

1. Any failure by the Donee in preparing and delivering the Statement of donation to the Income Tax Authority or in furnishing certificate to the donor within the time prescribed shall attract fee @Rs. 200 for every day during which the failure continues under section 234G along with the penalty for a sum not less than Rs. 10,000 which may be extended to Rs. 1,00,000 under section 271K. **[As Amended by Finance Act, 2020]**

2. If an Individual or HUF opts to be taxed as per the new alternative regime under section 115BAC he / it will not be entitled to claim deduction on account of payment to outside agencies for Scientific Research under section 35(1)(ii), (iia), (iii) and 35(2AA). ***[As Amended by Finance Act, 2020]***

Illustration 14 : Mr. X has incurred the below expenditure during previous year 2020-21. Discuss whether such expenditure will be allowed or not for Assessment year 2021-22.

(a) Payment of Rs. 50,000 on 1st October, 20 an association which is approved us 35(1) for carrying on scientific research related to business of Mr. X.

(b) Payment of Rs. 35,000 on 15th January, 21 to a university & which is approved up 35(1), for carrying out social & statistical research related to business of Mr. X.

(c) Payment of Rs. 60,000 on 4th December 20 to approved national laboratory for carrying on approved scientific research programme related to business of Mr. X.

Solution :

Particulars	**Deduction Amount(Rs.)**
(a) Payment of Rs. 50,000 on 1st October, 2020 an association which is approved us 35(1) for carrying on scientific research related to business of Mr. X.	50,000 x 100% = 50,000

(b) Payment of Rs. 35,000 on 15th January, 2021 to a university & which is approved up 35(1), for carrying out social & statistical research related to business of Mr. X.	35,000 x 100 % = 35,000
(c) Payment of Rs. 60,000 on 4th December 2020 to approved national laboratory for carrying on approved scientific research programme related to business of Mr. X.	60,000 x 100% = 60,000

Tax treatment on Sale of Asset used for Scientific Research

Option 1 : Sold without using for business

Step 1 : Find out **Opening Value** as on 1/4/2020 (Cost of asset less deduction claimed in prior p/y)

Step 2 :

Sale price < Opening W.D.V	**Sale Price > Opening W.D.V**
Loss is allowed as Business deduction in the P/Y of sale.	**Deemed Business Income** taxable u/s **41(3)** in P/Y of sale **: Selling price or Deduction Claimed, less Capital Gain : Selling price > Cost** *Short term or long term depending upon period of holding*

Special Point : Business income shall be taxable in the previous year of transfer even if business is not in existence in that previous year.

Option 2 : Sold after using for business

Step 1 : The cost of asset will be added to value of block to which it belongs. The cost added to value of block will be :

Actual Cost to Assessee

Less : Deduction claimed u/s.35(1)(iv)

Step 2 : Sale price will be deducted from value of WDV of the block to which it belongs

Illustration 15 : Mr X Purchased a machine to be used for scientific research for Rs.15,00,000 on 15/06/2019. It ceases to be used for scientific research on 18/12/2020 and therefore sold for Rs.18,00,000 on the same day. Determine tax treatment for A/Y 2021-22

Solution : Tax treatment for A/Y 2021-22

Particulars	**Amount (Rs.)**
Value of machine on 1/4/2020	Cost 15,00,000 – Deduction allowed earlier 15,00,000 = Nil
Sale of machine	18,00,000
Profit	18,00,000
Business Income u/s 41(3)	15,00,000
STCG	3,00,000

Illustration 16 : Mr X purchased a machine to be used for scientific research for Rs.15,00,000 on 15/06/2019. It ceases to be used for scientific research on 20/05/2020 and thereafter is brought into Mr X's business on the same day. The eligible depreciation on such machine is 15% and WDV of 15% block as on 01-04-2020 is Rs.20,00,000. The Machine is sold on 05-01-2021 for Rs.10,00,000. Determine tax treatment for A/Y 2021-22.

Solution :

Particulars	**Amount (Rs.)**
Opening WDV	20,00,000

Add : Actual cost of Machine brought into business	Nil (15lac – 15 lac)
Less : Sale of machine	10,00,000
Closing WDV	10,00,000
Depreciation @ 15%	1,50,000
No capital gain or loss u/s 50	

EXPENDITURE FOR OBTAINING TELECOMMUNICATION LICENSE [SECTION 35 ABB]

Capital Expenditure ACTUALLY INCURRED to acquire Telecom license	
Before commencement of business	*After commencement of business*
Period of Deduction Deduction shall be available from **P/Y in which business commences** to P/Y in which license expire **Amount of deduction** = License fees actually paid / No. of previous years in above period	**Period of Deduction** Deduction from **P/Y in which license fee actually paid** to P/Y in which license expires **Amount of deduction** = License fees actually paid / No. of previous years in above period

Illustration 17 : X Ltd purchased a telecommunication license for Rs.12,00,000 on 15/06/2017 for a period of 11 years. However X Ltd commences the business on 18-08-2020. Compute deduction u/s 35ABB for Assessment year 2021-22.

Solution : Deduction u/s 33AB for A/Y 2021-22

= License fees actually paid / P/Y in which business commences to P/Y in which license expire

= Rs.12,00,000 / 2019/20to 2027/28

= Rs.12,00,000/9 = Rs.1,33,333

TAX TREATMENT ON SALE OF LICENSE

Option 1 : Whole license sold

Computation of Profit /Loss on sale

Step 1 : Find out **Opening Value** as on **1/4/2020** (Cost of asset less deduction claimed in prior p/y)

Step 2 :

Sale price < Opening W.D.V	**Sale Price > Opening W.D.V**
Loss is allowed as deduction in the P/Y of sale.	**Deemed Business Income** taxable in P/Y of sale **:** **Selling price or Deduction Claimed, less** Capital Gain : Selling price > Cost *Short term or long term depending upon period of holding*

Option 2 : Part license sold

Computation of Profit /Loss on sale

Step 1 : Find out **Opening Value** as on **1/4/2020** (Cost of asset less deduction claimed in prior p/y)

Step 2 :

Sale price < Opening W.D.V	**Sale Price > Opening W.D.V**
Loss is allowed as deduction in balance P/Y of life of license	**Deemed Business Income** taxable in P/Y of sale **:** **Selling price or Deduction Claimed, less** **Capital Gain : Selling price > Cost** *Short term or long term depending upon period of holding*

Special point : Business income shall be taxable in the previous year of transfer even if business is not in existence in that previous year.

Illustration 18 : X Ltd, a Company which provides telecom services, acquire a telecom license for Rs.10,00,000 on 5th April 2018 for a period of 10 years. The license is sold by X Ltd on 15/10/2020. Compute tax treatment assuming license sold for :

a) 5,00,000

b) 8,00,000

c) 10,00,000

d) 12,00,000

Solution :

Tax treatment for A/Y 2021-22 All figures in (Rs.)

Particulars	**Case 1**	**Case 2**	**Case 3**	**Case 4**
Opening value as on 1/4/2020 Cost – deduction claimed in prior p/y 10,00,000 -1,00,000 (P/Y 2018/19) -1,00,000 (P/Y 2019/20)	8,00,000	8,00,000	8,00,000	8,00,000
Selling price	5,00,000	8,00,000	10,00,000	12,00,000
Profit / (loss)	(3,00,000)	NIL	2,00,000	4,00,000
Business Income	Nil	Nil	2,00,000	2,00,000
Capital Gains	Nil	Nil	Nil	STCG 2,00,000

Assuming 40% of telecom license is sold on 15/10/20.

Particulars	Case 1	Case 2	Case 3	Case 4
Opening value as on 1/4/2020 (Cost – deduction claimed in prior p/y) 10,00,000 -1,00,000 (P/Y 2018/19) -1,00,000 (P/Y 2019/20)	8,00,000	8,00,000	8,00,000	8,00,000
Selling price	5,00,000	8,00,000	10,00,000	12,00,000
Profit / (loss)	Nil	NIL	2,00,000	4,00,000
Business Income/(Loss)	Nil, But deduction u/s 35ABB shall be 3,00,000/8 =37,500	Nil	2,00,000	2,00,000
Capital Gains	Nil	Nil	Nil	STCG 2,00,000

EXPENDITURE FOR OBTAINING RIGHT TO USE SPECTRUM FOR TELECOMMUNICATION SERVICES [SECTION 35ABA]

1. Deduction : Capital expenditure, incurred for acquiring 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, there shall be allowed for each of the relevant previous years, a deduction equal to the appropriate fraction of the amount of such expenditure.

2. Applicability of Section 35ABB : The provisions of section 35ABB, shall apply as if for the word "licence", the word "spectrum" had been substituted.

3. Failure to comply : Where, in a previous year, any deduction has been claimed and granted to the assessee, and, subsequently, there is failure to comply with any of the provisions of this section, then, –

(*a*) Deduction shall be deemed to have been wrongly allowed;

(*b*) AO may, notwithstanding anything contained in this Act, re-compute the total income of the assessee for the said previous year and make the necessary rectification;

Special point :

(*i*) **"Relevant Previous years" means,**

- If spectrum fee is actually paid before the commencement of business to operate telecommunication services, the previous years beginning with the previous year in which such business commenced;
- in any other case, the previous years beginning with the previous year in which the spectrum fee is actually paid, and the subsequent previous year or years during which the spectrum, for which the fee is paid, shall be in force;

(*ii*) **"Appropriate fraction" means** the fraction, the numerator of which is one and the denominator of which is the total number of the relevant previous years;

(*iii*) **"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 or payable in such manner as may be prescribed.'.

DEDUCTION OF CAPITAL EXPENDITURE OF SPECIFIED BUSINESS [SECTION 35AD]

Assessee	**1)** Setting up & operating **Cold Chain facility** for specified product **2)** Setting up & operating agriculture **Warehousing facilities** **3)** Laying & operating Cross**-country Natural Gas/Crude / Petroleum** pipeline network for distribution, including storage facility **4)** Building and operating a **Hotel** of two-star or above category anywhere in India as classified by the Central Government (Where the assessee builds a hotel and subsequently, while continuing to own the hotel, transfers the operation thereof to another person, assessee shall be deemed to be carrying on Hotel Business) **5)** Building and operating a **Hospital** with at least 100 beds for patients **6)** Developing and building a **Housing project** under a scheme for **slum redevelopment or rehabilitation** framed by Government and notified by Board **7)** Developing and building **Affordable housing project** under a scheme framed by Government & notified by Board **8)** **Production of fertilizer in India** **9)** **Setting up and operating inland container depot or a container freight station notified under Customs Act** 10) Bee-keeping and production of honey and beeswax 11) Setting up and operating a sugar warehouse facility for storage of sugar 12) Laying and operating a slurry pipeline for transportation of iron ore
	13) Setting up and operating a **semi-conductor wafer fabrication manufacturing** unit and is notified by the Board **14)** Developing or operating and maintaining or developing, operating and maintaining, any **infrastructure facility (applicable from the assessement year 2018-19)** **Infrastructure facility means –** **(*i*)** **Road including toll road, bridge or rail system;** **(*ii*)** **Highway project including housing or other activities being an integral part of the highway project;** **(*iii*)** **Water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system;** **(*iv*)** **Port, airport, inland waterway, inland port or navigational channel in the sea**
Deduction	**100% Capital expenditure** incurred wholly and exclusively for above business incurred after commencement including Pre commencement Capital Expenditure **Actual cost of any capital asset on which deduction has been allowed or is allowable u/s 35AD, shall be treated as NIL**

Exclusions	**Does not include** expenditure on a) Land, b) Goodwill or c) Financial instrument *d) Any expenditure for which payment or aggregate of payments made to a person in a day, otherwise than by A/c payee cheque drawn on a bank or an account payee bank draft or use of ECS through a bank A/c, or through such other electronic mode as prescribed under Rule 6ABBA exceeds Rs.10,000* *e*) No deduction in respect of the expenditure under section 35AD(1) shall be allowed to the assessee under any other section in any previous year or under this section in any other previous year, if the deduction has been claimed or opted by the assessee and allowed to him under this section. ***[As Amended by Finance Act, 2020]]***
Conditions	1. It is not set up by **Splitting up or Reconstruction** of existing business 2. **Atleast 80%** of Plant & Machinery should not be **Previously used** for any purpose ***Exception to 2nd Condition*** - Plant & Machinery **used outside India** by any person other than assessee & - Such Plant & Machinery is **imported into India** & - **No deduction of depreciation** on that Plant & Machinery has been allowed to any person for any period prior to the date of installation by assessee
Limitations	If deduction under this section is allowed from specified business for any assessment year, no deduction shall be allowed under Part C of Chapter VI-A eg 80IA, etc or **u/s 10AA** in relation to such specified business for the same or any other A/Y.
Sale of asset	**Sum received/receivable** on account of destruction/ demolition/ discard/ transfer of such Capital asset shall be **deemed as P/G/B/P u/s 28**
Use of Asset	Any asset on which deduction allowed shall be used only for specified business, for 8 years beginning with p/y in which such asset is acquired or constructed. Otherwise deduction allowed in one or more p/y, as reduced by depreciation allowable u/s 32, as if no deduction under this section was allowed, shall be deemed to be income under PGBP of p/y in which the asset is so used. ***Where any capital asset on deduction is allowed u/s 35AD is deemed to be income as above, actual cost of asset shall be actual cost, as reduced by depreciation calculated at rate in force that would have been allowable had the asset been used for business since date of its acquisition***
Set off & C/F of Loss of business ***(Section 73A)***	- **Loss of Specified Business** can be set off against profits of other specified business only. - Unabsorbed loss will be **c/f & set off against profits of specified business** of subsequent A/Y - C/F & set off for **Unlimited period of A/Y**

Note: If an individual or HUF opts to be taxed as per the new alternative regime under section 115BAC he/it will not be entitled to claim deduction under section 35AD. ***[As Amended by Finance Act, 2020]***

PAYMENT TO ASSOCIATIONS FOR RURAL DEVELOPMENT PLANS [SECTION 35 CCA]

Deduction for payment of sum to			
Association whose object is to undertake Rural Development Program ***approved by prescribed authority before March 1, 1983***	Association or institution engaged in **Training of persons** for implementing Rural Development Program approved March 1, 1983	**Rural Development Fund** set up by Central Govt.	**National Urban Poverty Eradication Fund** Set up by Central Govt.

Deduction u/s 35CCA **shall not be disallowed** if subsequent to payment,approval of such institution or programme is withdrawn

EXPENDITURE ON AGRICULTURAL EXTENSION PROJECT [SECTION 35CCC]

(1) Where **an assessee** incurs **any expenditure** on **agricultural extension project** notified by the Board in this behalf in accordance with prescribed guidelines, then, there shall be allowed a weighted deduction of **150% such expenditure**.

(2) Where a deduction under this section is claimed and allowed for any A/Y in respect of any expenditure referred to in sub-section (1), deduction shall not be allowed in respect of such expenditure under any other provisions of this Act for the same or any other A/Y.

(3) W.E.F A/Y 21-22 : 100% deduction (but not weighted deduction)

EXPENDITURE ON SKILL DEVELOPMENT PROJECT [SECTION 35CCD]

(1) Where **a company** incurs **any expenditure (not being expenditure in the nature of cost of any land or building)** on any **skill development project** notified by the Board in this behalf in accordance with prescribed guidelines, then, there shall be allowed a weighted deduction of **150% such expenditure** for the assessment years 2013-14 to 2017-18.

(2) Where a deduction under this section is claimed and allowed for any A/Y in respect of any expenditure referred to in sub-section (1), deduction shall not be allowed in respect of such expenditure under any other provisions of this Act for the same or any other A/Y.

(3) W.E.F A/Y 21-22 : 100% deduction (but not weighted deduction)

(4) special points: A company engaged in manufacture/ production of any thing(not being alcoholic spirits and tobacco products) or a company engaged corporate engaged in providing specified services can be claimed the benefit of weighted deduction under section35CCD

(5) Expenditure must be incurred on notified skill development project .

(6) In order to claim weighted deduction, an application should be given in form No.3CQ to National Skill Development Agency (NSDA).

(7) A copy of form no. 3CQ should be sent to the commissioner of Income Tax.

(8) Form No. 3CQ to be submitted along with the detailed note on skill development, project, expected expenditure and expected completion date, letter of concurrence from the training institute.

(9) The project should be undertaken in separate facilities in training institute in the training institution which is set up by the government, local authority or any institute affiliated to National Council for Vocation Training or State Council for vocational Agency (NSDA).

AMORTIZATION OF PRELIMINARY EXPENSES [SECTION 35D]

1	**Assessee**	**Indian Company or Non Corporate Resident**
2	**Expenditure** **when incurred**	Before commencement of business **or** After commencement of business *for* – Extension of existing undertaking *or* – Setting up of new unit
3	**Specified Expenditure** ***(Expenditure under point i to iv, can be incurred by assessee himself or by a concern approved by Board)***	Expenditure in connection with preparation of: (i) Feasibility report (ii) Project report (iii) Conducting a Market/Other Surveys (iv) Engineering Services (v) Legal Charges for drafting agreements **For Company Assessee**, also expenditure on Memorandum & Articles, Legal Fees for registration, expenses on public issue
4	**Qualifying amount of Specified Expenditure**	**Non-Corporate resident Assessee** **A.** Total of Specified expenditure **or** **B.** 5% of **Cost of Project** **A or B,** *whichever is less* **Indian Company** **A.** Total of Specified expenditure **or** **B.** 5% of **Cost of Project or** 5% of **Capital employed**, *Higher* **A or B,** whichever is less
5	**Period of Deduction**	Qualifying Amount in **5 equal annual installments** starting from P/Y of *commencement* or *completion of extension* or *setting up new unit* (as the case may be)
6	**Compulsory Audit** *(Not applicable for Company, Cooperative society)*	Audit of accounts by CA for the previous year in which expenditure incurred & attach CA report with ROI for the 1st year. **Note:** The audit report is to be furnished at least one month prior to the due date for furnishing the return of income under section 139(1). ***[As Amended by Finance Act, 2020]***

Special Points :

1. Cost of Project : Means **Actual cost** of **FIXED ASSETS** [namely land, building, leaseholds, plant, machinery, furniture, fittings and railway sidings] as per books of accounts on the last day of P/Y in which business is commenced or extension is completed or new unit is Set up, as the case may be.

2. Capital Employed : Means *Aggregate* of **Issued share capital, Debentures, Long term borrowings** as on the last day of same P/Y as mentioned above

3. Long Term Borrowings : Means

a) Money borrowed from Govt. or IFCI or ICICI or Banking / Approved financial institution, ***which is eligible for deduction under section 36(1)(viii), no period is prescribed for repayment of loan.***

b) Money borrowed in foreign currency for purchase of Plant & Machinery outside India, ***repayable after 7 years***

4. Section 2(12) : Board means Central Board of Direct Taxes

NOTE: Interest accruing on the share application,money,lying with the bank under the mandate of section 42 of the companies act,2013 is not taxable as "Income From Others Sources" and is required to set off or adjusted against the public issue expenses,so as to reduce the amount of public issue expenses for the purpose of enabling the assessee to claim amortisation under in accordance with the provision of section 35D – *CIT v. Neha Proteins Ltd*. [2008] 171 Taxman 455 (Raj.), CIT v. Shree Rama Multi Tech Ltd. [2008] 255 Taxman 136 (SC).

Illustration 19 : X Ltd is incorporated in Haryana on 10th November, 2020. It commences production on 15th February, 2021. The following expenses are incurred by the company before commencement of business : -

a) Expenses on Incorporation, issue of shares : Rs.92,000

b) Preparation of feasibility report, Project report & conducting market survey : Rs.1,40,000.

c) Engineering services (work is carried on by a concern which is not approved by the board) : Rs.1,30,000

Determine the amount of deduction u/s 35D by taking into account below information

Value as on 31-03-2021

Cost of fixed asset : 45,00,000

Share Capital : 20,00,000

Debentures : 12,00,000

Long term borrowings from I.F.C.I : 8,00,000

Solution :

Computation of Deduction u/s 35D for A/Y 2021-22

Particulars	Amount (Rs.)
a) Expenses on Incorporation, issue of shares	92,000
b) Preparation of feasibility report, Project report & conducting market survey :	1,40,000
c) Engineering services (work is carried on by a concern which is not approved by the board)	Not allowed
Total	2,32,000
A) <u>5% of Cost of project</u> Cost of fixed Assets : <u>45,00,000</u> 5 % of 45,00,000	 2,25,000

B) <u>5% of capital Employed</u>		
Share Capital :	20,00,000	
Debentures :	12,00,000	
Long term borrowings from I.F.C.I :	8,00,000	
	5% of 40,00,000	2,00,000
Total deduction cannot exceed (A or B), whichever if higher		i.e. 2,25,000
Annual Deduction : 2,25,000 x 1/5		45,000

EXPENDITURE IN CASE OF AMALGAMATION OR DEMERGER [SECTION 35 DD]

- ***Indian Company*** incurs expenditure *wholly & exclusively* for amalgamation or demerger.
- Deduction shall be allowed of such expenditure in **5 equal annual installments** starting from P/Y of amalgamation or demerger.
- NOTE : AMALGAMATION OR DEMERGER OF CO-OPERATIVE BANKS: the following provision should be consider in the case of amalgamation or demerger
- The year in which ownership of assets changes because of aforesaid reasons, deduction under section 32,35D,35DD and 35DDA shall be calculated as under
- 1. Figure out the amount of deduction under the aforesaid previous year in the which the title of assets changes because of the aforesaid reasons on the assumption that the amalgamation or demerger has not taken place.
- 2. The amount of deduction so determined shall be allocated between the (a) amalgamating co-operative bank and amalgamated coperative bank or, (b) demerged co-operative bank and resulting co-operative bank, as the case may be, in the ratio of number of days for which the assets are used by them during the previous year in which the title(ownership) changes.

EXPENSES INCURRED UNDER VOLUNTARY RETIREMENT SCHEME [SECTION 35 DDA]

- ***Any assessee*** incurs expenditure for payment of sum under V.R.S.
- Deduction shall be allowed of such expenditure in **5 equal annual installments** starting from the P/Y in which the amount is actually paid.

DEDUCTION FOR PROSPECTING MINERALS [SECTION 35E]

- **Indian Company** or **non-corporate resident assessee** engaged in Production of any **specified mineral**.(Schedule VII)
- **Expenditure** incurred for Prospecting or Extraction or Production during **year of Commercial production*** or **4 p/y prior** to such commercial production.
- Expenditure does not include the following :
  1. Expenditure of a **Capital nature** in respect of any building, machinery, plant or furniture for which allowance by way of depreciation is admissible under section 32.
  2. Expenditure on the **acquisition of the site** of the source of any such specified mineral or groups of associated minerals or of any rights in or over such site.

3. Any expenditure which is **met directly or indirectly** by any other person or authority

- **Deduction :** 10% of qualifying expenditure is allowed in equal expenditure for 10 years starting from previous year of commercial production
- **Maximum deduction allowed each year** : 10% of qualifying expenditure **or** Income from such Business before 35E, *whichever is less.*
- **Unallowed qualifying expenditure** carried forward for next year and added to next year installment. However after 10^{th} year no deduction shall be allowed
- **Audit of accounts by C.A** for the previous year in which expenditure incurred & attach C.A report with ROI for the 1^{st} yr. *(Not applicable for Company, Cooperative society)*

Special Point : "Operation relating to prospecting" means any operation undertaken for the purposes of exploring, locating of deposits of mineral, and includes any such operation which proves to be **infructuous or abortive.**

* the term " year of commercial production" means the previous year in which, as consequences of any operation relating to prospecting, commercial production of one or more of the specified minerals commences.

EXPENSES ALLOWED FROM BUSINESS/PROFESSION [SECTION 36(1)]

1. Premium for insurance of **Stock in trade** used for Business or Profession.

Working Note :

Expenditure	Deduction
Insurance of Building	100% u/s 31
Insurance of Plant/ Machinery/Furniture/ Fixtures	100% u/s 31
Insurance of Stock in trade	100% u/s 36(1)

2. Amount of any **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 supplying milk raised by its members to such federal milk co-operative society. [Section 36(1)(ia)].

3. Premium by ***employer*** for **Health insurance** of his employees by **any mode other than cash** under a approved scheme. [Section 36(1)(ib)].

Working Note :

Mode of payment	Allowed u/s 36(1)
Cheque	Allowed
Pay Order/Demand Draft	Allowed
Credit card	Allowed
Debit card	Allowed
E - Payment	Allowed
ECS	Allowed
Cash	Disallowed

4. Bonus or Commission to employee provided such bonus or commission is **not payable** as profit or Dividend - Loyal Motor Service Co. v. CIT [1946]. ***(Subject to section 43B)***

Working Note :

Mr.A is an employee and also a shareholder,holding 10% equity shares. Mr.B is also a shareholder holding 10% equity shares.

Case 1 (Rs.)			
Shareholder	Dividend	Bonus	Deduction of Bonus u/s 36(1)
A B	20,000 20,000	5,000 ---	5,000 ---
Case 2 (Rs.)			
A : 10% B : 10%	5,000 20,000	15,000 ---	Nil [Bonus contains Dividend of Rs.15,000] ---
Case 3 (Rs.)			
A : 10%(Employee) B : 10%	5,000 20,000	25,000 ---	10,000 [Bonus contains Dividend of Rs. 15,000] ----

5. Interest on Capital Borrowed for the purpose of Business or Profession. ***(Subject to section 43B)***

Working Note :

	Type of Interest	**Deduction u/s 36(1)(iii)**
1.	Interest for purchase of raw material	Allowed
2.	Interest for Purchase of Fixed Asset	Allowed after asset put to use
3.	Interest for Payment of Expense	Not allowed
4.	Interest on Proprietor Capital Account	Not allowed

6. Prorata amount of **Discount** on a **Zero Coupon Bond**.

Special Points :

1. Section 2(48) : Zero coupon bond means a bond

(*a*) issued by any **Infrastructure capital company** or **Infrastructure capital fund** or **Public sector company** *or* **Scheduled bank on or after June 1, 2005.**

(*b*) For which **no benefit / payment** is received or receivable **before maturity or redemption** and

(*c*) which is **notified by Central Government** in the Official Gazette

2. Section 2(*26A*) : Infrastructure capital company means company which makes investments

- by way of acquiring shares or providing long-term finance
- to any undertaking wholly engaged in specified infrastructure business or a project for constructing a hotel of not less than three-star category or project for constructing a hospital with at least one hundred beds for patients

3. Section 2(*26B*) : Infrastructure capital fund means such fund operating under a trust deed

- established to raise monies for Investment
- by way of acquiring shares or providing long-term finance
- to any undertaking wholly engaged in specified infrastructure business or a project for constructing a hotel of not less than three-star category or project for constructing a hospital with at least one hundred beds for patients

Working Note : Suppose X ltd an Infrastructure Capital Company issues Zero Coupon Bond of Rs.10,00,000 having Maturity Value Rs.35,00,000 on 10th August, 2020 and Maturing on 15th December, 2030

Discount : 35,00,000 – 10,00,000 = Rs.25,00,000

No of calendar months : 10/8/2020 to 15/12/2030 = 125

Deduction per Month : 25,00,000/125 = Rs.20,000

Deduction for P/Y 19/20 : 8 x 20,000 = Rs.1,60,000

7. Employer contribution towards Recognised Provident Fund or Approved Superannuation Fund or Approved Gratuity Fund*.* **[Section 36(1)(iv)]** ***(Subject to section 43B)***

Working Note : Assumed due date of return 31st July, 2021 of Mr. X

Employer Contribution (Mr. X)	**Amount (Rs.)**	**Deposit upto Due date of return**	**Date of Actual deposit**	**Deduction u/s 36(1) for P/Y (Rs.)**
April, 2019	**10,000**	31/7/2021	15th May, 2020	10,000 allowed for p/y 2020/21
December, 2019	**10,000**	31/7/2021	16th January, 2021	10,000 allowed for p/y 2020/21
March, 2020	**10,000**	31/7/2021	4,000 on 15th April, 2021	4,000 allowed for p/y 2020/21
		31/7/2021	4,000 on 31st July, 2021	4,000 allowed for p/y 2020/21
		31/7/2021	2,000 on 10th August, 2021	2,000 allowed or p/y 2021/22

8. Employer contribution towards a pension scheme u/s 80CCD, on account of an employee upto 10% salary of the employee in the previous year. ***(Subject to section 43B)***

Special point : *SALARY = Basic + DA (retirement benefit) + commission based on fixed % of turnover*

9. Sum received ***by employer*** as employee contribution to Provident Fund, Superannuation Fund or under other welfare fund provided such amount is **credited** by employer in the account of employee **upto due date** of relevant fund

Special Point : Section 2(24) : Amount received by employer from employee as contribution to Provident Fund, Superannuation Fund or other welfare fund,shall be treated as deemed income of such employer. If the employer satisfies condition of section 36(1) then he will be entitled to deduction of such amount.

Working Note :

Employee Contribution	Amount	Due date of deposit in fund	Date of Actual Deposit	Income u/s 2(24)(x)	Deduction for P/Y u/s 36(1)
April, 2020	10,000	15th May, 2020	15th May, 2020	10,000	10,000
June, 2020	10,000	15th July, 2020	16th July, 2020	10,000	Nil
March, 2021	10,000	15th April, 2021	4,000 on 15th April, 2021	10,000	4,000
			4,000 on 31st July, 2021		Nil
			2,000 on 10th August, 2021		Nil

10. Animals used for Business or Profession (not as SIT) & have died or become useless for such purpose. Deduction is Difference between actual cost to such assessee & realisation (if any) from sale of carcass of such animal.

For Eg : Mr. X uses a horse for his business. It was purchased in year 2016 at Rs. 40,000. It died on 30/11/2020 & its carcass was sold for Rs. 5,000.

Solution : Rs.40,000 – Rs.5,000 = Rs.35,000 allowed as deduction u/s 36(1) for A/Y 2021/22

11. Bad **debt is written off as irrecoverable** in accounts of assessee during P/Y provided such debt should have been **taken into account for computing income of any P/Y**

Special Points :

1. Where assessee deals in money lending or is a Bank, income condition need not be satisfied.
2. No deduction is allowed for provision made for bad and doubtful debt.
3. Section 41(4) : Subsequent recovery of written off bad debt.
   - ✓ Where deduction claimed upto 36(1)for any previous year
   - ✓ and subsequently amount is recovered,
   - ✓ than such amount shall be the income under P/G/B/P
   - ✓ of P/Y in which it was recovered.

However,

a) Assessee claiming Bad Debt & who recovers the bad debt should be same

b) It is not necessary that business is in existence in previous year of recovery.

For Eg :

a) Mr. X had given advance of Rs. 20,000 for purchase of raw material. The supplier of raw material became insolvent and therefore could not supply the raw material. Mr. X writes off the debt as bad in his books.

b) Mr. X sells goods on credit. Out of total credit sales, one credit sale was made to Mr. Y of Rs. 25,000, who has become insolvent. Mr. X writes off Rs. 25,000 as bad debt in his books.

Solution :

a) Bad debt on account of advance is not allowed as deduction u/s 36(1) [Except banks/financial institutions]

b) Bad debt on account of credit sales is allowed as deduction u/s 36(1)

12. In respect of any provision for bad and doubtful debts made by [section 36(1)(viia)] –

(*a*) Scheduled bank [not being 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], an amount not exceeding **8.5%** of the total income (computed before making any deduction under this clause and Chapter VIA) and an amount **not exceeding 10%** of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner :

Provided that a scheduled bank or a non-scheduled bank referred to in this sub-clause 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 Reserve Bank of India as doubtful assets or loss assets in accordance with the guidelines issued by it in this behalf, for an amount not exceeding five per cent of the amount of such assets shown in the books of account of the bank on the last day of the previous year :

Provided further that for the relevant assessment years commencing on or after the 1st day of April, 2003 and ending before the 1st day of April, 2005, the provisions of the first proviso shall have effect as if for the words "5%", the words "10%" had been substituted :

Provided also that a scheduled bank or a non-scheduled bank referred to in this sub-clause 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 :

Provided also that no deduction shall be allowed under the third proviso unless such income has been disclosed in the return of income under the head "Profits and gains of business or profession."

(b) Bank, being a bank incorporated by or under the laws of a country outside India, **an amount not exceeding 5% of the total income** (computed before making any deduction under this clause and Chapter VI-A);

(c) Public financial institution or a State financial corporation or a State industrial investment corporation, **an amount not exceeding 5% of the total income** (computed before making any deduction under this clause and Chapter VI-A) *:*

Provided *that a public financial institution or a State financial corporation or a State industrial investment corporation referred to in this sub-clause shall, at its option, be allowed in any of the two consecutive assessment years commencing on or after the 1st day of April, 2003 and ending before the 1st day of April, 2005, deduction in respect of any provision made by it for any assets classified by the Reserve Bank of India as doubtful assets or loss assets in accordance with the guidelines issued by it in this behalf, of an amount not exceeding 10% of the amount of such assets shown in the books of account of such institution or corporation, as the case may be, on the last day of the previous year;*

(*d*) Non-banking financial company, **an amount not exceeding 5% of the total income** (computed before making any deduction under this clause and Chapter VI-A).

NOTE : No one can claim deduction under section 36(1)(via) without making provision for bad and doubtful debts in its books of account – *Kottakkal Co-op Urban Bank Ltd. v. ITO* [2013]

13. In respect of any special reserve created and maintained by a **specified entity**, an amount not exceeding **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 [Section 36(1)(viii)]:

Provided that where the aggregate of the amounts carried to such reserve account from time to time exceeds twice (i.e., 200 percent) the amount of the paid up share capital and of the general reserves of the specified entity, no allowance under this clause shall be made in respect of such excess.

Explanation : I**n this clause, –**

(*a*) "Specified entity" means :

(*i*) Financial corporation specified in section 4A of the Companies Act, 1956 ;

(*ii*) Financial corporation which is a public sector company and a Government company;

(*iii*) Banking company;

(*iv*) Co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank;

(*v*) Housing finance company (i.e., a public company incorporated in India with the main object of carrying on the business of providing long-term finance for purchase or construction of residential house in India); and

(*vi*) Any other financial corporation including a public company;

(*b*) "Eligible business" means :

(*i*) In respect of the specified entity referred to in sub-clause (*i*) or sub-clause (*ii*) or sub-clause (*iii*) or sub-clause (*iv*) of clause (*a*), the business of providing long-term finance for –

   (*A*) industrial or agricultural development;

   (*B*) development of infrastructure facility in India; or

   (*C*) development of housing in India;

(*ii*) in respect of the specified entity referred to in sub-clause (*v*) of clause (*a*), the business of providing long-term finance for the construction or purchase of houses in India for residential purposes; and

(*iii*) in respect of the specified entity referred to in sub-clause (*vi*) of clause (*a*), the business of providing long-term finance for development of infrastructure facility in India;

14. Expenditure incurred by ***Company***

- for promoting Family Planning among Employees [Section 36(1)(ix)]
- If expenditure is Revenue Expenditure : 100% allowed in P/Y in which incurred
- If expenditure is Capital Expenditure : Allowed in 5 equal installments from P/Y in which incurred

Special Points : Sale of family planning capital assets treatment same as sale of scientific research capital assets.

16. Commodities Transaction Tax (CTT) in respect of Specified Commodities Transactions if the income arising from such transactions is chargeable under Business or Profession. [Section 36(1) (xv)/(xvi)].

Special Point :

Commodities Transaction Tax is levied on every taxable commodities transaction, being sale of commodity derivative **@ 0.01 %** on value of such transaction & such tax shall be payable by the seller.

Specified Commodities Transaction means a transaction of sale of commodity derivatives in respect of commodities, other than agricultural commodities, traded in recognised associations.

17. Expenditure incurred by a co-operative society engaged in the business of manufacture of sugar for purchase of sugarcane at a price which is equal to or less than the price fixed or approved by Government.

18. ***Marked to market loss [Section 36(1) (xviii)] or other expected loss as computed in accordance with the income computation and disclosure standards notified u/s 145(2) [Finance Act,2018]***

GENERAL DEDUCTION [SECTION 37(1)]

If an expenditure fulfills ALL the below conditions it will allowed u/s 37(1) (residuary section):

- If not covered under Section 30 to Section36
- If not of Capital Nature
- If Not a personal expense of assessee
- If incurred in respect of a business carried on by the assessee.
- If incurred in the previous year
- If not incurred for any purpose which is an offence or is prohibited by any law

Special Points :

1. Expenditure of any purpose which relates to any Offence or which is prohibited by law shall not be allowed a deduction.
2. Section 37(2B) : Expenditure on advertisement in any Newspaper, Magazine, souvenir, pamphlet etc. of a political party is not allowed as deduction.
3. Any expenditure incurred on the activities relating to corporate social responsibility u/s 135 of Companies Act, 2013 shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession.

Case Studies:

1. Renovation in hotels-carpets in the hotel business require frequent changes. They are not in the nature of capital asset, thus the expenditure incurred on such assets for the replacement of the carpets, is revenue expenditure - *CIT v. Piem Hotels Ltd*. [2005] 1 SOT 382 (Mum.)
2. Market survey-expenditure incurred on the market survey is revenue expenditure - *CIT v. Orbit Resorts (P). Ltd*. [2011] 48 SOT 23 (Chd).
3. Employee Stock Option Plan: difference between the market value and issue price of the share, is revenue expenditure - *CIT v. PVP Ventures Ltd.* [2012] 211 Taxmann 554 (Mad.)
4. Royality paid under a 5 year collaboration agreement for use of technical know-how to run an existing business more profitability would be allowable as revenue expenditure - *CIT v. Southeren Pressing (P). Ltd.* [2000] 242 ITR 67 (Mad.).
5. Registration Fees - Registration fee paid by the company assessee for increasing in the authorised

share capital, is the capital expenditure *Bharat Carbon & Ribbion Mfg Co. Ltd. v. CIT* [1981] 127 ITR 239 (Delhi) [approved in *Punjab State Industrial Development Corporation Ltd. v. CIT* [1997] 93 Taxman 5 (SC).

6. Interest on delayed payments for purchase of machinery is allowable as a revenue expenditure - *CIT v. Sivakumari Mills Ltd*. [1997] 227 ITR 465/95 Taxmaan 73(SC).

7. Where the assessee, by paying damages to the preferance shareholders is actually discharging its liability to pay dividend under the contract, such kind of payments cannot be allowed as business expenditure - *G.G.L. Hotels & Resorts Co. Ltd v. CIT* [2017] 82 taxmann.com 107/390 ITR 160 (Cal.)

8. Commission paid at a higher rate in order to attract first customer in a new region is deductable - *CIT v. Bharat Collieries Ltd*. [1968] 68 ITR 42 (Pat.).

9. Payment made under know-how agreement to use technical know-how and trademark is allowable as revenue expenditure and merely because the agreements provided that the assesee shall be entitled to retain the technical know-how design, drawings etc even after the termination of the agreement,it will not alter the nature of the transaction - *Praga Tools Ltd. v. CIT* [1980] 123 ITR 773(AP).

10. Litigation expenses incurred to defend a suit filed by the shareholder where,it relief was granted by it would have affected the carrying on the assessee's business, are deductable - *Premire Construction Co. Ltd. v. CIT* [1966] 62 ITR 176 (Bom.).

11. Money spend by a partner in a suit against another partner for rendition of accounts is not an allowable deduction.

12. Taxes: General rule- Any tax (other than income tax, gift tax,fringe benefits tax,dividend tax,surtax) is allowed as deduction if it is paid /payable while carrying on the business and profession subject to the section 43B.

13. Municipal taxes paid by a running concern on plot purchased by it for business purposes is deductable even if the building is not constructed - *CIT v. Suri Sons* [1989] 177 ITR 406 (Punj.& Har,).

14. Professional tax paid by a person carrying on business or trade is deductable-Circular No.16, dated September 18, 1969.

15. Contribution to an association,which does not serve any business purpose - *Iron Traders (P.) Ltd. v. CIT* [1974] 97 ITR 606 (Delhi).

16. Contribution to insurance Fund cannot be considered as an admissible deduction - *CIT v. Thanthai Preiyar Transport Corporation*.

17. where loss is incurred by the company-assessee due to fluctuation of exchange rates in remittances of profit from India to its U.K. office, it is allowed as deduction - *Goodricke Groups Ltd. (No.2) v. CIT* [1993] 201 ITR 266 (Cal.)

18. if an society assessee as a corporate body make a decision to give presents to its members to celebrate silver jubilee celebration, the expenditure on such expenditure on such presents is allowable as deduction - *Karjan Co-operative Cotton Sales Ginning & Pressing Society v. CIT [1993] 199 ITR 17 (Guj.)(FB)*.

19. Expenditure on Diwali Gifts is allowable as business expenditure - *CIT v. Anil Alums (P.) Ltd.* [2005] 98 TTJ (Asr.) 56.

   - KEYMAN INSURANCE PREMIUM

     - Premium paid by the firm in respect of the life of its partners,assured under Keyman insurance policy - *P.G. Electronics v. ITO* [2007] 15 SOT 79 (Delhi)(SMC)(URO) circular no.38/2016,dated November 22, 2016, CBDT has admitted that premium paid by a firm on the Keyman Insurance policy of a partner, to safeguard the firm against a disruption of a business,is allowed as deduction under section 37.

- Just because Keyman Insurance Policy is assigned by the company to its director after sometime will not mean that expenditure incurred in first instance will loose flavour of it being "business expenditure" - *CIT v. Rajan Nanda* [2012] 205 taxman 138/18 taxmann.com 98 (Delhi).

Working Note :

Expenditure	Deduction u/s 37(1)
a) Expenses on legal proceedings under any law incurred in connection with Business	Allowed
b) Penalty for breach of law	Not allowed
c) Penalty for breach of contract	Allowed
d) Interest under Income Tax Act	Not allowed
e) Interest under any other law provided not for breach of law.	Allowed
f) Expenses on advertisement in brochure of a political party	Not allowed
g) Interest on loan taken to pay Income Tax	Not allowed
h) Professional Tax paid in carrying on business or trade	Allowed
i) Diwali & muhurat expenses	Allowed
j) Deposit under acquiring a telephone	Allowed
k) Laga contributions	Allowed
l) Fees paid to registrar of companies	Allowed

DISALLOWANCES

EXPENSES NOT DEDUCTIBLE [SECTION 40(a)]

Overriding Section 30 to Section 38

1. **Expenditure to Non resident without TDS**
   - Expenditure during P/Y of Interest,Royalty, fees for technical services or other sum chargeable under this act (other than salary)
   - Payable to Non-Resident
   - No Deduction of such expenses shall be allowed if
   - Tax has been not been deducted at source or after deduction has not been deposited upto due date of return u/s 139(1)
   - However, if deposited after above date, then deduction will be allowed in previous year in which it is actually deposited.

Where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purposes of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee referred to in the said proviso. **[Inserted by Finance Act, 2019]**

Working note : Following is interest payments for loan taken by Mr. X from non resident

Date of payment	Amount	Actual date of deduction	Date of Deposit of TDS	Previous Year in which deductible
25/5/19	50,000	25/5/19	7/6/19	50,000 allowed in PY 19-20
26/6/19	60,000	26/6/19	10/7/19	60,000 allowed in PY 19-20
15/8/19	1,00,000	Not deducted	NA	Nil
20/9/19	80,000	20/9/19	Not deposited	Nil
15/2/20	20,000	15/2/20	30/4/20	20,000 allowed in PY 19-20
31/3/20	25,000	31/3/20	15/9/20	25,000 allowed in PY 20-21

2. **Salary to Non resident**
   - Salary Payable to Non-Resident
   - No Deduction of such salary shall be allowed if tax has not been deducted at source or after deduction has not been deposited within due date u/s 200(1)
3. **Expenditure to Resident**
   - Who incurs Any Expenditure subject to TDS during Previous Year.
   - Payable to a Resident
   - 30% of such expenditure shall be disallowed allowed if
   - Tax has not been deducted at source or after deduction has not been deposited upto the Due Date of Return u/s 139(1)

However, **if deposited after above date**, then 30% of such expenditure shall be allowed as deduction in previous year in which it is actually deposited.

Special point : *If Payer fails to deduct whole/part of tax for above payment to resident payee but is not deemed to be assessee in default as resident payee has directly paid the tax, than it shall be deemed that payer has deducted & paid the tax on such sum on the date of furnishing of return of income by the payee*.

Working Note : Following is interest payments for loan taken from non resident by Mr. X

Date of payment	Amount	Actual date of deduction	Date of Deposit of TDS	Previous Year in which deductible
25/5/19	15,000	25/5/19	7/6/19	15,000 allowed in PY 19-20
26/6/19	20,000	26/6/19	11/12/19	20,000 allowed in PY 19-20
16/8/19	10,000	Not deducted	NA	Nil

20/2/20	20,000	20/2/20	Not deposited	Nil
25/2/20	10,000	25/2/20	30/6/20	10,000 allowed in PY 19-20
25/3/20	12,000	25/3/20	15/7/20	12,000 allowed in PY 19-20
31/3/20	13,000	31/3/20	10/8/20	70% of 13,000 allowed in PY 19-20

4. Income Tax shall not be allowed as deduction.
5. Royalty / License fee / Service fee / Privilege fee / Service charge by State Government undertaking to State Government is not allowed as deduction.

   Special point : State Government undertaking includes :

   (i) Corporation established under any Act of State Government

   (ii) Company in which more than 50%of paid-up equity share capital is held by State Government

   (iii) Undertaking in which State Government has the right to appoint the majority of the directors
6. Tax u/s 10(10CC) on Non Monetary Perquisite shall not be allowed deduction.

EXPENSE GREATER THAN MARKET VALUE [SECTION 40A(2)]

- Expenditure by which payment made /is to be made to Specified Person
- AO may disallow so much expenditure as he consider Excessive or Unreasonable having regard to FMV of goods or service or facilities for which payment made or legitimate needs of business.

Special Points :

1. Specified Persons :

i. Where assessee is an **Individual.**

- His Relative
- Company/Firm/AOP/BOI/HUF

(*In which such Individual or his Relative has* ***Substantial Interest***)

ii. Where Assessee is Company/Firm/AOP/BOI/HUF

COMPANY/FIRM/AOP/BOI/HUF [A]

Director/ Partner/ Member or their Relatives [B]	**ANY PERSON** In whose business Substantial interest held by **[A]** or**[B]**	**INDIVIDUAL or RELATIVE** Provided Individual having Substantial Interest in **[A]**	***Any company carrying on business or profession in which [A] has substantial interest***	**CO./FIRM/AOP/ BOI/HUF or Director/Partner / Member Or their Relative** Provided Co, firm etc has Substantial interest **[A]**	**CO./FIRM/AOP/ BOI/HUF or Director /Partner/Member Or their Relative** Provided Director, Partner, Member has Substantial interest in **[A]**

2. A Person has Substantial Interest in

➔ Company, if he holds at any time during the P/Y beneficial ownership of at least 20% Equity Shares in that company.

➔ Other than company, if he is at any time during the Previous Year entitled to at least 20% profits

Illustration 20 : Examine in the following cases, what amount of deduction shall be available to assessee under head P/G/B/P for AY 20-21.

(a) Mr X who is carrying on business purchases goods at Rs. 8,00,000 from his brother. The Market value of similar goods is Rs.2,00,000.

(b) Mr X holds 30% equity shares of Y Ltd. Mr X purchases goods worth Rs. 5,00,000 from Y Ltd at Rs. 500 per article. The Market value of such article is Rs. 300 per article.

Solution :

(a) Deduction of Rs. 2,00,000 allowed as deduction and Rs.6,00,000 disallowed u/s 40A(2)

(b) Deduction of Rs.5,00,000/500 x 300 i.e. Rs. 3,00,000 is allowed and Rs.5,00,000/500 x 200 i.e. Rs.2,00,000 is disallowed u/s 40A(2)

EXPENDITURE IN CASH [SECTION 40A(3)]

- Where the assessee incurs any expenditure
- For which a payment or aggregate of payments
- Made to a person
- In a day,
- Exceeds Rs.10,000
- Otherwise than by account payee cheque drawn on bank or
- Account payee bank draft or
- Such other electronic clearing modes as prescribed under Rule 6ABBA
- No deduction shall be allowed in respect of such expenditure.

Special Point :

1. The limit for Payment for plying, hiring or leasing goods carriages is Rs.35,000 (applicable with effect from October 1, 2009).

2. Where an **expenditure is allowed** during any previous year and in subsequent previous year the assessee makes payment in respect thereof in excess of *Rs.10,000* otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through bank account or through such other electronic mode as may be prescribed the payment so made shall be **Deemed to be P/G/B/P** Income of subsequent Previous Year.

3. Prescribed electronic modes (Rule 6ABBA) are;-

(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. ***[As Amended by Finance Act, 2020]***

Exceptions to Section 40A(3) : Rule 6DD

No disallowance in the following cases even if payment is greater than Rs. 10,000 is made otherwise by Account payee cheque or Account payee bank draft or Use of electronic clearing system through bank account.

a) Payment to Banks, LIC

b) Payment to Government (both Central and State).

c) Payment through the banking system, e.g., letter of credit, telegraphic transfer, bill of exchange, ECS, credit card or debit card.

d) Payment to cultivator or producer of agriculture, forest, animal husbandry, dairy, poultry farming or fish products.

e) Payment for purchase of products manufactured by producer without aid of power in a cottage industry.

f) Payment in a village or town not served by any bank on date of payment to a person who resides in such village or carrying on his business, profession or vocation in such village.

g) Payment to an employee or his legal heir of gratuity, retrenchment compensation or similar terminal benefit provided aggregate of such amount does not exceed Rs. 50,000.

h) Payment on the day on which banks were closed on account of holiday or strike.

i) Payment made by book adjustment by an assessee in the account of the payee against money due to the assessee for any goods supplied or services rendered by him to the payee.

Working Note :

Particulars	**Deduction (Rs.)**	**Particulars**	**Deduction (Rs.)**
Case 1 : Bill : Rs.20,000 Payment in Cash : 15th April, 2019 : 10,000 16th April, 2019 : 10,000	20,000 allowed as deduction	**Case 2 :** Bill : Rs.40,000 Payment in Cash 15th April, 2019 -10.am : 10,000 15th April, 2019 -11.am : 10,000	20,000 disallowed as deduction us/ 40A(3)
Case 3 : Bill : Rs.25,000 Payment in cash 15th April, 2019 : Rs.25,000	25,000 disallowed as deduction u/s 40A(3)	**Case 4 :** Bill : Rs. 20,000 Payment in Cash : 10,000 Payment by A/C payee cheque : 10,000	20,000 allowed as deduction

DISALLOWANCE FOR GRATUITY [SECTION 40A(7)]

No deduction shall be allowed of any provision made by the Assessee being an Employer for payment of Gratuity to his employees unless provision made

- Towards Approved Gratuity Fund or
- For payment of gratuity actually becoming payable during P/Y

Note: Even if provision is not made for gratuity in the books of accounts of the assessee, the quantam of actuarial valuation of such gratuity cannot be claimed on the ground that section 47A(7) is not attracted as no" provision" is made in the books of the accounts - *Shree Sajjan Mills Ltd. v. CIT* [1985] 156 ITR 585 (SC).

EMPLOYER CONTRIBUTION TOWARDS FUNDS REQUIRED BY LAW [SECTION 40A(9)]

No deduction shall be allowed of sum paid by employer towards the setting up/formation or as contribution to any fund not required to be kept under law.

NO DEDUCTION OF MARKED TO MARKET LOSS SECTION 40A(13) [FINANCE ACT, 2018]

No deduction or allowance shall be allowed in respect of any marked to market loss or other expected loss, except as allowable u/s 36(1).

SALARY /INTEREST BY FIRM TO PARTNER [SECTION 40(b)]

- Partnership firm/LLP shall be allowed deduction of
- Salary, Bonus, commission or other remuneration to Working Partner and
- Interest to Any Partner
- Subject to certain conditions :
    - Remuneration and interest must be authorized by partnership deed
    - It should not pertain to period prior to partnership deed
    - Remuneration and interest should not exceed permissible limit

Working Partner : Individual who is actively engaged in conducting the affairs of Business or Profession of the firm of which he is a partner.

Analysis of Section 40(b)

<table>
<tr><th>Type</th><th colspan="2">Salary/Bonus/Commission/other Remuneration</th><th>Interest on Capital</th></tr>
<tr><td>Partner</td><td colspan="2">Working Partner</td><td>All Partner</td></tr>
<tr><td>Partnership deed</td><td colspan="2">Authorized by the terms of Partnership Deed</td><td>Authorized by the terms of Partnership Deed</td></tr>
<tr><td>Prospective</td><td colspan="2">Such payment should relate to period after date of Partnership Deed.</td><td>Such payment should relate to period after date of Partnership Deed</td></tr>
<tr><td rowspan="3">Amount of deduction</td><td>Book Profits</td><td>Maximum Deduction</td><td rowspan="3">Upto 12 % P.A.</td></tr>
<tr><td>First 3,00,000
(Including Loss)</td><td>Rs. 1,50,000 or
90% Book profits (whichever is more)</td></tr>
<tr><td>Balance Book profit</td><td>60% of Book Profit</td></tr>
</table>

Computation of Book Profits

1. Compute Net profit of firm under head P/G/B/P after making adjustments as per Section 29 to 43D
2. Add Remuneration to working partner (if Debited to P&L A/C)

Tax treatments in hands of Partner

Type of Payment	Working Partner	Non working Partner
Salary from firm	Taxable to the extent allowed as deduction to firm	Not Taxable
Interest from firm	Taxable upto 12%pa	Taxable upto 12%pa
Share of Profit	Exempt u/s 10(2A)	Exempt u/s 10(2A)

Illustration 21 : Profit and loss account of A Co. (A firm engaged in manufacturing of Garments, which satisfies all condition of section 40(b) for the year ending 31st March, 2020 is as follows :

Particulars	**Rs.**	**Particulars**	**Rs.**
Cost of goods sold :	9,00,000	Sales :	12,00,000
Remuneration to Partners			
A : 72,000 B : 60,000 :	1,32,000	Long Term Capital Gain :	2,00,000
Remuneration to Employees :	1,00,000		
Interest to partner			
A : 16,000 B : 14,000 :	30,000		
Other expenses :	25,000		
Depreciation :	33,000		
Net profit :	1,80,000		
	14,00,000		14,00,000

Other information :

1. Depreciation not allowable as per Income tax act is Rs.18,000
2. Expenses of Rs.5,000 not allowed under 43B
3. Mr. A is Working Partner
4. Interest Paid is as follows : Mr. A @ 20% & Mr. B @7 %

Compute income of Mr. A & Mr. B for A/Y 2021-2022

Solution :

Computation of Book Profit

Particulars	**Amount (Rs.)**
Net profit as per P&L A/C	1,80,000
Add : Depreciation not allowable	18,000
Add : Expenses of not allowed under 43B	5,000
Add : Remuneration to B (Non working partner not allowed as deduction)	60,000
Add : Remuneration to A (Working partner added to determine book profits)	72,000
Add : Interest to A in excess of 12% p.a. (16,000/20 x 8)	6,400

Less : Long term capital gains	2,00,000
Book profit	**1,41,400**

Maximum allowable remuneration to Working partner A

Book profit	Maximum remuneration
Upto 3,00,000	1,50,000 or 90% of 1,41,400,higher i.e. 1,50,000

Therefore entire remuneration paid to A i.e. Rs. 72,000 will be allowed as deduction to firm.

Computation of Income of partners for A/Y 2021-22

Income under business	Partner A (Rs.)	Partner B (Rs.)
Interest on capital	16,000 -6,400 = 9,600	14,000
Remuneration	72,000	Not Taxable
Share of profit	Exempt u/s 10(2A)	Exempt u/s 10(2A)
Total	81,600	14,000

CERTAIN DEDUCTIONS ON ACTUAL PAYMENT BASIS [SECTION 43B]

- Overriding other provisions of IT Act
- Specified Expenses which are allowable under other sections
- Shall be allowed only in Previous year in which such expenditure is actually paid
- Irrespective of previous year in which liability was incurred as per method of accounting

Specified expenses :

1. Tax, duty under any law
2. Employer Contribution to Provident fund, superannuation fund, Gratuity fund or other welfare fund
3. Bonus or Commission to employee
4. Interest on Loan from Public Financial Institution, State Financial Corporation or State industrial investment corporation
5. Interest on any loan or advance from schedule bank or a co-operative bank (with effect from the assessment year 2018-19) other than a primary agricultural credit society or primary co-operative agricultural and rural development bank
6. Payment of leave Salary to employee
7. Sum payable to Indian Railways for use of railway asset
8. Any sum payable by the assessee as interest on any loan or borrowing from a deposit taking non-banking financial company or systemically important non-deposit taking non-banking financial company, (applicable from the assessment year 2021-22), in accordance with the terms and conditions of the agreement governing such loan or borrowing.

where a deduction in respect of any sum referred in point 8 is allowed in computing the income referred to in section 28, of the previous year (being a previous year relevant to the assessment year commencing on the

1st day of April, 2020, or any earlier assessment year) in which the liability to pay such sum was incurred by the assessee, the assessee shall not be entitled to any deduction under this section in respect of such sum in computing the income of the previous year in which the sum is actually paid by him.

A deduction of any sum, being interest payable under point 8, shall be allowed if such interest has been actually paid and any interest referred to in that clause which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

Inserted by Finance Act, 2019

Special point :

- Provision of Section 43B Shall not apply
- for the Previous Year in which liability to pay such sum was incurred
- If such sum is Actually Paid by Assessee
- On or before the due date of return u/s. 139(1)
- And evidence of such payment is furnished along with ROI

Working note : Mr. X maintains his accounts on **accrual basis**. He has taken a loan from a scheduled bank for the purpose of his business. Total interest liability relating to P/Y 2020-21 is Rs. 40,000.

Mr. X has made the following payments. Deduction will be as follows :

Date of payment	Amount(Rs.)	Deduction / P/Y of deduction
15 May, 2020	8,000	8,000 for PY 2020-21
15 November, 2020	12,000	12,000 for PY 2020-21
15 April, 2020	5,000	5,000 for PY 2020-21
15 July, 2021	8,000	8,000 for PY 2020-21
20 August, 2021	7,000	7,000 for PY 2021-22

DEEMED PROFITS CHARGEABLE TO TAX [SECTION 41]

Recovery of Loss/Deductions etc. allowed earlier [Section 41(1)]

- Deduction allowed in any P/Y for loss/Expense (revenue or capital expenditure) or Trading liability
- Subsequently during any P/Y, same assessee or his successor
- Obtains any amount in respect of such loss/expense (in cash or other manner) or some benefit in respect of such trading liability through remission or cessation thereof.
- Then such amount or benefit shall deemed to be P/G/B/P of P/Y in which received.

Special Points : Provision of section 41(1) will apply even if business is not in existence.

Illustration 22 : Determine whether following amount will be taxable for A/Y 2021-22.

(a) Mr X had claimed a deduction of Rs. 50,000 paid as Indirect Tax for P/Y 2019-20 and the same was allowed as deduction to him. Mr. X receives a refund of Rs. 10,000 on 15/11/2020 from the Tax department.

(b) Mr X had taken a Loan of Rs. 50,000 from Mr. Y on 14/09/2017. Both X & Y decided on 4/11/2020 that Loan need not be paid.

Solution :

(a) Rs.10,000 taxable as Deemed Business Income u/s 41(1) for A/Y 2021-22

(b) Cessation of liability on account of loan is not deemed as business income u/s 41(1) as it is not a trading liability

Section 41(2) : Balancing Charge (*discussed earlier)*

Section 41(3) : Sale of Capital Asset used for Scientific Research. (*discussed earlier)*

Section 41(4) : Recovery of Bad Debt. *(discussed earlier*)

Section 41(5) : Loss of only that P/Y in which business cease to exist can be **set off** from Deemed incomes u/s. 41(1), (3), (4). ***(Exception to rule that business loss can be carried forward for 8 years only)***

Recovery after discontinuation of business or profession[section 176(3A,(4)]: This section is applicable where any business is discontinued in any year, by the virtue of this sub-section of section 176(3A),any sum received after the discontinued of the business or profession is deemed to be income of the recipient and charged to tax in the year in which it is received. it may be noted that, if the books of accounts are maintained on mercantile basis, any receipt after discontinuation of the business or profession must necessary have accrued and been charged during the continuance of the business or profession and nothing would be chargeable to tax in the year of receipt of income. If, however the books are maintained on cash basis and some of the profits are received after the discontinuance of business or profession,it would be chargeable to tax under section 176(3A)(4) in the year of receipt of income even if the business or profession is not carried on during that year.

Illustration 23 : Mr X's business was discontinued on 15/10/09 because the business was running into losses. The business loss upto 31-3-2009 was Rs. 10,000 and loss for the period 01-04-2009 to 15/10/2009 was Rs. 5,000. On 20/11/2020 Mr. X receives a debt of Rs. 40,000 from a debtor which was allowed as bad debt u/s 36(1) for P/Y 05-06. Determine business income for A/Y 2021-22.

Solution :

Business Income of A/Y 2021-22

Particulars	Amount (Rs.)
Recovery of bad debt u/s 41(4)	40,000
Less : Set off of business loss of P/y 08/09	5,000
Taxable Business Income	35,000

Note :- Business loss of ₹10,000 is not an allowable deduction as per section 41(5) because loss of only that previous year is allowable in which the business cease to exist.

MAINTENANCE OF ACCOUNTS BY PERSONS CARRYING ON PROFESSION OR BUSINESS [SECTION 44AA]

Section 2(12A) : Books or books of accounts *includes ledgers, day-books, cash books, account-books and other books, whether kept in the written form or as print-outs of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device.*

Specified Profession		**Non specified Profession / Business**	
Gross Receipts **>** Rs.1,50,000 for **All** the 3 years preceding the P/Y ***or*** where profession is *newly setup* in P/Y, gross receipts is likely to exceed Rs.1,50,000 for that P/Y	Other case	Gross Receipt **>** Rs.10,00,000 ***(For Individual/HUF Rs.25,00,000*** ***[from the A/Y 2018-19]*** **Or** Income from P/G/B/P **>** Rs.1,20,000 ***(For Individual/HUF Rs.2,50,000*** ***[from the A/Y 2018-19]*** in **Any** of 3 years preceding P/Y's	Other Case
		or where profession is *newly setup* in P/Y, above limits are likely to exceed for that P/Y	
Specified books of accounts has to be maintained for that P/Y	Such **books of accounts** has to be maintained that **will enable the AO** to compute his Total Income *(i.e. Cash Book, & Ledger)*		**Not required to maintain** any books of accounts

Special Points :

1. Specified profession : Legal, Medical, Engineering, Architectural, Accountancy, Technical Consultancy, Interior decoration or other notified professions [i.e., authorised representative, film artist, company secretary and information technology]
2. Specified books of accounts :
   a. Journal (if accounts on mercantile basis).
   b. Cash Book & Ledger.
   c. Carbon copies of bill issued exceeding Rs. 25
   d. Original bills or receipts received for expenditure incurred exceeding Rs. 50
   e. Payment vouchers prepared and signed for expenditure incurred upto Rs. 50

   These books are required to be kept and maintained for 6 years from end of relevant A/Y
3. A person carrying on Medical Profession (i.e., a practitioner of any system of medicine –physicians, surgeons, dentists, pathologists, radiologists, vaids, hakims, etc.), in addition to above shall maintain :
   a. A daily case register in Form 3C showing date, patient name, nature of professional services rendered (i.e.,general consultation,surgery,injection,visit,etc.)
   b. A stock register showing inventory as on the 1st and last day of previous year of stock of drugs, medicines and other consumable accessories used for profession.

Illustration 24 : Mr. X is Company Secretary in practice. His Receipts for the following year are as follows : -

Previous Year	**Gross Receipts**
P/Y 2019-20	2,50,000

P/Y 2018-19	1,80,000
P/Y 2017-18	1,50,000

Determine whether Mr. X has to maintain Accounts u/s 44AA for A/Y 2021-22.

Solution : Since Mr. X is carrying out specified profession and his turnover does not exceed Rs.1,50,000 for all the 3 prior p/y, he is not requires to maintain specified books of Accounts for A/Y 2021-22. He is required to maintain such accounts to enable the AO to compute his total Income.

COMPULSORY AUDIT OF ACCOUNTS [SECTION 44AB]

PROFESSION : Compulsory audit of accounts for **that P/Y** in which Fees/Gross receipts* ***exceeds Rs.50,00,000***

BUSINESS : Compulsory audit of accounts for **that P/Y** in which Sales/Turnover/Gross receipts ***exceed Rs. 1,00,00,000***

Special Points : Accounts have to be audited u/s. 44AB by a CA before due date u/s 139(1) and also the audit report is to be furnished on or before the said date.

* for the purpose for applicability of this section,receipts by an assessee by the means of sale of trading business and receipts for doing job work can clubbed to seek whether limit of Rs. 1 crore prescribed for the applicability of this section is made out - Bajrang Oil Mills v. ITO [2007] 163 taxman 154 (Raj).

Rs 2 crore in the case of a person, who declares his business profits or gains under section 44AD(1) (applicable from the assessment year 2017-18)

In order to reduce the compliance burden on the small and medium enterprises carrying on the Business, the threshold of turnover/sales limit for tax audit requirements has been increased from 1 Crore to 5 Crores, subject to following conditions:

a. Aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed five per cent of the said amount; and

b. Aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed five per cent of the said payment. **[As Amended by Finance Act, 2020]**

Illustration 25 : Whether in following cases, tax Audit u/s 44AB is applicable

1) Mr X is a CS in Service. Salary Rs.65,00,000
2) Mr X is a CS in practice. His Gross Receipts are Rs.50,00,000
3) Mr X is a CS in practice. His Gross Receipts are Rs.60,00,000
4) Mr X is carrying on a Chemical Business. His turnover is Rs.90,00,000
5) Mr X Chemical Business turnover : Rs.70,00,000 & Plastic Business turnover : Rs.40,00,00 [Aggregate of all payment made in cash exceeds 5% during the PY]

Solution :

1) Section 44AB not applicable for Persons not carrying out Business or profession.
2) Section 44AB not applicable as professional receipts does not exceed Rs. 50,00,000
3) Section 44AB applicable as professional receipts does exceed Rs. 50,00,000
4) Section 44AB not applicable as Business receipts does not exceed Rs.1 crore
5) Section 44AB applicable as Business receipts exceed Rs. 1 crore

COMPUTATION OF P/G/B/P ON PRESUMPTIVE BASIS

		SECTION 44AD	SECTION 44AE
1.	Overriding	Section 28 to 43C	Section 28 to 43C
2.	**Assessee**	Resident Individual, Resident HUF or Resident Partnership Firm Excluding Limited Liability Partnership	Any Assessee (Resident/Non Resident)
3.	Business	**Any Business** except business u/s 44AE ***EXCEPTION :*** ***(i) Specified Profession u/s 44AA*** ***(ii) Income in nature of commission or brokerage or***	Plying, Hiring or Leasing goods carriage
4.	**Limitations**	*Provided Gross receipts/turnover* ***does not exceeds 2 Cr***	***Owns not more than 10 goods*** *carriage at any time during p/y*
5.	**Sum deemed as P/G/B/P**	***8 %*** *of Gross Receipts/ Turnover in P/Y* *6% of Total turnover /Gross receipts received by A/c payee cheque or A/c payee bank draft or use of ECS through a bank A/c or through such other electronic mode as may be prescribed during p/y or before due date u/s 139(1) of that p/y.*	***Heavy goods vehicle (more than 12,000 kg. gross vehicle weight)*** Rs.1,000 per ton of gross vehicle weight or unladen weight, as case may be, for every month or part of a month during which the heavy goods vehicle is owned by the assessee in p/y or amount claimed to have been actually earned from such vehicle, ***whichever is higher;*** ***Other than heavy goods vehicle***
			Rs.7,500 for every month or part of month during which the goods carriage is owned by the assessee in p/y or amount claimed to have been actually earned from such goods carriage, whichever is higher. ***[Finance Act 2018]***
6.	**Deductions under PGBP**	***No deduction u/s Section 30 to 38*** *shall be allowed from Deemed income*	**No deduction u/s Section 30 to 38** shall be allowed from Deemed income
7.	**B/F losses**	**Set off of** Brought Forward losses Shall be **available**	**Set off of** Brought Forward losses Shall be **available**
8.	Benefits	If assessee declares **Deemed income** or any **amount higher**,then **no requirement** to maintain books u/s **44AA** or to get audit u/s **44AB ***	If assessee declares **Deemed income or** any **amount higher**,then **no requirement** to maintain books u/s **44AA** or to get audit u/s **44AB**

9.	Limit for 44AA/44AB	The turnover of such business will not be added to turnover of other business for applicability of Section 44AA/44AB of other business	The turnover of such business will not be added to turnover of other business for applicability of Section 44AA/44AB of other business

Special point :

1. Section 44AD : Where assessee declares profit for any P/Y u/s 44AD & he declares profit for any of 5 P/Y succeeding such P/Y not in accordance with section 44AD, he shall not be eligible to claim the benefit of this section for 5 subsequent P/Y from P/Y in which the profit has not been declared.

Eligible assessee to whom above provisions are applicable & whose total income exceeds exemption limit, shall be required to keep and maintain such books of account u/s 44AA & get them audited and furnish a report of such audit as required u/s 44AB.

Section 44AB shall not apply to person, who declares profits for p/y u/s 44AD and his total sales, turnover/gross receipts in business does not exceed Rs. 2 crores in such previous year

2. Section 44AE : Assessee covered u/s 44AE & disclosing lower profits than deemed profits, shall be required to keep and maintain such books of account u/s 44AA & get them audited and furnish a report of such audit as required u/s 44AB

3. "Goods carriage", "Gross vehicle weight" and "Unladen weight" shall have the respective meanings assigned to them in section 2 of the Motor Vehicles Act, 1988;

"Heavy goods vehicle" means any goods carriage, the gross vehicle weight of which exceeds 12,000 kgs

Illustration 26 : Mr X is engaged in the business of plying goods carriage. He has purchased the following vehicles during the previous year 31-3-2021.

1) Three Light goods vehicle on 11-06-2020 (put to use on 1-11-2020)
2) Five Light goods vehicle on 20-4-2020 (put to use on 30-06-2020)

Income claimed to have earned from business is Rs.6,00,000

Brought Forward business loss of p/y 2020/21 is Rs.10,000

Solution :

Computation of Presumptive Business Income u/s 44AE for A/Y 2021-22

Income under Business/Profession	Amount (Rs.)
3 Light goods vehicle 7,500 x 10 x 3	2,25,000
5 Light goods vehicle 7,500 x 12 x 5	4,50,000
Total	6,75,000
Less : B/F losses	10,000
PGBP	6,65,000
Gross Total Income	6,65,000
Less : Deduction u/s 80C to 80U	NIL
Total Income	6,65,000

PROFITS AND GAINS OF PROFESSION ON PRESUMPTIVE BASIS [SECTION 44ADA]

1. Overriding : Notwithstanding anything contained in **sections 28 to 43C**

2. Assessee : Resident in India, who is engaged in specified profession u/s 44AA & whose Gross receipts is upto 50 lakh in a P/Y.

3. Sum Deemed as business profits : 50%. of the total gross receipts in the P/Y or sum higher claimed to have been earned by the assessee.

4. Deductions : Deduction sections 30 to 38, including depreciation and unabsorbed depreciation, shall be deemed to have been allowed and no further deduction under those sections shall be allowed.

5. WDV of block : The WDV of any asset used for purposes of profession shall be deemed to have been calculated as if assessee had claimed and had been actually allowed the deduction of depreciation for each of relevant A/Y.

6. Lower Profits : An assessee who claims that his profits from profession are lower than deemed profits & whose total income exceeds exemption limit shall be required to maintain books of account u/s 44AA and get them audited and furnish a report of such audit as required u/s 44AB.

TAXATION OF FOREIGN EXCHANGE FLUCTUATION [SECTION 43AA]

(1) 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, and such gain or loss shall be computed in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145.

(2) For the purposes of sub-section (1), 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 –

(i) monetary items and non-monetary items;

(ii) translation of financial statements of foreign operations;

(iii) forward exchange contracts;

(iv) foreign currency translation reserves.

SALE CONSIDERATION IN CASE OF REAL ESTATE TRANSACTIONS [SECTION 43CA]

- Consideration received or accruing on transfer of land or building or both
- Not being a capital asset
- is less than the Stamp duty valuation by any authority of a State Government,then
- Such value shall be deemed to be full value of the consideration for computing Business Profits

Option available to Assessee

- Assessee can claims before AO that
- Stamp duty Valuation exceeds fair market value of property
- On the date of transfer &
- Such value has not been disputed in any Appeal/Revision or
- No reference is made before any authority, court or the High Court, Than
- AO may refer the valuation of Asset to a Valuation Officer and

- Provisions of Wealth tax Act shall apply

Valuation of Valuation Officer

- Valuation of valuation officer is less than Stamp Duty Valuation,
- the value of valuation officer shall be
- taken as the full value of the consideration

Provided that where the value adopted or assessed or assessable by the authority for the purpose of payment of stamp duty does not exceed 110% [increased from 105% to 110% vide Finance Act, 2020] of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of computing profits and gains from transfer of such asset, be deemed to be the full value of the consideration.

Where Date of agreement for transfer of asset & Date of registration of such transfer are different, the Stamp duty Value on date of Agreement shall be considered if consideration or part thereof has been received by account payee cheque or an account payee bank draft or by use of electronic clearing system through a bank account" or through such other electronic mode as may be prescribed on or before the date of agreement for transfer of the asset.

COMPUTATION OF INCOME FROM CONSTRUCTION AND SERVICE CONTRACTS [SECTION 43CB]

(1) The profits and gains arising from a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145 :

Provided that profits and gains arising from a contract for providing services, –

(i) **with duration of not more than 90 days shall be determined on the basis of project completion method;**

(ii) **involving indeterminate number of acts over a specific period of time shall be determined on the basis of straight line method.**

(2) For the purposes of percentage of completion method, project completion method or straight line method referred to in sub-section (1) –

(i) **the contract revenue shall include retention money;**

(ii) **the contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains.**

QUESTIONS FOR PRACTICE

1 : JK & Co. a partnership firm engaged in the business has a Gross receipt of Rs. 32,00,000 from such business. The partnership deed provides for payment of salary Rs. 3,000 p.m. to each of the partners i.e. J and K. .The firm uses machinery for the purpose of its business and the WDV of the machinery as on 1-4-2020 is Rs. 2,00,000. The machinery is eligible for depreciation @ 15%. Compute the profits from the business, if the firm opts for the scheme under section 44AD. (Assume receipts in cash)

Solution : As per section 44AD the profits will be computed as under :

8% of gross receipts i.e. Rs.32,00,000 = Rs.2,56,000

2 : Arjun Singh is the owner of a business. Following is his P & L A/c for year ended on 31-3-2021 :

Particulars	Rs.	Particulars	Rs.
Establishment charges	51,110	Gross profit	5,08,700
Rent, rates and taxes	29,000	Interest on Govt. Securities (Gross)	53,500
Sundry expenses	70,500	Rent from property	54,000
House hold expenses	18,800		
Provision for bad debts	12,000		
Loss on sale of motor car (used for private purpose)	18,000		
Insurance premium			
(including life insurance of Rs.1790 of Arjun Singh)	28,800		
Interest on bank loan	13,800		
Provision for Depreciation	64,000		
Net profit	3,10,200		
Total	6,16,200	Total	6,16,200

Additional information :

(i) Bad debts written off during the year Rs.6,500

(ii) Admissible depreciation as per Income tax rules Rs.16,000

(iii) The assessee is running his business in a rented property, half of which is used by him for his own residence. Rent of Rs. 24,000 in respect of entire house is included in rent, rate and taxes. The balance of Rs.5.000 is on municipal tax paid for property given on rent.

(iv) Compute the Gross total Income of Sri Arjun Singh for the assessment year 2021-22.

Solution :	**Rs.**	**Rs.**
Income from house property		
Rent received	54,000	
Less : Municipal taxes	(5,000)	
		49,000
Less : Statutory deduction @ 30%		(14,700)
		34,300
Profit and gains from business or profession		
Profit as per P & L Account		3,10,200
Add : Inadmissible expenses		
Rent	12,000	
Household expenses	18,800	
Provision for bad debts	12,000	
Loss on sale of car	18,000	

Life insurance premium	17,900	
Provision for depreciation	64,000	
M. Taxes for let out house property	5,000	1,47,700
Total		4,57,900
Less : Expenses allowed but not debited to P & L A/c		
Bad debts	(6,500)	
Depreciation	(16,000)	(22,500)
Total		4,35,400
Less : Incomes not taxable under this head but		
Credited to P & L A/c.		
Interest on Govt. securities	(53,500)	
Rent from property	(54,000)	(1,07,500)
Income from Business		3,27,900
Income from other sources :		
Interest on Govt. securities		53,500
Gross Total Income (34,300 + 3,27,900 + 53,500)		**4,15,700**

3 : Mr. Avinash furnishes the following particulars of his income for the A/Y 2021-22.

Profit and Loss Account for the year ending 31-3-2021

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
To Office expenses	12,400	By Gross Profit	2,98,000
To General expenses	12,000	By Sundry Receipts	19,000
To Legal Expenses	8,000	By Custom Duties recovered back from Govt. (earlier not allowed as deduction)	15,300
To Depreciation on Machinery	11,000		
To staff Salary	21,000		
To bonus to staff	15,000		
To contribution to approved gratuity fund	16,000	By bad debts recovered (earlier allowed as deduction)	3,000
To O/s liability for GST	18,000	By Gift from son	40,000
To Audit Fees	21,000		
To Net Profit	2,40,900		
	3,75,300		3,75,300

Other information :

1. Bonus to employees according to the Payment of Bonus Act 1965, comes to Rs. 4,200.

2. Depreciation on machinery shown in the profit and loss account is calculated according to the income tax provisions.
3. General expense includes payment of Rs.9,000 to an approved educational institute for the purpose of carrying on scientific research in natural science. The research is, however now related to the business of the assessee.
4. During the previous year Mr. Avinash also made a capital expenditure of Rs.5,000 for the purpose of carrying on a scientific research related to his business. This expenditure is however not recorded in the profit and loss account.
5. Outstanding liability in respect of GST amounting to Rs.10,500 was paid on 10-4-2021, Rs.1,000 on. 10-5-2021, Rs.2,000 on 30-6-2021, Rs.1,000 on 10-7-2021 and Rs.3,500 is still outstanding. The return is furnished on 31-7-2021.
6. No tax has been deducted at source on the audit fees of Rs.21,000

Determine the taxable income of Mr. Avinash for the assessment year 2021-22 assuming he, annually deposits Rs.10,000 in a public provident fund account and his turnover for P/Y 2020-21 was Rs.70,00,000.

Solution :

Computation of Business Income of Mr. Avinash for the Assessment Year 2021-22

	Rs.	**Rs.**
Profit and Gains from business or profession		
Net profit as per P & L A/c	2,40,900	
Add : Outstanding for GST	3,500	2,44,400
Less :		
Custom duties recovered back	15,300	
Gift from son	40,000	
Capital expending on scientific research	5,000	
Additional deduction of 50% for scientific research	4,500	(64,800)
Income from business		1,79,600
Less : Deduction u/s 80C		(10,000)
Taxable income		1,69,600

4 : State with reason whether the following expenses are admissible a deduction while computing income from business or profession :

(i) Stock in trade was lost in fire, amounting to Rs.12,000 and was debited to profit and loss Account.

(ii) Amount spent on successful suit filed against a person for infringing trade mark of assessee Rs.10,000

(iii) Interest paid to bank Rs.15,000 in connection with overdraft obtained for paying dividend

(iv) Entertainment expenses of Rs.28,000 incurred during the previous year.

(v) Capital expenditure of Rs.1,00,000 has been incurred towards promotion of family planning amongst employees of ABC Ltd.

(vi) Rs.20,000 were spent in the previous year in connection with statutory income tax proceedings.

(vii) Rs.3,000 spent in connection with installation of a new telephone connection.

(viii) Traveling expenses of a Director of ABC Ltd. Rs.20,000 incurred on a tour to U.S.A. in connection with the negotiation of purchase of a new machinery.

(ix) Compensation paid to the widow and children of deceased employees of the factory on the order of labour Court

Solution :

(i) Loss of stock in trade by fire is deduction from profit and gains of business or profession.

(ii) Amount spent on a suit field for infringing the trade mark of Rs.10,000 is fully admissible u/s 37(1) because it is a commercial expediency for security or registration of trade mark.

(iii) Interest of Rs.15,000 paid to bank for overdraft for payment of dividend is allowed u/s 36(1)

(iv) Entertainment expenditure is covered under section 37(1) hence fully allowed.

(v) Expenditure on promotion of family planning incurred by a company amongst its employees is allowed u/s 36(1) but if it is of capital nature then 1/5th of the amount spent is allowed in the previous year in which it is incurred and balance in four equal installments in next four previous years. In this case Rs.20,000 is allowed in the current previous year and balance in next four previous year (Rs. 20,000 each year)

(vi) Amount spent on income tax is allowed as legal charges. Hence Rs.20,000 is deductible u/s 37(1).

(vii) Rs.3,000 is allowed as deduction which is incurred for installation of a new telephone connection u/s 37(1).

(viii) Traveling expenses of a director are fully allowed u/s 37(1) because the tour was for business purposes. It may also be treated as part of the cost of new machine, if the assessee so desires.

(ix) Compensation paid to the widow & children of deceased employee as per order of court are fully allowed u/s 37(1).

Illustration 5 : Mr. Vinod caries on his own business. For the year ending 31-3-2021, his Trading/Profit & loss account was as follows :

	Rs.		**Rs.**
Opening stock	20,000	Sales	2,89,000
Purchases	1,09,000	Closing stock	52,000
Salaries	6,000	Interest on Jay Co. Ltd	
Rent	11,000	Debentures	2,000
Bonus	3,000	Dividend from UTI	2,000
Printing & Postage and stationery	4,000	Discount received	12,000
Miscellaneous expenses	4,000	Race winning (Gross)	12,000
Advertisement expense	22,000		
Drawings	12,000		
LIC Premium	5,000		
Car expenses :			
Driver's Salary	6,000		
Petrol & repair	12,000		

Property tax	4,000		
Medical expense of son with			
Disability at Apollo hospital	3,000		
Cost of NSC (IX series)	3,000		
Net Profit	1,45,000		
	3,69,000		3,69,000

Other information :

(a) Advertisement expenses included cost of 20 gift packs of Rs.1100 each presented to esteemed customers on occasion of Diwali.

(b) Assume : Taxes deducted at source on dividends and debentures are 'Nil'

(c) The car was used both for business and personal purposes. 2/3rd is for business purposes.

(d) The property tax of Rs. 4,000 was in respect of his self occupied house whose rental value is Rs.18,000.

Compute Gross Total Income and Total Income of Mr. Vinod for assessment year 2021-22 showing the incomes under various heads.

Solution :

Computation of Total Income of Mr. Vinod for the Assessment year 2021-22

	Rs.	**Rs.**	**Rs.**
Profit and gains from business or profession			
Net profit as per P & L A/c.		1,45,000	
Add : expenses/ Payments not admissible			
Drawings.	12,000		
LIC premium	5,000		
Car expenses			
Driver salary (1/3)	2,000		
Petrol (1/3)	4,000		
Property tax	4,000		
Medical expenses	3,000		
Cost of NSC	3,000	33,000	
		1,78,000	
Less : Incomes which are not taxable under this head			
Interest on debentures	(2,000)		
Dividend from U.T.I	(2,000)		
Horse race income	(12,000)	(16,000)	
Income from business			1,62,000

Income from other sources

Interest		2,000	
Dividend from U.T.I.		Exempt	
Horse race income		12,000	14,000
Gross total income			1,76,000
Less : Deduction under Chapter VIA			
U/s 80C (LIC : Rs.5,000 + NSC : Rs.3,000)	(8,000)		
U/s 80DD	(75,000)		(83,000)
Taxable Income			**93,000**

6 : X furnishes the following particulars for the previous year relevant to A/Y 2021-22.

Profit and Loss A/c for the year ending 31-3-2021

	Rs.		**Rs.**
To salary to staff	22,000	By gross profit	2,50,000
To entertainment expenses	13,000		
To general expenses	11,000		
To bad debts	4,500		
To reserve for bad debts	10,000		
To advertising expenses	7,000		
To interest on X capital A/c	3,000		
To acquisition of patent's rights	28,000		
To telephone expenses	12,000		
To depreciation	10,000		
To provision or Income Tax	4,000		
To Net Profit	1,25,500		
	2,50,000		2,50,000

Other information :

1. Salary to staff includes salary paid to a relative which is unreasonable to the extent of Rs.3,100.
2. Provision for income tax is excessive to the extent of Rs.3,000
3. Depreciation according to the income tax provision comes to Rs.9,500
4. During the previous year 2020-21 the following payment were made and the same have not been debited to profit and loss account of 2020-21.
   a. Rs.3,000 paid on 10-6-2020 on account of outstanding customs duty of the previous year 2019-20, and
   b. Rs.5,000 paid on 15-6-2020 on account of outstanding GST of the previous year 2020-21
5. Patents were acquired on 4-11-2020

Find out the taxable income of X for the A/Y 2021-22. Due date of filling return of income of assessment year 2020-21 and 2021-22 is 31st July of the relevant A/Y.

Solution :

Computation of Taxable Income of X for the Assessment year 2021-22

	Rs.	Rs.
Profit and gains from business or profession		
Net profit as per P & L A/c		1,25,500
Add : Expenses / payments not admissible		
Salary to a relative	3,100	
Depreciation (in excess of Income tax provision)	500	
Provision for Income tax (full amount)	4,000	
Interest on X capital A/c	3,000	
Reserve for bad debts	10,000	
Expenditure on acquisition of patent rights	28,000	48,600
		1,74,100
Less : GST for assessment year 2020-21	5,000	
Depreciation on patent rights 12 ½ % of Rs. 28,000	3,500	(8,500)
Income from business / Gross total income		1,65,600

7 : Shri Mihir furnished the following information relevant for the assessment year 2021-22 :

Profits & loss A/c for the year ending 31-3-2021

Particulars	**Rs.**	**Particulars**	**Rs.**
Household expenses	11,200	Gross profit	2,69,000
Bad debts	600	Commission	5,000
Provision for bad debts	4,800	Sundry receipts	8,000
Fire Insurance	1,000	Bad debts recovered (earlier	
Salary to staff	8,000	allowed as deduction)	2,000
Salary to Mihir	3,000	Interest on Govt. securities	17,000
Contribution to			
Unrecognised provident fund	32,000		
Interest on overdraft	6,000		
Interest on capital	13,000		
Interest on loan given by			
Mihir's brother	1,000		
Depreciation on building and furniture	13,600		

Advertisement		
Revenue expenses	3,800	
Capital expenses on Neon sign board	1,000	
General expenses	4,700	
Net profit	1,97,300	
	3,01,000	3,01,000

Other information :

1. General expenses include personal expense of Rs.1,700
2. Income of Rs.3,000, accrued during previous year ending 31-3-2021 is not recorded in the profit and loss A/c
3. Mihir contributes Rs.14,000 towards public provident fund
4. Depreciation on building and furniture comes to Rs.3,000 according to the tax provision. Determine the taxable income of Shri Mihir for the assessment year 2021-22.

Solution :

Computation of Taxable Income of Shri Mihir for A/Y 2021-22

	Rs.	**Rs.**
Profit and gains from business or profession		
Net profit as per P & L A/c		1,97,300
Add : Expenses / payments not admissible		
General Expenses	1,700	
Depreciation (in excess of tax provision i.e.		
Rs.13,600 – Rs.3,000)	10,600	
House hold expenses	11,200	
Provision from bad debts	4,800	
Salary to Mihir	3,000	
Contribution towards URPF	32,000	
Capital expenditure on Neon sign board	1,000	
Interest on capital	13,000	77,300
		2,74,600
Add : Income not recorded in P & L A/c		3,000
		2,77,600
Less : Interest on government securities		(17,000)
Less : Depr on Neon sign board @ 10%		(100)
Business income		2,60,500

Income from other sources :	
Interest on government Securities	17,000
Gross total income	2,77,500
Less : Deduction under section 80C (PPF)	(14,000)
Taxable Income	**2,63,500**

8 : G (Age : 68 years) a Resident individual, furnishes following particulars relevant for the A/Y 2021-22 :

PROFIT AND LOSS ACCOUNT

for the year ending 31st March, 2021

Particulars		**Rs.**	**Particulars**	**Rs.**
Salary to staff		34,000	Gross profit	6,86,000
General expenses		48,000	Commission and discount	2,17,200
Bad debts written off		15,000	Sundry receipts	43,000
Reserve for losses		2,000	Short term profit on sale of Investment	31,000
Fire insurance premium (office premises)		4,200		
advertisement	2,400			
Add : outstanding	1,600	4,000		
interest on G's Capital		3,500		
Interest on Bank Loan		14,500		
Expenditure on acquisition of a Patent right acquire and put to use on June 30, 2020		17,000		
Lump sum Consideration for acquiring				
Know how on March 3, 2021		60,000		
Depreciation on plant and machinery		28,000		
Provision for outstanding GST		13,000		
Net profit		7,34,000		
		9,77,200		9,77,200

Other information :

1. Advertisement expenditure includes Rs.3,400 being cost of 2 diaries (cost of each being Rs.1,700) presented to customers.
2. Depreciation on plant and machinery according to income tax provision comes to Rs.29,700.
3. Salary to staff includes payment of Rs. 8,000 to a relative which is unreasonable to the extent of Rs.3,000.
4. General expenses include (a) expenditure of Rs.4,800 incurred by G on training of his employees (b) Commission of Rs.10,000 for securing a business order, and (c) compensation of Rs.6,000 paid to an employee while terminating his service in the business interest.
5. Out of outstanding GST, Rs.3,000 is paid July 31, 2021 and Rs.8,000 is paid on October 3, 2021. The balance is not paid as yet. Due date of filling return of income is July 31, 2021.

6. Income of G from company deposit is Rs.12,000, which is not shown in the profit and loss account.

Determine the taxable income and tax liability of G for the assessment year 2021-22, assuming that insurance premium paid by G on the life insurance policy of Mrs. G is Rs.3,200.

Solution :

Particulars	**Rs.**	**Rs.**
Profit as per profit and loss account		7,34,000
Add : Inadmissible expenditure		
Salary to staff (salary paid to a relative to the extent is treated as excess or unreasonable)	3,000	
Reserve for losses	2,000	
Interest on capital	3,500	
Depreciation on Patent Right (amount deductible is 25% of Rs.17,000, i.e., Rs.4,250; therefore amount inadmissible is Rs.17,000 – Rs.4,250)	12,750	
Depreciation on know-how (50% of 25% of Rs.60,000, as it is put to use for les than 180 days, is deductible which comes to Rs.7,500 ; amount not deductible is Rs.52,500)	52,500	
Outstanding GST {Rs.3,000 paid on or before July 31, 2021 is deductible.		
The balance is not deductible for the previous year ending March 31, 2021}	10,000	83,750
		8,17,750
Less : Provisions for depreciation on plant and machinery		(1,700)
(ie., Rs.29,700 – Rs.28,000)		8,16,050
Less : Short term capital gain on sale of investment		(31,000)
Business income		7,85,050
Computation of Net Income :		
Profits and Gains of Business and Profession		7,85,050
Capital gains		31,000
Income from other sources		12,000
Gross total income		8,28,050
Less : Deduction under section 80C (Payment of insurance premium)		(3,200)
Net income		8,24,850
Tax on Net Income		74,970
Add : Health & Education Cess (4% of tax)		2,999
Tax liability (rounded off)		77,970

9 : R (age : 26 years), a resident individual furnishes the following :

Profit and Loss Account for the year ending March 31, 2021

Particulars	**Rs.**	**Particulars**	**Rs.**
Office expenses	11,000	Gross profit	8,78,000
Security deposit for Telephone	8,000	Sundry receipts	8,000
Salary to staff	42,000		
Depreciation	28,000		
Traveling expenses	43,000		
Los of cash by an employee through embezzlement	5,000		
Amount transferred to Special reserve account	7,500		
Expenditure on Diwali	7,100		
Interest and legal expenses	44,000		
Sundry expenses	8,500		
Net profit	6,81,900		
	8,86,000		8,86,000

Other information :

1. Salary to staff includes payment of Rs.12,000 out of India on which tax has not been deducted at sources nor paid to the Government.
2. Depreciation value of plant and machinery on April 1, 2020 is Rs.1,10,000 (rate of depreciation : 15%)
   a. A plant whose WDV on April 1, 2020 is Rs.17,440 is sold during previous year for Rs.11,000.
   b. A machinery (cost price Rs.20,000) whose written down value on April 1, 2020 is Rs.2,350 is sold during the previous year for Rs.15,000.
   c. During the year, R purchase a new plant for office Rs.1,22,670 which is eligible for depreciation at the rate of 15%. The plant is installed and put to use on May 15, 2020.
3. Traveling expenses includes Rs.10,000 being hotel expenditure of an employee in respect of an official visit to Mumbai for 5 days.
4. Expenditure on the occasion of Diwali includes a gift of Rs.2,000 to Mrs. R.
5. Interest includes a payment of Rs.3,000 out of India on Which tax has not been deducted.
6. Sundry expenses includes expenditure of Rs.1,000 on maintenance of guest house in Delhi for the purpose of carrying on the business and Rs.4,000 being employer’s contribution towards EPF out of which Rs.600 is paid after the due date of submission of return of income.
7. Legal expenses includes the following payments :
   a. Payments of Rs.4,000 to B, an Employee of R, for filing income tax appeal.
   b. Payment of Rs.5,000 to C, not being an employee of R, for preparation of return of income.
   c. Payment of Rs.11,000 to D, an advance who is not an employee of R, for filing income tax appeals and giving tax advice.

d. Payment of Rs.2,000 to E, a Chartered accountant who is not an employee of R for obtaining tax advice.

Determine the taxable income of R for A/Y 2021-22 assuming that sundry receipts includes Rs.5,000, being amount of endowment insurance policy received from the Life Insurance Corporation of India at the time of maturity of the policy (i.e., December 5, 2020) {Amount of Insurance premium last paid on June 5, 2020 : Rs.400}

Solution :

	Rs.	**Rs.**
Net profit as per profit and loss account		6,81,900
Add : Inadmissible expenses		
Salary paid outside India {not deductible as tax has not been deducted at sources}	12,000	
Depreciation (taken separately)	28,000	
Traveling expenses {fully deductible under section37(1)} --		
Gift to Mrs. R on the occasion of Diwali	2,000	
Payment of interest out of India {not deductible as tax is not deducted at sources }	3,000	
Expenditure on maintenance of guest house {deductible under section {37(1)}	--	
Employer's contribution towards EPF which is paid after due date of submission of return income	600	
Legal expenses in respect of income tax matters {such expenses are fully deductible}	--	
Amount transferred to special reserve account	7,500	53,100
		7,35,000
Less : Depreciation		(31,000)
		7,04,000
Less : Amount credited but not taxable (amount of insurance policy)		5,000
Income under the head "Profits and gains of business or profession"		6,99,000
Income from other sources		Nil
Gross total income		6,99,000
Less : Deduction under section 80C {Payment of Insurance premium}		400
Net income		6,98,600
Tax on Net income		52,220.00
Add : Health & Education cess (4% of tax)		2088.80
Tax liability (rounded off)		54,310.00

LESSON ROUND UP

- Sections 28 to 44D contain the provisions for computation of Income from Business and Profession.
- Section 28 defines the scope of income which can be taxed under this head.
- Sections 29 to 44D specify the method of computation of income under the business or profession.
- Expenses/allowances expressly allowed by the Act are listed under sections 29 to 37, whereas sections 40, 40A and 43B enumerate those expenses which are expressly disallowed while computing taxable income under this head.
- Section 44AA provides for maintenance of accounts by the assessee carrying on business or profession.
- Mandatory tax audit of accounts of the persons carrying on business or profession is prescribed in section 44AB.
- Computation of profit from business and profession on presumptive basis are covered under sections 44AD and 44AD.

TEST YOURSELF

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

1. What is the importance of method of accounting while computing business or profession income.
2. What is the percentage of additional depreciation and what are the conditions for the allowability of the same.
3. If a businessman is not maintaining any books of accounts for his business, can he still compute his business income.
4. What expenses are allowed as deduction from Business or Profession on actual payment basis.
5. Who is required to maintain books of accounts u/s 44AA and what are the limits for getting them Audited u/s 44AB.
6. Which taxes are allowed as deduction from Business or Profession Income.
7. Whether expenditure incurred on Corporate Social Responsibility allowed as deduction from Business or Profession income'.
8. Whether expenditure on contribution to a Political Party allowed as deduction from Business or Profession income.
9. Mr. X has started a business on 15/4/2020. He has incurred expenditure before setting up the business. Are there expenditure allowed as deduction and if yes what are the limits and conditions.
10. What are the cases where capital expenditure is fully allowed as deduction from Business or Profession income.

PRACTICAL QUESTIONS

Question 1 : Y (age : 34years) is a businessman in Delhi. Determine his net income and tax liability on the basis of the following profit and loss account for the year ending 31, 2021.

Particulars	**Rs.**	**Particulars**	**Rs.**
Opening stock	1,04,000	Sales	92,51,000
Purchases	80,08,750	Closing stock	2,10,000

Salaries and wages	1,75,000		
Rent and rates	1,31,000		
Commission	21,500		
Household expenses	20,000		
Income tax for 2020-21	36,100		
Advertisement	5,000		
Postage and telegram	4,000		
Interest on own capital	84,000		
Reserve for bad debts	3,400		
Depreciation on furniture	18,000		
Net profit	8,50,250		
Total	**94,61,000**	**Total**	**94,61,000**

Other particulars :

1. Closing stock and opening stock has consistently been valuated at 10 % below cost price.
2. Depreciation on furniture as per tax provisions is Rs.17,200.
3. Amount of sales includes a sum of Rs.41,250 representing the value of goods withdrawn for the use of Y's family members. These goods were purchased at cost of Rs.27,850. Market value of these goods is Rs.45,240.
4. Household expenses include a contribution of Rs.1,000 towards public provident fund.
5. On September 20, 2020, Y has received a gift of Rs.96,000 from a friend settled in UK.

Question 2 : From the profit and Loss Account of Y (age : 35 years) for the year ending March 31, 2021, ascertain his total income and tax liability for A/Y 2021-22 :

Particulars	**Rs.**	**Particulars**	**Rs.**
General expenses	13,400	Gross profits	3,15,500
Bad debts	22,000	Commission	8,600
Advance tax	8,000	Brokerage	37,000
Insurance	600	Sundry receipt	2,500
Salary to staff	26,000	Bad debt recovered	
Salary to Y	45,000	(earlier allowed as deduction)	11,000
Interest on overdraft	4,000	Interest on debentures (i.e. net	
Interest on loan to Mrs. Y	42,000	amount Rs.22,500 + tax deducted	
Interest on capital of Y	23,000	at source : Rs.2,500)	25,000
Depreciation	48,000	Interest on deposit with	13,000
Advertisement expenditure	7,000	company (Net interest : Rs.11,700	

Contribution to employee's		+ TDS : Rs.1,300)	
Recognized provident fund	13,000		
Net Profit	1,60,600		
Total	4,12,600	Total	4,12,600

Other Information :

1. The amount of depreciation allowable Rs.37,300 as per the Income-tax Rule. It includes depreciation on permanent sign board.
2. Advertisement expenditure includes Rs.3,000, being cost of permanent sign board fixed on office premises.
3. Income of Rs.4,500, accrued during the p/y is not recorded in the Profit and Loss Account.
4. Y pays Rs.6,000 as premium on own life insurance policy of Rs.70,000
5. General expenses include (a) Rs.500 given to Mrs. Y for arranging a party in honour of a friend who has recently come from Canada (b) Rs.1,000 being contribution to a political party.
6. Loan was taken from Mrs. Y for payment of arrears of income-tax.
7. Interest on debentures is paid to Y on December 31, 2020.

Question 3 : Find out the Gross Total Income of Shri Sunder Kumar on the basis of following particulars -

PROFIT & LOSS ACCOUNT

for the year ended 31st March, 2021

Particulars	**Rs.**	**Particulars**	**Rs.**
Interest	1,800	Gross profit b/d	1,22,700
Repairs and Renewals	2,200	Interest on debenture of an	
Insurance	4,200	Institution (gross)	10,000
Depreciation	5,600	Rent from house property	36,000
Compensation	10,200		
Law charges	5,100		
Labour Welfare expenses	3,800		
Subscription	5,800		
Net profit	1,30,000		
Total	1,68,700	Total	1,68,700

Interest includes Rs.200 on loan for purchasing debentures of a company and Rs.300 on loan taken for reconstruction of house property let out.

(i) The expenses relating to house property let out are 40% of the repairs and renewal expenses.

(ii) Depreciation includes Rs.1,200 on house property let out.

(iii) Compensation was paid to an employee whose dismissal was in business interest.

(iv) Insurance includes 30% for fire insurance of the house property let out 30% for workers accident insurance and the balance for life insurance.

(v) Law charges includes Rs.2,000 relating to a petition filed against breach of contract and the balance regarding sales tax appeal.

(vi) Subscription includes Rs.2,000 given for election purpose to political parties.

The amount not debited to profit and loss account are as follows

(vii) Expenses incurred on the occasion of Diwali Rs.500

(viii) Theft of cash from iron safe Rs.1,500

(ix) Expense for new telephone connection in the business Rs.2,000

Question 4 : XYZ Ltd., an Indian company, furnishes following particulars for assessment year 2021-22 :

Profit and Loss account for the year ending March 31, 2021

Particulars	**Rs.**	**Particulars**	**Rs.**
Salary to staff	2,40,000	Gross profit	15,58,000
Expenses on issue of shares for setting up an industrial undertaking (cost of project : Rs.10 lakh)	18,000	Rent of flats given to officers	12,000
Expenditure on promotion of family planning among employees	3,000	Sundry receipts	5,000
Custom duty	2,000	Interest on bank deposits	17,000
Contribution to a National Laboratory for carrying out approved scientific research	1,06,000	Capital gains on sale of short-term investment	3,000
Gratuity fund	5,000		
Reserve for future losses	20,000		
Bad debts written off	3,000		
Reserve for payment of advance income-tax	13,000		
Car expenses	9,000		
Depreciation :			
➢ Machinery	18,000		
➢ Car	3,000		
➢ Furniture	5,000		
➢ Building	3,000		
Office expense	7,500		
Rent and repairs of building	3,000		
Municipal taxes and ground rent of flats given to officers	7,000		

Sundry expenses	11,000		
Stationery expenses	5,000		
Income-tax	11,700		
Net profit	11,01,800		
Total	15,95,000	Total	15,95,000

Other information :

1. Expenditure on family planning includes capital expenditure of Rs.2,500.
2. Car is utilized partly for private purpose by a director. In the past years, one-fourth of this expenditure was disallowed.
3. Sundry expenses include Rs.9,000 being payment of printing bill to relative of the managing director ;payment is unreasonable to the extent of Rs.4,700.
4. Salary includes payment of Rs.21,000 in cash to an employee. It also includes “mediclaim” insurance premium for the benefit of employees of Rs.15,000 out of which Rs.6,000 is paid in cash.
5. Though amount of depreciation on building, car and furniture is calculated as per tax provisions, depreciation in respect of machinery is excessive to the extent of Rs.2,000.
6. Rs.1,06,000 being payment to National Laboratory is qualified for weighted deduction u/s 35(2AA).
7. The company has deposited Rs.2,40,000 with Maruti Udyog Ltd. on March 1, 2021 for purchasing Maruti 800 car. The car is likely to be delivered by June 2021. The said amount is not debited to Profit and Loss Account.
8. During the previous year 2020-21, the company pays Rs.15,00,000 as compensation to employees on voluntary retirement under the voluntary retirement scheme of the company. The amount is not debited to the P&L A/c.
9. The company deposits Rs.10,000 in National Housing Bank.
10. On March 16, 2021 the company gets a refund of sales tax of Rs.3,000 (it was allowed as deduction for the previous year 2016-17). The amount is not credited to the profit and loss account, as the commissioner’s appeal against the refund is still pending in the Delhi High Court.

Determine the taxable income of the assessee-company for the assessment year 2021-22. Assume tax rate 30%

Question 5 : Mr. Inder Kumar Sharma furnishes the following manufacturing profit and loss account for the previous year ending 31-3-2021 :

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
To Stock	11,000	By Sales	2,84,500
To Purchases	80,000	By Stocks	26,400
To manufacturing wages	65,900		
To Factory Rent Rates and Taxes	30,000		
To Depreciation	15,000		
To Gross profit	1,09,000		
Total	3,10,900	Total	3,10,900

Profit and Loss Account

Particulars	Amount Rs.	Particulars	Amount Rs.
To Office Salaries	27,000	By Gross profit B/D	1,09,000
To Establishment Expenses	6,100	By Rent of staff quarters	19,000
To Interest on Capital	3,300	By Refund of income-tax penalty	2,000
To Fire Insurance	200	By sale of a machinery	25,000
To Bad debts	7,000	By Recovery of Bad debts, not allowed as deduction earlier	6,000
To Income tax	6,000	By Sundry Receipts	35,000
To Expense on GST proceedings	2,000		
To Expenses of income-tax proceedings	13,000		
To Diwali Expenses	4,000		
To Legal Expenses	7,000		
To Medical Expenses of proprietor	3,000		
To Staff Welfare Expenses	2,000		
To Repair of Staff quarters	4,000		
To Security Deposit for telex connection	10,000		
To Bonus payable to Employees	20,000		
To Provision for GST	25,000		
To Municipal taxes for staff quarters	4,000		
To General Reserve	26,00		
To Entertainment expenses	16,000		
To Net profit	10,400		
Total	1,96,000	Total	1,96,000

You are required to compute the taxable profits from business after taking the following into consideration :

(i) Purchase include a petty purchase of Rs.21,000. Its payment was made by a crossed cheque.

(ii) Assessee has always valued the stock at cost price but since 2019-20 he has valued it at market price which was in excess of the cost price by 10%.

(iii) Office salaries paid include Rs.10,400 to the proprietor of the business

(iv) Diwali expense include gifts of Rs.1,000 made to the relatives.

(v) The written down value (WDV) of the block consisting of machinery as on 1-4-2020 is Rs.59,000. Machinery whose WDV as on 1-4-2020, was Rs.5,000 was sold for Rs.25,000 during the year.

(vi) The written down value (WDV) of the block consisting of factory buildings as on 1-4-2020 is Rs.90,000.

(vii) GST amounting to only Rs.20,000 were paid on or before 31-7-2021.

Answers :

1. Rs. 10,87,930 Tax Liability 1,44,430
2. Nil, Tax Refundable Rs. 11,800
3. Rs. 1,22,220
4. Rs. 2,65,080
5. Rs. 71600

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 5
Computation of Income under the Head of Capital Gains

LESSON OUTLINE

- Chargeability of Income under Capital Gains [Section 45(1)]
- Impact of Section 115BAC under the head of Capital Gains
- Definition of Capital Asset [Section 2(14)]
- Definition of Transfer [Section 2(47)]
- Types of Capital Gains
- Computation of Capital Gains
- Cost of Acquisition [Section 55(2)]
- Cost of Improvement [Section 55(1)]
- Computation of Capital Gains in Certain Cases
- Special cases of computation of capital gains e.g. Slump Sale, Destruction, and Compulsory Acquisition etc.
- Distribution of Assets by Company to tis shareholders in Liquidation [Section 46(1)]
- Capital Gains on Purchase by Company of its own shares/specified securities (Buyback) [Section 46A]
- Certain transfers not treated as transfer [Section 47]
- Special cases of computation of full value of consideration [Section 50C / Section 50CA / Section 50D]
- Reference to Valuation Officer [Section 55A]
- Tax rates of Capital Gains
- Exemptions from Capital Gains
- LESSON ROUNDUP
- TEST YOURSELF

LEARNING OBJECTIVES

The provisions for computation of Income from Capital Gains are applicable for incomes from transfer of Capital Asset.

At the end of this lesson, students will be able to understand:

- What are Capital Asset u/s 2(14)
- What transactions are treated as transfer u/s 2(47)
- Calculate Capital gains
- Know what transaction are not treated as transfers
- Exemptions available
- Compute tax on capital gains

KEY SECTIONS COVERED IN THIS CHAPTER

Section 45(1)	Basis of charge
Section 45(IA)	Destruction of Capital Asset
Section 45(2)	Conversion of Capital Asset into Stock in Trade
Section 45(2A)	Transfer of Demat Securities
Section 45(3)	Transfer of capital asset by Partner to Firm
Section 45(4)	Transfer of capital asset by Firm to Partner
Section 45(5)	Compulsory Acquisition of Capital Asset
Section 45(5A)	Joint development Agreement
Section 46(1)(2)	Liquidation of Company
Section 46A	Buy back of own shares
Section 47	Transactions not regarded as transfers
Section 50B	Slump sale
Section 50C	FVC for Real estate transaction
Section 50CA	FVC of unlisted shares
Section 50D	FVC not ascertainable
Section 54	Exemptions from capital gains
Section 55	Cost of acquisition and cost of improvement
Section 55A	Reference to valuation officer
Other Sections	
Section 2(14)	Capital asset
Section 2(47)	Transfer
Section 10(37)	Capital gain exempt on compulsory acquisition of Urban agricultural land
Section 10(37A)	Capital gain arising under land pooling scheme of Andhra Pradesh
Section 111A	STCG @ 15% on shares, units
Section 112	Tax rates of LTCG
Section 112A	Tax on long term capital gains in certain cases.

CHARGING SECTION [SECTION 45(1)]

- Any Profit or Gains arising from
- TRANSFER
- Of a CAPITAL ASSET
- Effected in a Previous year
- Shall be chargeable to Income Tax

- Under the Head Capital Gains
- In the Previous Year in which transfer took place

IMPACT OF SECTION 115BAC UNDER THE HEAD CAPITAL GAINS [AMENDMENT VIDE FINANCE ACT, 2020]

Finance Act, 2020 has introduced a New Optional Tax System for Individuals and HUFs u/s 115BAC of the Income Tax Act, 1961 w.e.f. A/Y 21-22 to provide for concessional rate of Slab Rates to be applied on Total Income calculated without claiming specified deductions and exemptions.

Hence, from AY 2021-22 or FY 2020-21, there are two operative tax system:

1. One is the Existing tax system where all the applicable deductions and exemptions are allowed and the tax rates are as per the Slab rates of tax specified in the Finance Act, 2020.
2. The second one is section 115BAC which is an Optional Tax System under which many deductions and exemptions have not been allowed but lower slab tax rates are provided in the section 115BAC itself.

Individual and HUF opting for concessional tax regime under section 115BAC: The deduction under Chapter VI-A other than the provisions of sub-section (2) of section 80CCD or section 80JJAA; not available to the Individual and HUF opting to pay tax under concessional tax regime under section 115BAC of the Income Tax Act, 1961.

Under the new tax system, many deductions & exemptions are not allowed but under the head Capital Gains, all exemptions and deductions are allowed even under the New tax system. So computation of Capital Gain Income will not be effected under the new tax system.

CAPITAL ASSET [SECTION 2(14)]

Capital Asset means:

(a) Property of any kind, whether fixed or circulating, movable or immovable, tangible or intangible held by assessee, whether or not connected with his business or profession.

(b) Any securities held by Foreign Institutional Investor (FII) which has invested in such securities as per SEBI regulations (applicable with effect from the assessment year 2015-2016) but does not include:

1. Any stock-in-trade [other than securities referred to in sub-clause (b)]
2. **Personal Effects**
   - Movable property (**including** wearing apparel & furniture)
   - for **personal use** of
   - assessee ***or*** for dependent family member.

   Personal effects **excludes** the following

   a. Jewellery
   b. Archaeological collections
   c. Drawings
   d. Paintings
   e. Sculptures
   f. Any work of art

Special Point

Jewellery *Includes*	
Ornaments of Gold, Silver, Platinum or Other precious Metal Whether or not containing precious or semi-precious stones & whether or not worked or sewn into wearing apparel	Precious or Semi-precious stones Whether or not set in any furniture, utensil or other article and whether or not worked or sewn into weaning apparel

Note: (a) Gold & silver coins and bars used for puja of deities as a matter of pride or for ornament purpose are not intended for personal or household use, will not be treated as personal effects and therefore are capital effects. [*Maharaja Rana Hemant Singhji* v. *CIT* [1976] 103 ITR 61 (SC)]

(b) A property intended for personal or household use (may be for ceremonial occasions only), is always a "personal effects". For instance, clothes meant for use at weddings or formal occasions are not used daily. Yet, they are stiched for personal use of the wearer. As such, they would form a part of his personal effects – *CIT* v. *H.H. Maharani Usha Devi* [1998] 98 Taxman 309 (SC)

3. **Agricultural Land** in India situated in **RURAL AREA**

Following types of Agricultural Lands are Capital Assets

a) Agricultural Land situated in Urban area of India

b) Agricultural land situated outside India

Urban Area [section 2(1A)]

(a) Any area within the **Jurisdiction** of a municipality /Municipal corporation/cantonment board and which has a population of **atleast 10,000 OR**

(b) Any area within the distance, measured aerially,

(I) Upto 2 kms from local limits of **above jurisdiction** having population **> 10,000 but upto 1,00,000 or**

(II) Upto 6 kms from local limits of **above jurisdiction** having population **> 1,00,000 but upto 10,00,000 or**

(III) Upto 8 kms, from the local limits of **above jurisdiction** having population of **> 10,00,000.**

Special point: "Population" means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

Note: If agricultural land is situated in a village which comes within a municipality, then population of the municipality shall be considered and not of the village. . In such a case if population of the municipality exceeds 10,000, then agricultural land is capital asset, even if population of the village is less than 10,000 – [G.M.Omer Khan v. CIT [1992] 63 taxmann 533] (SC)

4. **Gold Deposit Bonds** issued under gold deposit scheme,1999 /**Gold deposit certificates** issued under Gold Monetisation Scheme, 2015

TRANSFER [SECTION 2(47)]

(a) **Sale***, **Exchange**** or **Relinquishment***** of Capital Asset.

(b) **Extinguishment** of any right in a Capital Asset.

(c) **Compulsory Acquisition** of Capital Asset under Any law.

(d) **Conversion** of Capital Asset into Stock in trade of Business.

(e) Any transaction in which **possession of Immovable Property** is taken u/s 53A of Transfer of Property Act.

(f) Any transaction (whether by way of becoming a member of, or acquiring shares in a Cooperative Society, Company or AOP), which has effect of transferring or enabling enjoyment of Immovable Property.

(g) Maturity or Redemption of a **zero coupon bond.**

Note: Forfeiture of share application money because of failure by an assessee to pay balance amount on allotment of shares is a transfer. [CIT v. BPL Sanyo Finance Ltd [2009] 312 ITR 63 (Kar)]

* Following are the essentials for sales:-

a) Must have mutual agreement

b) Parties must be competent

c) Money consideration

d) Absolute or general property transfer from seller to buyer

**An exchange means the transfer of property by one person to another and reciprocally the transfer of property by that other person to the first person. There must be a mutual transfer of ownership of the one thing for the ownership of another – CIT v. Rasiklal Maneklal (HUF) [1989] 177 ITR 198 (SC)

***A relinquishment arises when owner withdraws himself from the property and abandons his rights thereto. It presumes that the property continues to exist after the relinquishment – CIT v. Rasiklal Maneklal (HUF) [1989] 177 ITR 198 (SC)

TYPES OF CAPITAL GAINS

There are two types of Capital Gains:

1. **Short Term Capital Gain (STCG)** : It arises on transfer of Short Term Capital Assets(<36 months)*
2. **Long Term Capital Gain (LTCG)** : It arises on transfer of Long Term Capital Assets(>36 months)**

*Short terms capital assets means a capital asset held by an assessee for not more than 36 months, immediately prior to its date of transfer.

**Exceptions – Usually, holding period should be more than 36 months to become long-term capital asset. However, in some cases it is 12 /24 months which (see the below table).

CAPITAL ASSETS		
• Listed Security* (other than unit of MF) on recognised stock exchange in India • Unit of UTI or Equity oriented mutual fund (listed or unlisted • Zero Coupon Bonds (listed or unlisted)	**Unlisted shares / Immovable property**	**Other Capital Asset****

Held for a period **Upto 12 months preceding** date of transfer	Held for period **more than 12** months **preceding** date of transfer	Held for a period **Upto 24 months preceding** date of transfer	Held for a period **more than 24** months **preceding** date of transfer	Held for a period **Upto 36 months preceding** date of transfer	Held for a period **more than 36** months **preceding** date of transfer
Short Term Capital Asset	***Long term Capital Asset***	***Short Term Capital Asset***	***Long term Capital Asset***	***Short Term Capital Asset***	***Long Term Capital Asset***

*Listed Securities – Debentures, bonds, government securities, derivatives, etc.

**Other Capital asset – Units of debt oriented mutual fund (listed or unlisted)

COMPUTATION OF CAPITAL GAINS [SECTION 48]

Long Term Capital Gain		**Short Term Capital Gain**	
Sales Consideration	XXX	Sales Consideration	XXX
(Full Value Consideration)*		(Full Value Consideration)*	
Less :- Incidental cost	XXX	Less :- Incidental cost	XXX
Net Sales Consideration	XXX	Net Sales Consideration	XXX
Less :- Indexed Cost of Acquisition	XXX	Less :- Cost of Acquisition	XXX
Less :- Indexed Cost of Improvement	XXX	Less :- Cost of Improvement	XXX
Long Term Capital gain	XXX	Short Term Capital gain	XXX
Less :- Exception u/s 54 to 54H	XXX	Less :- Exception u/s 54B, 54D, 54G, 54GA	XXX
Taxable Long Term Capital Gain	XXX	Taxable Short Term Capital Gain	XXX

*Following points should be considered while taking Full Value of Consideration (FVC) :-

1) FVC is the consideration (may be in cash or in kind) received or receivable by the transferor in lieu of the assets which has been transferred. If it is received in kind, then the fair market value of such assets is taken as FVC.

2) FVC does not mean market value of that asset which is transferred.

3) For the purpose of determining the FVC, adequacy or inadequacy of consideration is not a relevant factor.

4) Where consideration for the transfer of capital asset(s) is not determinable, then for computing capital gains under section 45 , the fair market value of the asset shall be taken as the full market value of consideration [section 50D].

5) Where by acquiring a portion of a larger plot, the value of unacquired portion is injuriously affected, compensation received for such unacquired portion will also form the part of FVC – CIT v. P. Mahalakshmi [1982] 134 ITR 428 (Kar.).

6) Where a mill belonging to the assessee-company is transferred in a public auction and the payment has been made in installments along with interest by the purchaser of the mill, the amount of interest will also form the part sale consideration and thus, the same will be treated as capital gain under section 45

and not as income from other sources – Cauvery Spg. & Wvg. Mills Ltd. v. CIT[2011] 200 Taxman 22 (Mad.)(Mag.)

NOTE :- Long Term Capital Assets on which Indexation is not available :-

a) Equity or Preference shares which are listed in a recognised stock exchange in India (listing of shares is not mandatory if transfer of such shares took place on or before July 10, 2014),

b) Units of Equity oriented Mutual Funds,

c) Listed securities like Debentures and Government securities,

d) Units of UTI and

e) Zero Coupon Bonds

Indexed Cost of Acquisition

Cost of Acquisition of Capital Asset X

Cost inflation index
*(of financial year in which asset **transferred)***

Cost inflation index
(*of the 1st financial year in which asset **held** by **Assessee) or (***of financial year 2001-02***)**,whichever is later*

Indexed Cost of Improvement

Cost of Improvement X

Cost inflation index (*of **financial year** in which asset **transferred***)

Cost inflation index (*of **financial years** in which improvement has taken place by Assessee **or/and** Previous Owner*

COST INFLATION INDEX

Financial Year	Cost Inflation Index	Financial Year	Cost Inflation Index
2001-02	100	2011-12	184
2002-03	105	2012-13	200
2003-04	109	2013-14	220
2004-05	113	2014-15	240
2005-06	117	2015-16	254
2006-07	122	2016-17	264
2007-08	129	2017-18	272
2008-09	137	2018-19	280
2009-10	148	2019-20	289
2010-11	167	**2020-21**	**301**

Special Points:

- ✓ In case of **Long Term Capital Assets**, **Indexed** cost of Acquisition and **Indexed** cost of Improvement should be taken.
- ✓ However, where Long Term Capital Asset consists of **Bonds** (*other than capital indexed bonds of Government & gold sovereign bonds*) **& Debentures,** <u>No indexation is to be done</u>

Note: Base year for the purpose for calculation of Indexed cost of acquisition or improvement has been shifted from 1981-82 to 2001-2002. Accordingly if any assesee/previous owner has acquired capital asset prior to 1-4-2001 then he will have option to choose actual cost of acquisition or FMV as on 1-4-2001* as his cost of acquisition. Cost of improvement incurred by assesse or previous owner prior to 1-4-2001 shall taken as NIL. In case of goodwill, trademark or other intangible assets, the option to take cost of acquisition or market price whichever is higher is not available (as on 01.04.2001), irrespective its purchased or self generated.

In case of a capital asset being land or building or both, the fair market value of such asset on the 1st day of April, 2001, shall not exceed the stamp duty value, wherever available, of such asset as on the 1st day of April, 2001.

Explanation: For the purposes of this proviso, “stamp duty value” means the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property.

COST OF ACQUISITION [SECTION 55(2)]

Meaning – Cost of acquisition of any asset is the value for which the asset is actually acquired by the assessee. Expenses of capital nature for acquiring the title to the property are includible in the cost of acquisition.

	Types of Capital Asset	**Cost of Acquisition**	**Section 2(42A) : Period of holding**
A	1) Goodwill of **business**** 2) Trademark, Brand name of **business** 3) Tenancy Rights 4) Stage Carriage permits (route permit) 5) Loom Hours 6) Right to manufacture produce or process any article or thing 7) Right to carry any **Business or profession**	**N I L** *[If Self generated]** Or **Purchase price** *[If acquired by purchase]* *FMV on 1.4.2001 is not available when such assets are purchased upto 1.4.2001****	Date of Purchase/Self development **To** Date of Transfer
B	Shares purchased from company	Amount actually paid to company	Date of Allotment by Company **To** Date of Transfer
	Shares purchased from Broker/ Market	Amount actually paid to broker including brokerage	Date of broker note **To** Date of Transfer

** Amendment by Finance Act, 2020*

	Types of Capital Asset	Cost of Acquisition	Section 2(42A) : Period of holding
	Shares purchased from other person	Amount actually paid	Date of Contract of purchase **To** Date of Transfer
	Right Shares **subscribed** by original shareholder	Amount Actually paid to company	Date of Allotment by Company **To** Date of Transfer
	Offer of right shares **not subscribed** but renounced	Nil	Date of offer **To** Date of Renouncement
	Person **purchasing** renounced offer	Amount paid to Seller of right **and** Company	Date of allotment of right shares **To** Date of Transfer
	Bonus Shares/Other Asset allotted **free of cost**	Nil ***[FMV on 1.4.2001 available if such assets acquired on or before 31.3.2001***	Date of allotment of bonus shares **To** Date of transfer
C	**Other Capital Assets**	**Cost of Acquisition** ***FMV on 1.4.2001 available if such assets acquired on or before 31.3.2001***	Date of Acquisition **To** Date of Transfer

*Self-generated asset – An asset which does not cost anything in terms of money to the assessee

**When goodwill, right to manufacture, etc. are purchased – If goodwill of a business (right to manufacture, produce or process any article/thing or right to carry on any business or profession) is purchased and later on transferred, the purchase price will be taken as cost of acquisition and its cost of improvement will be taken as nil.

***Options not available – Even when the aforesaid assets were actually acquired before April 1, 2001, the option of adopting the fair market value on the said date is not available.

NOTE – a) The Brand name associated with a business is taken in expression "goodwill" – Vysali Chemotherapeutics (P.) Ltd. v. CIT[2004] 134 Taxman 445 (Ker.).

b) When transfer of a Self-Generated asset is not chargeable to Tax – Transfer of self-generated goodwill like self-generated goodwill of a profession, a new formula patented by the inventor to grow seedless oranges is not chargeable to tax. The rule is based upon the Supreme Court's ruling in CIT v. B.C. Srinivasa Setty [1981] 5 Taxman 1, wherein it was said that the income chargeable to capital gain tax is to be computed by deducting "the cost of acquisition of the capital asset and the cost of any improvement thereto" from the full value of the consideration. And if it is not possible to ascertain cost of acquisition and / or cost of improvement, the transfer of that asset is not chargeable to tax under the act.

COST OF IMPROVEMENT [SECTION 55(1)]

Meaning – It is the capital expenditure incurred by the assessee in making any improvement/additions to the capital asset. It also includes any expenditure incurred to protect or complete the title to the capital asset.

A	Capital Assets	Cost of improvement
	- Goodwill of **Business** - Right to manufacture, produce or process any article or thing - Right to carry on any **business or profession**	**NIL** (Whether capital asset is Self generated or purchased)
B	Other Capital Assets	• All Capital Expenditure incurred by assessee • on improvement of Capital Asset • On or after 1.4.2001 (NOTE)

NOTE : Any cost of improvement incurred before April 1, 2001 is not taken into consideration for calculating capital gain chargeable to tax (with no exceptions)

Illustration 1: Mr. X had acquired a building on 1-3-20 for ₹ 1,00,000. He had paid ₹1,000 as registration charges for purchase of building. It is sold on 01-01-21 for ₹ 2,00,000. He paid ₹ 3,000 to a broker as commission for selling the building. Determine Capital Gains.

Solution: STCG for AY 21-22: ₹2,00,000 – ₹1,00,000 - ₹1,000 - ₹3,000 = ₹96,000

Illustration 2: Mr. X had acquired a building for ₹5,00,000 on 1.1.1995.Mr X had built two additional floors, one on 01.01.1999 at a cost of ₹25,000 and the other on 01-01-2004 at a cost of ₹40,000. He has also incurred expenses on repairing the building on 1-10-2010 of ₹10,000. The Building is sold on 1-1-2021 for ₹30,00,000. Selling expenses incurred ₹15,000. Determine Capital Gains assuming Fair market value as on 1-4-2001 is ₹3,00,000

Solution: LTCG for A/Y 21-22: ₹30,00,000 – ₹5,00,000 x 301/100 – ₹40,000 x 301/109 - ₹15,000 = ₹13,69,541

NOTE : a) If the building is acquired before 1-4-2001 then, Cost of acquisition is taken at actual cost to the assessee or the fair market value as on 1-4-2001 whichever is higher.

b) Any Cost of Improvement before 1-4-2001 is always ignored.

Illustration 3: Mr. X had acquired 100 unlisted debentures of Y ltd on 1-01-5-2012 at a price of ₹200 per Debenture. Commission paid 2%. The debentures are sold on 01-01-2021 at ₹400 per debenture. Commission paid 3%. Determine Capital Gains.

Solution: LTCG for AY 21-22: 100 x ₹400 – 100 x ₹200 -2% of ₹20,000 -3% of ₹40,000 = ₹18,400

Question 4: Mr. X has self developed a patent on 01-01-05 The patent is sold on 01-01-20 for ₹1,00,000. Determine Capital Gain.

Solution: LTCG for AY 21-22: ₹1,00,000 – Nil = ₹1,00,000

Question 5: Mr X had applied for 100 shares at ₹200 per share under IPO of Reliance power Ltd on 15.3.2020. On 16.6.2020 the company allots 50 shares to Mr. X The Shares are sold by Mr. X on 20-12-20 for ₹350 per share. Determine Capital Gains

Solution: STCG: 50 x ₹350 - 50 x ₹200 = ₹7,500

COMPUTATION OF CAPITAL GAINS IN CERTAIN CASES

Insurance Compensation on Damage/Destruction of Capital Asset [Section 45(1A)]

- Overriding Section 45(1)
- Where any person receives at any time during previous year

- Any money or other asset
- Under insurance from an Insurer
- On account of Damage or destruction of Capital Asset due to,
    - ❖ Flood, Typhoon, Cyclone, Earthquake or other Natural Disaster,
    - ❖ Riot or Civil Disturbance or
    - ❖ Accidental Fire or Explosion or
    - ❖ Enemy action or action taken from combating enemy (whether or no war declared)

Then Capital Gains shall be chargeable in hands of such person in **Previous year** in which money or other asset is **Received** from Insurer.

Special Points:

1. Period of Holding**: Date of Acquisition to Date of Destruction**
2. Full value of Consideration**: Value of Money + FMV of asset on date of receipt**
3. Indexation**: P/Y of Holding to P/Y of Destruction**

Illustration 6: Mr. X had purchased a Building on 15-01-2005 for ₹10,00,000.The building was used for residential purposes. The building is destroyed due to fire on 10-01-2015. The insurance company gives a new building to the assessee and ₹16,00,000 in cash on 20th August, 2020. The fair market value of the new building is ₹9,00,000. Compute Capital Gains.

Solution : LTCG for AY 21-22 : ₹16,00,000 + ₹9,00,000 – [₹10,00,000 x 240/113] = ₹3,76,106

Conversion of Capital Asset into Stock in Trade [Section 45(2)]

- Overriding Section 45(1)
- Where assessee Converts a Capital Asset into Stock in Trade (SIT)
- Capital Gain arising on above transfer
- shall be chargeable in hands of Assessee
- In PY in which such SIT is Sold or otherwise transferred

  NOTE :- a) With effect from assessment year 1985-86, conversion of investment into stock in trade of a business carried on* by the taxpayer will be treated as transfer under section 2(47). The capital asset which is converted into stock in trade will be treated as transfer in the year in which it is being converted.

  *The business can either be new one or an existing one.

  b) It is not necessary that the provisions of section 45(2) would be applicable only in the case of profit or gain and not when there is loss – CIT v. Claridges Investments & Finances (P.) Ltd. [2007] 18 SOT 390 (Mum.).

Special Points:

1. Period of Holding : **Date of Acquisition to Date of conversion of asset to SIT**
2. Full value of Consideration : **FMV of such Capital Asset on Date of conversion**
3. Indexation : **PY of Holding to PY of conversion**

4. Where **Sale price is greater than FMV** on date of conversion then (Sale Price – FMV) is taxable under head Profit and gains from business and profession.

NOTE :- If stock-in-trade is sold in parts in different years then tax on capital gain on conversion of capital asset into stock-in-trade as per section 45(2), can be said to arise in parts in different years and not in one year in which last of stock-in-trade is sold – CIT v. Crest Hotels Ltd. [2001] 78 ITD 213 (Mum.)

Illustration 7: Mr. X had purchased jewellery on 15-1-1995 for ₹1,00,000. (FMV as on 1-4-2001 is ₹3,00,000). The assessee starts a jewellery business and brings jewellery as stock in trade of the jewellery business on 01-01-2016 when the fair Market value of the jewellery is ₹18,00,000. The jewellery is sold on 20-12-2020 for ₹20,00,000. Compute Capital Gains.

Solution: LTCG for AY 21-22: ₹18,00,000 – [₹3,00,000 x 254/100] = ₹10,38,000

Business Income for AY 21-22: ₹20,00,000 – ₹18,00,000 = ₹2,00,000

Capital Gain on Transfer of Securities [Section 45(2A)]

Applicability – Where shares/securities are transferred in "demat" form.

- Where any person had at anytime during previous year.
- Any beneficial interest in any securities.
- Then profit or gains arising from Transfer made by depository, of such beneficial interest.
- Shall be chargeable under Capital Gains in previous year of transfer.

Special Points:

1. Capital Gain shall be taxable in hands of person having **beneficial interest** and not in the hands of Depository who is the registered Shareholder.
2. Period of Holding & Cost of acquisition**:** Calculated on **FIFO basis**

Illustration 8: Transfer of demat Shares

Mr. X gives details of his demat account as follows:

Date of Credit	Particulars
20-06-2014	120 Shares of X Ltd purchased directly in dematerialized form for ₹200/Share
28-06-2015	80 Shares of Y Ltd purchased directly in dematerialized form for ₹120/Share
30-06-2016	100 Shares of X Ltd originally purchased in physical form on 15-10-2013 for ₹100/Share
15-08-2017	200 Shares of X Ltd originally purchased in physical form on 15-10-2010 for ₹150/Share

Mr. X sells 300 Shares of X Ltd on 01-01-2020 for ₹800/ Share. Compute Capital Gains.

Solution: LTCG for FY 19-20 All figures in (₹)

Particulars	120 shares	100 shares	80 shares
Period of holding	20/6/14 to 1/1/20 : LTCA	15/10/13 to 1/1/20 : LTCA	15/10/15 to 1/1/20 : LTCA
FVC	120 x 800 = 96,000	100 x 800 = 80,000	80 x 800 = 64,000
Less : ICOA	120 x 200 x 289/240= 28,900	100 x 100 x 289/220 =13,136	80 x 150 x 289/167 =20,776
LTCG	67,100	66,864	43,224

Capital Gain on Transfer of Capital Asset to Firm etc. [Section 45(3)]

- Where a person transfers a Capital Asset
- To a firm, AOP or BOI
- In which he is/or becomes partner or member
- By way of Capital Contribution or Otherwise
- Shall be chargeable to Capital Gain in hands of such person in the previous year of transfer.

Special Points:

1. Period of Holding : Date of acquisition by partner/member to Date of transfer to firm/AOP/BOI
2. Full value of consideration : Amount recorded in books of account of Firm/AOP/BOI
3. Indexation : P/Y of Holding to P/Y of Transfer

NOTE – As per section 45(3) there is no requirement that in case of transfer of an asset to the firm by a partner, the amount of sale consideration has got to be credited to his capital account ; crediting of purchase consideration to current account of the partners is sufficient – Mafatlal Holding Ltd. v. CIT [2004] 85 TTJ (Mum.) 821.

Illustration 8: Mr. X becomes a partner of a partnership firm M/s XYZ on 20/09/2020. He transfers a Capital asset on 15-12-2020 as capital contribution to the firm. The Capital Asset was acquired by Mr. X on 1-1-02 for ₹1,00,000. The firm records the asset at ₹5,00,000 in its books of Account. The Fair market value of the asset is ₹1,50,000. Compute Capital Gains.

Solution: LTCG in hands of Mr. X for A/Y 21-22: ₹5,00,000 – ₹1,00,000 x 301/100 = ₹1,99,000

Capital Gains on Transfer of Capital Asset on dissolution of Firm etc [Section 45(4)]

- Where a Firm, AOP or BOI transfers a Capital Asset (can be short term/long term, depreciable/non-depreciable) by way of distribution
- To its Partner or Members
- On its dissolution or otherwise
- Shall be chargeable to Capital Gains to such Firm, AOP or BOI, in the previous year of transfer.

Special Points:

1. Period of Holding : Date of acquisition of asset to date of transfer by Firm/AOP/BOI
2. Full value of Consideration : FMV on date of such transfer

3. Indexation : PY of Holding to PY of Transfer

4. "Dissolution or Otherwise" : Otherwise means something like dissolution

NOTE:- a) These rules are applicable even when an asset is transferred by an association of persons or body of individuals.

b) These rules are not applicable when an asset is transferred by a company or a co-operative society.

c) If a firm distributes a depreciable asset, the capital gain/loss shall always be short term capital gain/loss.

d) Amount credited by retired partner in capital account upon revaluation of assets of firm is not taxable as capital gain as there is no transfer – ITO v. Ramesh M. Shah [2004] 2 SOT 558 (Mum.).

e) Section 45(4) is not applicable where some partners retire and the firm continues to carry on the business with remaining partners and with new partners or without new partners – CIT v. G.K. Enterprises [2003] 131 Taxman 181 (Mag.).

Illustration 9: X ,Y & Z are three partners of M/s XYZ, a partnership firm. On 10th March, 2021, the firm is dissolved. The followings assets are distributed to the partners on the same day. Determine Capital Gains.

Particulars	**land (taken by X)**	**Listed Preference Shares (taken by Y)**	**Factory Building (taken by Z)**
FMV on 10th March, 2021	34,60,000	50,000	6,50,000
Agreed Value as per dissolution deed	11,70,000	46,000	5,00,000
Cost of acquisition	40,000	5000	1,20,000
WDV as on 1/4/2020	---	----	4,00,000
Year of Acquisition	1995-96	2005-2006	2002-2003
FMV on 1st April 2001	3,00,000	NA	NA

Solution: Capital gains in hands of Firm for AY 2021-22 All figures in (₹)

Particulars	**land (taken by X)**	**Listed Preference Shares (taken by Y)**	**Factory Building (taken by Z)**
Period of holding	1995/1996 to 10/3/2021: LTCA	2005/2006 to 10/3/2021 : LTCA	STCA u/s 50
Full value of consideration	34,60,000	50,000	6,50,000
Less Indexed cost of acquisition / Cost of acquisition	3,00,000 x 301/100 = 9,03,000	5,000 x 301/117 = 12,863	4,00,000
Capital Gains	LTCG 25,57,000	LTCG 37,137	STCG 2,50,000

Compulsory Acquisition of an Asset [Section 45(5)]

- Overriding Section 45(1)
- Where a Capital Asset is Compulsorily acquired under ANY law or
- Where consideration for transfer is to be determined by Central Government (not by a state government) or RBI.

- It shall be chargeable to Capital Gain in the Previous year in which compensation or part thereof is FIRST received by the assessee and not in the year in which capital asset is transferred.

Special Points:

1. Period of Holding : Date of acquisition to Date of compulsory acquisition

2. Full value of Consideration : Full amount of compensation/consideration

3. Indexation : P/Y of Holding to P/Y of Compulsory Acquisition

4. **Enhanced Compensation :**

a) Where the amount of compensation is increased by any

– Court or tribunal or any authority

– Such increased amount shall be deemed as Capital Gain,

– Of the P/Y in which such amount is **Received** by the Assessee.

b) The nature of capital gain of Enhanced compensation is **SAME** as for original compensation.

c) Cost of acquisition. & Cost of improvement of enhanced compensation will be **NIL.**

d) Expenses incurred for enhanced compensation can be **deducted** as transfer expenses – Chakiri Ashok Kumar v. ITO [2002] 80 ITD 410 (Hyd.)

5. **Reduced Compensation:** If subsequently compensation is reduced by court than Capital Gain of original compensation recomputed by taking the reduced compensation.

6. **Enhanced compensation received by other person**

– Where due to death of person who made transfer *or* for other reason,

– Enhanced compensation is received by other person,

– Deemed to be Capital Gain of the person receiving the same.

– Enhanced compensation can be short term capital gains or long term capital gains depending on the nature of original capital gains.

– Enhanced compensation is always taxed in the year of receipt, ignoring the fact that such enhanced compensation has been received by the assessee on furnishing bank guarantee or on any other condition – Catherine Thomas v. CIT [2008] 111 ITD 132 (Coch.).

Question 10 :

(a) Mr. X purchased a house Property in Delhi on 15-4-02.Cost of acquisition ₹1,00,000. It is compulsorily acquired by the government on 25-12-15.Compensation determined ₹6,00,000

(b) Compensation paid by government:₹4,00,000 on 10-05-2020: and ₹2,00,000 on 15-04-2021.

(c) Mr. X. files an appeal in the Delhi High court on 20-10-2021.The HC increases the Compensation from ₹6,00,000 to ₹9,30,000 by its order dated 25-1-2022. Legal expenses incurred by Mr. X is ₹10,000.The government on 20-06-2022 pays additional compensation of ₹3,30,000 but the government files an appeal in the Supreme court against the Judgment of Delhi High Court.

(d) The supreme court reduces the quantum of compensation from ₹9,30,000 to ₹7,50,000 by its judgment dated 20th March, 2023. Mr X repays ₹1,80,000 to government on 25th March, 2023. Legal Expenditure by Mr. X in Supreme Court is ₹25,000. Compute Capital Gains.

Solution:

(a) & (b) : LTCG on original compensation for A/Y 21-22 : ₹6,00,000 – ₹[1,00,000 x 254/105] = ₹3,58,095

(c): LTCG on enhanced compensation for A/Y 23/24 : ₹3,30,000 -₹10,000 = ₹3,20,000

(d): Recomputed LTCG of A/Y 23/24 : ₹3,20,000 -₹1,80,000 -₹25,000 = ₹1,15,000

Capital gain in case of Joint Development Agreements [Section 45(5A)]

- Notwithstanding anything contained in section 45(1)
- Individual or HUF,
- Transfer of land or building or both,
- under a specified agreement,
- capital gains shall be chargeable in PY
- in which certificate of completion for whole/part of project is issued by competent authority
- FVC shall be SDV (on date of issue of certificate) of his share, being land or building or both in project, as increased by consideration received in cash, if any,

Special point:

1. If assessee transfers his share in project on or before date of issue of certificate , **Section 45(5A) shall not apply** & capital gains shall be deemed to be income of **PY in which such transfer takes place** & other provisions of this Act shall apply.
2. **Specified agreement** means a registered agreement in which person owning land or building or both, agrees to allow another person to develop a real estate project in consideration of a share, being land or building or both in such project, whether with or without payment of part of consideration in cash.
3. **SDV means** the value adopted or assessed or assessable by any authority of Government for purpose of payment of stamp duty of an immovable property.
4. **Section 49(7):** If **sec 45(5A) is applicable**, **cost of acquisition** of such asset, shall be amount which is deemed as FVC under the section.

SLUMP SALE [SECTION 50B]

In case of slump sale, profits on such sale shall be chargeable under capital Gains in the P/Y in which slump sale is effected.

Section 2(42C): Slump Sale means

- Transfer of one or more Undertaking
- As a result of sale for lumpsum consideration
- Without values being assigned to individual assets and liabilities

Special Points:

1) Full value of consideration: Sale price of the undertaking

2) Period of holding: **Date of ownership of the undertaking to Date of slump sale**

However if Undertaking is ***LTCA, (more than 36 months),*** *no indexation will be done.*

3) Cost of Acquisition: **Value of assets** of undertaking

***L*ess : Value of liability** of Undertaking

Type of Assets	Value to be Taken
Non depreciable Asset	Book Value
Depreciable asset **(A)- (B)**	**Actual Cost** of assets forming part of undertaking **(A)** ***Less :*** Depr allowed on that assets assuming that assets were only assets in the block **(B)**

4) WDV OF BLOCK shall be reduced by the following amount **(A) – (B)**

5) Revaluation of assets shall not be taken into account for valuation of assets

NOTE :- a) If the individual value of assets to be transferred is specified in the transfer agreement, then such a transaction is not covered by "slump sale". Hence, capital gain shall be computed separately.

b) In case of slump sale, depreciation/ accumulated business loss will be carried forward and set off by the transferor (even if the business is discontinued).

Every assessee, in the case of slump sale, shall furnish in the prescribed form a report of an accountant as defined in the Explanation below sub-section (2) of section 288 before the specified date referred to in section 44AB indicating the computation of the net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division, as the case may be, has been correctly arrived at in accordance with the provisions of this section. **[Amended by Finance Act, 2020]**

CIT v/s Equinox Solution Pvt. Ltd (SC): If an undertaking is sold as a running business with all assets and liabilities for a slump price, consideration in respect of depreciable assets cannot be assessed as a short-term capital gain u/s 50(2).

The Apex Court, however, opined that where the entire running business with assets and liabilities stood transferred in one go, such sale could not be treated as short-term capital assets and is in the nature of long term capital gains.

FORFEITURE OF ADVANCE MONEY [SECTION 51]

Amount forfeited is upto 31/3/2014

- Where any Capital Asset
- Was on any previous occasion subject matter of negotiation for the transfer
- Any advance or other money received by Assessee
- Is forfeited by him
- Then such amount shall be deducted from cost of acquisition of such Capital Asset

NOTE : If capital asset is not transferred during the lifetime of the assessee, advance money forfeited by him will not be chargeable to tax. However, if the capital asset is transferred during his lifetime, the advance money will be deducted from the cost for which the asset was acquired or the written down value or the fair market value, in computing the cost of acquisition.

Amount forfeited is on or after 1/4/2014

Section 56(2)(ix): Advance or other money forfeited will be included in Income of the recipient under the head Income from other sources in the year in which advance money forfeited. Consequently, it will not be deducted from cost of acquisition when the capital asset is ultimately transferred.

Proviso to Section 51: If forfeited amount is included in Income of previous year u/s 56(2), then, such sum shall not be deducted from cost of acquisition

Illustration 11: Mr. X acquired a land on 1/1/2002 for ₹2,00,000. He enters into an agreement to sell his land to Mr. Y on 1/1/2011 and received ₹50,000 as advance money. Mr. Y did not purchase the Land and therefore Mr. X forfeited the advance. Mr. X sell the land on 1/1/2021 for ₹10,00,000 to Mr. Z. Determine Capital Gains.

Solution: LTCG for A/Y 21-22: ₹10,00,000 – [{₹2,00,000 -₹50,000} x 301/100] = ₹5,48,500

DISTRIBUTION OF ASSETS BY COMPANY TO ITS SHAREHOLDERS IN LIQUIDATION [SECTION 46(1)]

- Overriding Section 45
- Where any asset of a Company
- Is distributed to its shareholders
- On its liquidation
- Such distribution will NOT be regarded as a Transfer
- In the hands of the company

NOTE :- Where, however the liquidator sells the assets and distributes the cash so realized to the shareholders then section 46(1) will not apply and the company shall be liable to tax on capital gain arising from sale of the assets – Sri Kannan Rice Mills Ltd. v. CIT [1954] 26 ITR 351 (Mad.).

Question 12: X Ltd goes into Liquidation and distributes the following assets to the shareholders on 15.10.2020

Shareholder	Asset given	FMV of asset	Book Value	Cost of Acquisition
X	Building	10,00,000	6,00,000	4,00,000
Y	Machinery	5,00,000	2,00,000	1,00,000

Compute capital gains in hands of X ltd.

Solution: Section 46(1): No capital gain in hands of X ltd

Section 46(2)

1. Where a shareholder on liquidation of a company
2. Receives any money or other assets from a company
3. He shall be chargeable under Capital Gain in the **Previous year** in which above is **Received**

Special Points:

1) Period of Holding : Date of acquisition of shares to Date of liquidation

2) Full value of Consideration : Money received

Add: MV of assets received as on date of distribution

Less: Deemed dividend u/s. 2(22)(c)

3) Indexation : P/Y of Holding to P/Y of Liquidation

4) Sale of Assets received on liquidation: Cost of acquisition shall be FMV on date of distribution of such asset

Illustration 13: Mr. X Purchased 2000 Shares of A Ltd on 1-1-05 for ₹20,000. The company A Ltd goes into Liquidation on 30-06-17 and he receives the following from the Liquidator on 02-03-21:

Cash : ₹25,000

Machinery : Book Value : 40,000 & FMV : ₹60,000.

As on 30.06.17, the accumulated profits of the company were ₹1,50,000. Mr X holds 20% of shares of A Ltd. Mr. X sells the Machinery on 31.03.21 for ₹1,00,000. The Company had acquired the Machinery on 1-1-01 for ₹40,000. Determine tax treatment.

Solution:

LTCG for A/Y 21-22 u/s 46(2) in hand of Mr. X All figures in (₹)

Period of holding	1/1/05 to 30/6/17 : LTCA
Full Value of Consideration	25,000 + 60,000 – Deemed dividend u/s 2(22)(c) i.e. 20% of 1,50,000 = 55,000
Less : Indexed cost of acquisition 20,000 x 272/113	48,142
Long Term Capital Gains	6,858

CAPITAL GAIN ON PURCHASE BY COMPANY OF ITS OWN SHARE/SPECIFIED SECURITIES (BUY BACK) [SECTION 46A]

- Where a shareholder or holder of specified securities,
- Received any consideration from company for purchase of its own shares or specified securities,
- Shall be chargeable to Capital Gain in year in which shares /securities are purchased by company.

Special Points:

1) Period of Holding : Date of acquisition of Shares/Securities to Date of buy back by company

2) Full value of Consideration : Amount Received from the company

3) Indexation : P/Y of Holding to P/Y of Buy Back

4) Buy Back of shares is exempt in hands of shareholder u/s 10(34A) if TAX paid by Domestic company u/s 115QA*

*In the case given below, the company is (buying its own shares) is required to pay tax on distributed income (Quantum of distributed income shall be determined in accordance with rule 40BB) under section 115QA with effect from June 1, 2013.

a) Buy-back of unlisted shares (during June 1, 2013 and July 4, 2019),

b) Buy-back of listed/unlisted shares (on or after July 5, 2019).

NOTE :- "Specified securities" includes employees' stock options or other securities as may be notified by the Central Government.

TRANSACTIONS NOT REGARDED AS TRANSFER [SECTION 47]

- Overriding Section 45
- Transactions referred to in Section 47, will not be regarded as transfer
- And therefore No Capital Gain will arise in hands of transferor.

1. Distribution of Any Capital Asset on Total or Partial partition of H.U.F.

2. Transfer of Any Capital Asset under Gift or Will or irrevocable trust **(*Does not include transfer under a gift of shares, debentures allotted by company to its employees under E.S.O.P)***

In the above cases, there will be no transfer and no Capital Gain will arise in hands of **transferor**. However, when **transferee** transfers the above Capital Assets, he will be chargeable to Capital Gains.

Computation of capital gains in hands of transferee

1. Cost of Acquisition to transferee in above cases. **(Section 49(1))**	**Cost to previous owner** who had actually purchased the Capital Asset
2. Period of Holding. **(Section 2(42A))**	Period of holding will include **period of holding of previous owner**
3. Indexation	***P/Y of Holding to P/Y of transfer** ***CIT v Manjula J.Shah [2012] 204 Taxmann 691, indexation has to be done from p/y in which original owner has acquired the asset and not when assessee has acquired it**.

Illustration 14: Mr. X had acquired the Property in the previous year 2001-02 for ₹5,00,000 and paid ₹18,000 as registration charges. Mr. X gifted the property to Mr. Z on 15-10-16. The Market Value of the Property as on 15-10-16 is ₹10,00,000. Mr. Z sold the property on 31-05-2020 for ₹15,00,000. Compute Capital Gains for A/Y 2021-22.

Solution:

LTCG in hands of Mr.Z for AY 21-22

[Period of holding : 2002/03 to 31/5/20 = LTCA]

₹15,00,000 – ₹[5,18,000 x 301/100] = ₹59,180

3. Transfer of Any Capital Asset by amalgamating company to amalgamated **Indian** company in a scheme of amalgamation.

4. Transfer of **Shares of Amalgamating Company** by shareholder of such Company to Amalgamated Indian Company in a scheme of Amalgamation provided transfer is made in consideration of allotment to him of shares in Amalgamated Company except where the shareholder itself is the amalgamated company. For the purpose of computing capital gains on transfer of shares of Amalgamated company.

1 Cost of acquisition of shares in Amalgamated Company	**Cost of acquisition of shares in Amalgamating Company**
2. Period of Holding	Period of holding of shares in Amalgamated Company **will include period of holding shares in Amalgamating Company**
3. Indexation	P/Y of Holding shares in Amalgamated Company to P/Y of transfer

5. Transfer of Capital Asset by Demerged company to Resulting **Indian** company in a scheme of Demerger.

6. Transfer/ issue of Share by resulting company to shareholders of the de merged company if the transfer/ issue is made in consideration of Demerger of the undertaking.

Special Points: For computing capital gain on transfer of shares in resulting company

1. Cost of Acquisition of shares in Resulting company.	Cost of acquisition of shares in De-merged co. **X** Book value of assets T/F in Demerger Net worth of De-merged company
2. Cost of Acquisition of shares of Demerged company.	Reduce Original cost by **above**
3. Period of Holding of shares in Resulting company	Period of holding of shares in Resulting Co. will include ***holding period of shares in Demerged company***
4. Indexation	PY of Holding shares in Resulting Company to P/Y of transfer

7. Any transfer by way of conversion of **Debentures** of a company into Shares of that company.

Special Points: If converted shares are transferred:

1. Cost of Acquisition of shares	**Cost of that part of Debenture,** which is so converted
2. Period of Holding of Shares	***Period of holding will include period of holding of Debentures***
3. Indexation	P/Y of allotment of shares to P/Y of transfer

Illustration 15: Mr. X acquired 200 listed debentures of ₹100 each on 15-5-2013. 50% value of the debenture was converted into 4 equity share of the face value of ₹10 each on 20-08-2016. The shares are sold on 15-06-2020 @ 40 share. Compute Capital Gains.

Solution: LTCG on sale of shares for AY 2021-22

800 shares x 40/share = ₹32,000

Less : [50% of (200 x 100)] x 301/264 = ₹11,402

Other Provisions [Section 47]

1. Any transfer of a capital asset by a company to its subsidiary company, if –

(*a*) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and

(*b*) the subsidiary company is an Indian company;

2. Any transfer of a capital asset by a subsidiary company to the holding company, if –

(*a*) the whole of the share capital of the subsidiary company is held by the holding company, and

(*b*) the holding company is an Indian company :

Provided that nothing contained in clause (*iv*) or clause (*v*) shall apply to the transfer of a capital asset made after the 29th day of February, 1988, as stock-in-trade;

3. Any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if –

(*a*) at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company, and

(*b*) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated;

4. Any transfer, in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government u/s 45(7) of the Banking Regulation Act, 1949, of a capital asset by the banking company to the banking institution.

5. Any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, referred to in the *Explanation 5* to Sec 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, if –

(*A*) at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and

(*B*) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated;

6. Any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if –

(*a*) the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(*b*) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated :

Provided that the provisions of sections 391 to 394 of the Companies Act, 1956 shall not apply in case of demergers referred to in this clause;

7. Any transfer in a business reorganisation, of a capital asset by the predecessor co-operative bank to the successor co-operative bank;

8. Any transfer by a shareholder, in a business reorganisation, 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.

9. Any transfer in a demerger, of a capital asset, being a share of a foreign company, referred to in the *Explanation 5* to section 9(1)(i), 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, if –

(*a*) the shareholders, holding not less than three-fourths in value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and

(*b*) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated:

Provided that the provisions of sections 391 to 394 of the Companies Act, 1956 shall not apply in case of demergers referred to in this clause;

10. Any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if –

(*a*) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholder itself is the amalgamated company, and

(*b*) the amalgamated company is an Indian company;

11. Any transfer of a capital asset, being bonds or Global Depository Receipts referred u/s 115AC(1), made outside India by a non-resident to another non-resident;

12. Any transfer, made outside India, of a capital asset being rupee denominated bond of an Indian company issued outside India, by a non-resident to another non-resident;

13. Any transfer of a capital asset, being –

(a) bond or Global Depository Receipt referred to in sec 115AC(1); or

(b) rupee denominated bond of an Indian company; or

(c) derivative, or

(d) such other notified securities

made by a non-resident or a notified fund on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in foreign currency.

14. Any transfer of a capital asset, being a Government Security carrying a periodic payment of interest, made outside India through an intermediary dealing in settlement of securities, by a non-resident to another non-resident.

15. Any transfer of Sovereign Gold Bond issued by the Reserve Bank of India under the Sovereign Gold Bond Scheme, 2015, by way of redemption, by an assessee being an individual;

16. Any transfer of agricultural land in India effected before the 1st day of March, 1970;

17. Any transfer of a capital asset, being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print, to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government (i.e., Indira Gandhi National Centre of Art for the A/Y 1987-88 to 2008-09) in the Official Gazette to be of national importance or to be of renown throughout any State or States.

18. Any transfer by way of conversion of bonds referred u/s115AC(1)(a) into shares or debentures of any company;

19. Any transfer by way of conversion of preference shares of a company into equity shares of that company; (applicable from the assessment year 2018-19);

20. Any transfer made on or before the 31st day of December, 1998 by a person (not being a company) of a capital asset being membership of a recognised stock exchange to a company in exchange of shares allotted by that company to the transferor.

21. Any transfer of a capital asset, being land of a sick industrial company, made under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 where such sick industrial company is being managed by its workers' co-operative :

Provided that such transfer is made during the period commencing from the previous year in which the said company has become a sick industrial company u/s 17(1) of that Act and ending with the previous year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

22. 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 demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company :

Provided that –

(*a*) all the assets and liabilities of the firm or of the association of persons or body of individuals relating to the business immediately before the succession become the assets and liabilities of the company;

(*b*) all partners of firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of the succession;

(*c*) the partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; and

(*d*) the aggregate of the shareholding in the company of the partners of the firm is not less than fifty per cent of the total voting power in the company and their shareholding continues to be as such for a period of five years from the date of the succession;

(*e*) the demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation which is approved by SEBI established under section 3 of the Securities and Exchange Board of India Act, 1992);

23. Any transfer of a capital asset being a membership right held by a member of a recognised stock exchange in India for acquisition of shares and trading or clearing rights acquired by such member in that recognised stock exchange in accordance with a scheme for demutualisation or corporatisation which is approved by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 ;

24. Any transfer of a capital asset or intangible asset by a private company or unlisted public company (hereafter in this clause referred to as the company) to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership in accordance with the provisions of section 56 or section 57 of the Limited Liability Partnership Act, 2008 :

Provided that –

(*a*) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;

(*b*) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion;

(*c*) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership;

(*d*) the aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion;

(*e*) the total sales, turnover or gross receipts in the business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees;

(*ea*) the total value of the 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 does not exceed five crore rupees; and

(*f*) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

25. Where a sole proprietary concern is succeeded by a company in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset or intangible asset to the company :

Provided that –

(*a*) all the assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;

(*b*) the shareholding of the sole proprietor in the company is not less than fifty per cent of the total voting power in the company and his shareholding continues to remain as such for a period of five years from the date of the succession; and

(*c*) the sole proprietor does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company;

26. Any transfer in a scheme for lending of any securities under an agreement or arrangement, which the assessee has entered into with the borrower of such securities and which is subject to the guidelines issued by the Securities and Exchange Board of India, established under section 3 of the Securities and Exchange Board of India Act, 1992 or the Reserve Bank of India constituted under sub-section (1) of section 3 of the Reserve Bank of India Act, 1934, in this regard;

27. Any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government;

28. Any transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust to the transferor;

29. Any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating scheme of a mutual fund, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated scheme of the mutual fund:

Provided that the consolidation is of two or more schemes of equity oriented fund or of two or more schemes of a fund other than equity oriented fund.

30. Any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating plan of a mutual fund scheme, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated plan of that scheme of the mutual fund.

REFERENCE TO VALUATION OFFICER [SECTION 55A]

- For ascertaining Fair Market Value of Capital Asset
- U/S 45(1A), 45 (2), 45 (4), 46 (2), Exchange of asset u/s 2(47) & 50C
- The Assessing Officer may
- Refer the valuation of Capital Asset to valuation officer in following cases

Case 1	Case 2
Where value claimed by assessee is **according** to estimate by a registered valuer	Where value claimed by assessee is **not according** to estimate by a registered valuer
If AO is of opinion that Value claimed by assessee is at variance with its Fair Market Value (applicable from July 1, 2012) [section 55A(a)]	If AO is of opinion that • Fair Market Value exceeds • value claimed by assessee • by more than 15% or by ₹25,000, whichever is less [section 55A(b)(i)]

Where the AO is of opinion that, having regard to nature of an asset and relevant circumstances, it is necessary to make a reference to the Valuation Officer [section 55A(b)(ii)]

FULL VALUE CONSIDERATION FOR REAL ESTATE TRANSACTIONS [SECTION 50C]

- Sale consideration on transfer of Land or Building or both
- Is Less than
- Value determined by Stamp valuation authority for payment of stamp duty
- then value so assessed or assessable shall be
- Deemed to be FVC

Note: Assessee claims that Stamp Valuation ***exceeds*** FMV of property on date of transfer and It has not been disputed in any appeal or by any court AO may refer the valuation of above capital asset to valuation officer u/s 55A. Then, valuation determined by valuation officer u/s **50C is less than** Stamp valuation then **value u/s 50C** shall be **Deemed** to be FVC.

Provided also that where the value adopted or assessed or assessable by the stamp valuation authority does not exceed one hundred and ten per cent. of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of section 48, be deemed to be the full value of the consideration. **[Finance Act, 2020]**

Where the date of the agreement fixing the amount of consideration and the date of registration for the transfer of the capital asset are not the same, the value adopted or assessed or assessable by the stamp valuation authority on the date of agreement may be taken for the purposes of computing full value of consideration for such transfer:

Above provision shall apply only in a case where the amount of consideration, or a part thereof, has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed , on or before the date of the agreement for transfer

Judicial Ruling :-

1) Mode of valuation by Valuation Officer- while valuating property the Department Valuation Officer cannot blindly base his valuation on circle rates - Ravi Kant v. ITO [2007] 110 TTJ (Delhi) 297.
2) Section 50C is not applicable if income is taxable under section 28 – Section 50C is not applicable for calculating business income under section 28 – Inderlok Hotels (P.) Ltd. v. ITO [2009] 32 SOT 419 (Mum.), CIT v. Thiruvengadam Investments (P.) Ltd. [2010] 320 ITR 345 (Mad.).

Illustration 16: Mr. X had purchased a house property on 15/10/2008 for ₹3,00,000. The property is sold to Mr. Y on 1.1.2021 for ₹8,00,000. Compute Capital Gains assuming Value assessed by the government authority for purpose of Stamp Valuation is

Case 1 : ₹7,00,000

Case 2 : ₹9,00,000

Solution:

Capital gain for A/Y 21/22 Figures (₹)

Particulars	Case 1	Case 2
Full value of consideration	8,00,000	9,00,000

Less : ICOA	3,00,000 x 301 / 137 = 6,59,124	3,00,000 x 301 / 137 = 6,59,124
LTCG	1,40,876	2,40,876

Illustration 17: Mr. X had purchased a Land on 15/10/2010 for ₹7,00,000. The said Land is sold on 1-1-2021 for ₹15,00,000, whereas value assessed by government authority for stamp duty valuation is ₹18,00,000. On an assessee claim, that FMV of Land on date of transfer is less than value determined by stamp valuation authority, AO refers the valuation to the valuation officer u/s 55A.

Compute capital Gains assuming, Valuation officer ascertains the Value of Land as:

a) 16,00,000 b) 20,00,000 c) 12,00,000.

Solution :

Capital gain for A/Y 21/22 Figures (₹)

Particulars	Case 1	Case 2	Case 3
Period of holding	15/10/10 to 1/1/21: LTCA	15/10/10 to 1/1/21 : LTCA	15/10/10 to 1/1/21 : LTCA
Full value of consideration	16,00,000	18,00,000	15,00,000
Less: Indexed cost of acquisition	7,00,000 x 301/167 = 12,61,677	7,00,000 x 301/167 = 12,61,677	7,00,000 x 301/167 = 12,61,677
LTCG	3,38,323	5,38,323	2,38,323

FULL VALUE OF CONSIDERATION FOR TRANSFER OF SHARE OTHER THAN QUOTED SHARE [SECTION 50CA]

If consideration for transfer of share of company other than quoted share, is less than fair market value(FMV) of such share (determined in prescribed manner), FMV shall be deemed to be consideration.

Exceptions – With effect from assessment year 2020-21 the provisions of this section shall not apply 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 by the Board.

Special point : "Quoted share" means 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.

FAIR MARKET VALUE DEEMED TO BE FULL VALUE OF CONSIDERATION IN CERTAIN CASES [SECTION 50D]

Where the consideration as a result of transfer of a capital asset by assessee is not ascertainable, then for the purpose of computing capital gains under section 45, FMV of asset on the date of transfer shall be deemed as full value of consideration.

Where by acquiring a portion of a larger plot, the value of the unacquired portion is injuriously affected, compensation received for injurious affection of unacquired portion is also part of full value of consideration – CIT v. P. Mahalakshmi [1982] 134 ITR 428 (Kar.).

INCOME EXEMPT FROM COMPULSORY ACQUISITION OF LAND [SECTION 10(37)]

- Individual or HUF

- Compulsory acquisition of urban agricultural land (LTCA or STCA)
- Used for 2 years before date of transfer of agricultural purposes by individual/his parents/HUF
- Compensation received shall be exempt
- from capital gains

CAPITAL GAIN ARISING UNDER LAND POOLING SCHEME OF ANDHRA PRADESH GOVERNMENT [SECTION 10(37A)]

Clause (37A) has been inserted in section 10 with effect from the assessment year 2015-16.

The clause says any income chargeable under the head "Capital gains" in respect of transfer of a specified capital asset arising to an assessee, being Individual or Hindu undivided family, who was the owner of such specified capital asset as on 2nd day of June, 2014 and transfers that specified capital asset under the Land Pooling Scheme (herein referred to as "the scheme") covered under the Andhra Pradesh Capital City Land Pooling Scheme (Formulation and Implementation) Rules, 2015 made under the provisions of the Andhra Pradesh Capital Region Development Authority Act, 2014 and the rules, regulations and Schemes made under the said Act is exempt from Capital gains.

Explanation: "specified capital asset" means:

(*a*) the land or building or both owned by the assessee as on the 2nd day of June, 2014 and which has been transferred under the scheme; or

(*b*) the land pooling ownership certificate issued under the scheme to the assessee in respect of land or building or both referred to in clause (*a*); or

(*c*) the reconstituted plot or land, as the case may be, received by the assessee in lieu of land or building or both referred to in clause (*a*) 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;

INCOME EXEMPT FROM TRANSFER OF CERTAIN CAPITAL ASSETS [SECTION 10(38)]

Upto AY 2017-18

Capital Asset being Equity shares in company or **units of equity oriented fund** or **unit of business trust** sold through **recognized stock exchange** & transaction subjected to **security transaction tax.** Then Long Term Capital Gains shall be **Exempt.**

For AY 2018-19

Capital Asset being Equity shares in company or **units of equity oriented fund** or **unit of business trust** **s**old through **recognized stock exchange** & transaction subjected to **security transaction tax.** Then Long Term Capital Gains shall be **Exempt.**

Exemption u/s Section 10(38) shall not apply on transfer of equity share in a company, if the transaction of acquisition, other than the acquisition notified by Central Government in this behalf, of such equity share is entered into on or after the 1st day of October, 2004 and such transaction is not chargeable to securities transaction tax.

W.E.F. AY 2019-20

Exemption u/s Section 10(38) shall not apply to any income arising from the transfer of long-term capital asset, being an equity share in a company or unit of equity oriented fund or unit of business trust, made on or after the 1st day of April, 2018.

STCG ON LISTED EQUITY SHARES/LISTED UNITS OF EQUITY ORIENTED MUTUAL FUND [SECTION 111A]

- Equity shares in company or Units of Equity oriented Mutual Fund
- Sold through Recognized stock exchange & Transaction subjected to Security Transaction tax
- STCG shall be chargeable @15% [+ SC + HEC]*

*Surcharge + Higher Education Cess = 4%

Circular no. 36/2016 dated 25th October, 2016: Capital gain arising out of any award/agreement under Right to fair compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act,2013 is exempt from Tax.

TAX RATES ON CAPITAL GAINS FOR AY 2021-22

Short Term Capital Gain (STCG)		
Section 10(37)	**Section 111A**	**other STCG**
Exempt	**15%**	**Taxable at slab rate/Normal rates**

Long Term Capital Gain (LTCG)		
10(37)	**Listed securities *other than Units of Mutual funds or* Zero Coupon Bonds**	**Other LTCG**
Exempt	**20% (with Indexation) Or** **10% (without indexation)** *whichever is lower*	**20%**

TAX ON LONG TERM CAPITAL GAINS IN CERTAIN CASES [SECTION 112A]

Notwithstanding anything contained in section 112, the tax payable by an assessee on his total income shall be determined in accordance with the provisions of sub-section (2), if:

(i) the total income includes any income chargeable under the head “Capital gains”;

(ii) the capital gains arise from the transfer of a long-term capital asset being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust;

(iii) securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004 has,

(a) in a case where the long-term capital asset is in the nature of an equity share in a company, been paid on acquisition and transfer of such capital asset; or

(b) in a case where the long-term capital asset is in the nature of a unit of an equity oriented fund or a unit of a business trust, been paid on transfer of such capital asset.

The tax payable by the assessee on the total income referred to in sub-section (1) shall be aggregate of:

(i) the amount of income-tax calculated on such long-term capital gains exceeding one lakh rupees at the rate of ten per cent (The rate of 10 percent is applicable whether the assessee is a corporate – assessee or non – corporate assessee); and

(ii) the amount of income-tax payable on the total income as reduced by the amount of long-term capital gains referred to in sub-section (1) as if the total income so reduced were the total income of the assessee:

Provided that in the case of a resident individual or a resident Hindu undivided family (may be ordinarily resident or not ordinarily resident), where the total income as reduced by such long-term capital gains is below the maximum amount which is not chargeable to income- tax, then, the long-term capital gains, for the purposes of clause (i), shall be reduced by the amount by which the total income as so reduced falls short of the maximum amount which is not chargeable to income-tax.

The condition specified in clause (iii) of sub-section (1) shall not apply to a transfer undertaken on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transfer is received or receivable in foreign currency.

The Central Government may, by notification in the Official Gazette, specify the nature of acquisition in respect of which the provisions of sub-clause (a) of clause (iii) of sub-section (1) shall not apply.

Where the gross total income of an assessee includes any long-term capital gains referred to in sub-section (1), the deduction under Chapter VI-A shall be allowed from the gross total income as reduced by such capital gains.

Where the total income of an assessee includes any long-term capital gains referred to in sub-section (1), the rebate under section 87A shall be allowed from the income-tax on the total income as reduced by tax payable on such capital gains.

Note:

(a) "equity oriented fund" means a fund set up under a scheme of a mutual fund specified under clause (23D) of section 10 and, –

 (i) in a case where the fund invests in the units of another fund which is traded on a recognised stock exchange, –

  (A) a minimum of ninety per cent of the total proceeds of such fund is invested in the units of such other fund; and

  (B) such other fund also invests a minimum of ninety per cent of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and

 (ii) in any other case, a minimum of sixty-five per cent of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange:

 Provided that the percentage of equity shareholding or unit held in respect of the fund, as the case may be, shall be computed with reference to the annual average of the monthly averages of the opening and closing figures;

(b) "International Financial Services Centre" shall have the meaning assigned to it in clause (q) of section 2 of the Special Economic Zones Act, 2005 ;

(b) "recognised stock exchange" shall have the meaning assigned to it in clause (ii) of Explanation 1 to clause (5) of section 43.

Cost of acquisition if Section 112A is applicable [Section 55(2)]

In relation to a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust referred to in section 112A, acquired before the 1st day of February, 2018 shall be higher of:

(i) the 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.

"fair market value" means,:

(i) *in a case where capital asset is listed on any recognised stock exchange as on 31st day of January, 2018,* ***highest price of the capital asset quoted on such exchange on the said date****:*

Provided *that where there is no trading in such asset on such exchange on the 31st day of January, 2018, the highest price of such asset on such exchange on a date immediately preceding the 31st day of January, 2018 when such asset was traded on such exchange shall be the fair market value;*

(ii) *in a case where the capital asset is a unit which is not listed on a recognised stock exchange as on the 31st day of January, 2018,* ***the net asset value of such unit as on the said date****;*

(iii) *in a case where the capital asset is an equity share in a company which is –*

(A) not listed on a recognised stock exchange as on the 31st day of January, 2018 but listed on such exchange on the date of transfer;

(B) listed on a recognised stock exchange on the date of transfer and which became the property of the assessee in consideration of share which is not listed on such exchange as on the 31st day of January, 2018 by way of transaction not regarded as transfer u/s 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 for the year beginning on the first day of April, 2001, whichever is later

EXEMPTIONS FROM CAPITAL GAINS [SECTION 54 TO 54H]

Section		*Section 54 : Transfer of Residential Property*	*Section 54B : Transfer of Agricultural Property*	*Section 54EC : Transfer of LTCA*	*Section 54EE Investment in units of specified funds*
1	Assessee	Individual or HUF	Individual or HUF	Any Assessee	Any Assessee
2	Capital Asset Transferred	Residential House	Urban Agricultural Land used by assessee / parent for agricultural for min 2 years prior to transfer.	land or building or both [Finance Act,2018]	Any Capital Asset
3	Nature of CA	LTCA	STCA or LTCA	LTCA	LTCA

Section		*Section 54 : Transfer of Residential Property*	*Section 54B : Transfer of Agricultural Property*	*Section 54EC : Transfer of LTCA*	*Section 54EE Investment in units of specified funds*
4	New Asset	One Residential house in India Provided that where the amount of the capital gain does not exceed two crore rupees, the assessee may, at his option, purchase or construct two residential houses in India	Agricultural Land (any area)	Bonds redeemable after 3 years issued by ▪ National Highway Authority of India or ▪ Rural electrification corporation of India ▪ Power Finance Corporation ltd. ▪ Indian Railway Finance Corporation Ltd. ▪ Notified bond by CG W.E.F 1/4/18, investments in above bonds redeemable after 5 years [Finance Act, 2018] Max Investment in F/Y of Transfer & Subsequent F/Y is 50 lakhs	Units of start up fund Max Investment in F/Y of Transfer & Subsequent F/Y is 50 lakhs
5	Time period of New Asset	Within 1 year before or within 2 years after transfer or construct within 3 yrs after transfer	Within 2 yrs after transfer	Within 6 months of transfer	Within 6 months of transfer
6	Capital Gain Account Scheme [CGAS]	Deposit in CGAS on or before Due Date of Return (DDR) u/s.139(1)	-Do-	NA	NA
7	Exemption	LTCG invested in New Asset + Deposited in CGAS upto DDR	-Do-	LTCG invested in Specified Bonds upto 6 months of transfer	LTCG invested in units of start fund upto 6 months of transfer
8	Transfer of New Asset	If New Asset transferred within 3 years from date of purchase/ construction, then Cost of acquisition of new asset Reduced by Capital Gain exempted earlier	-Do-	If New Asset is transferred or converted into money within 3 years from date of acquisition., then exempt LTCG taxable in p/y of transfer/ conversion of new asset	If New Asset is transferred or converted into money within 3 years from date of acquisition., then exempt LTCG taxable in p/y of transfer/ conversion of new asset

Section		*54F : Transfer of LTCA*	*54GB: Capital gain on transfer of residential property not to be charged in certain cases [upto 31/3/21]*
1	Assessee	Individual or HUF	Individual or HUF
2	Capital Asset Transferred	Any Capital Asset **(Other than Residential house)**	Residential property (a house or a plot of land)
3	Nature of CA	LTCA	LTCA
4	New Asset & Time period	Purchased **1 year** before **or** within **2 yrs** after transfer **or** constructed within **3 yrs** after transfer ***One Residential house in India***	Subscription in Equity shares of an **Eligible company** & company has within 1 year from date of subscription in Equity shares by assessee, utilised this amount for purchase of **New asset** **Eligible Company** means **(i)** Indian Company incorporated between 1st April of P/Y of capital gain upto due date of return u/s 139(1) (ii) Engaged in **eligible business (manufacture of any article or thing)** (iii) company in which assessee has more than 50% share capital(30%, applicable from the assessment year 2020-21) (iv) company qualifies to be **an eligible start-up** **New Asset** means new plant and machinery but does not include **(i)** P&M which, before its installation by assessee, was used by any other person **(ii)** P&M installed in any office premises or any residential accommodation, including guest-house **(iii)** any office appliances including computers or computer software **(iv)** any vehicle or **(v)** P&M the whole of the actual cost of which is allowed as 100% deduction (by depreciation or otherwise) under PGBP
5	CGAS	Available	Available
6	Exemption	LTCG **X** (Cost of new asset + Amount deposit in CGAS) ------------------------- **Net** Consideration	LTCG **X** (Cost of new asset + Amount deposit in CGAS) --- **Net** Consideration
7	Transfer of New Asset	If **New Asset** t/f within **3 yrs** from date of purchase/ construction, then **Exempt Capital Gains taxable in P/Y of transfer of new asset**.	If **Equity shares or New Asset** t/f within **5 yrs** from date of purchase/ construction, then **Exempt Capital Gains taxable in P/Y of transfer of Equity shares/New asset** 'Provided that in case of a new asset, being computer or computer software, acquired by an eligible start-up, the lock in period will be 3 years

NOTE :- Amount deposit in CGAS if deposited within the prescribed time period.

Section		54D : Compulsory Acquisition of Land & Building	54G : Transfer under shifting of Industrial Undertaking	54GA: Transfer of industrial undertaking to SEZ
1	Assessee	Any Assessee	Any Assessee	Any Assessee
2	Capital Asset Transferred	Compulsory acquisition of Land & Building used for Industrial undertaking in Any Area	Plant & Machinery / Land & Building used for Industrial undertaking in Urban Area	Plant & Machinery / Land & Building used for Industrial undertaking in Urban Area
3	Nature of CA	STCA or LTCA	STCA or LTCA	STCA or LTCA
4	Conditions	▪ Used by Assessee for Business for 2 years immediately prior to date of acquisition. ▪ Above undertaking shifted (in any area)	▪ Above undertaking shifted (to Rural Area)	▪ Above undertaking shifted to SEZ (in any area)
5	New Asset & Time period	▪ Within 3 years after transfer ▪ Purchase/Construction of ▪ Other Land/Building	▪ 1 year before or within 3 yrs of transfer ▪ Purchase Plant/Machinery ▪ Purchase /Construct Land/ Building ▪ Including expenses on transfer	▪ 1 year before or within 3 yrs of transfer ▪ Purchase Plant/Machinery ▪ Purchase /Construct Land/Building ▪ Including expenses on transfer
6	Treatment of unutilized Capital Gains	Same as Section 54	Same as Section 54	Same as Section 54
7	Exemption	Same as Section 54	Same as Section 54	Same as Section 54
8	Transfer of New Asset	Same as Section 54	Same as Section 54	Same as Section 54

COMMON POINT FOR ALL EXEMPTIONS

Non utilization of balance in Capital Gain A/c. Scheme:

a. Amount deposited is not utilized wholly or partly for specified purpose by specified time.

b. Exemption claimed on unutilized amount is taxable as Capital Gain of P/Y in which specified time expires.

c. It will be taxable as short term capital gain/long term capital gain depending upon the original capital gain.

Section 54H: Extension of time for acquiring new asset

- Where transfer of capital asset is by compulsory acquisition under any law.
- Time limits for acquiring new asset & for depositing in CGAS (Capital Gain Account Scheme) shall be.
- Computed from date of receipt of compensation and not from the date of compulsory acquisition.

- Enhanced Compensation – If any enhanced compensation is received, it is taxable in the year in which such compensation is received and for acquiring new asset under sections 54, 54B, 54D, 54EC, 54F, the time limit shall be determined from the date of receipt of additional compensation.

Illustration 18 : X sold a residential house on 15/12/2020 for a consideration of ₹41,00,000/-. Transfer expenses incurred amounted to ₹1,00,000/-. The said residential house was purchased in P/Y 01/02 for ₹1,00,000/- (FMV as on 1.4.01 is ₹ 3,60,000). Compute the Capital Gains for assessment Year 2021-22 :

Case 1 : He invests ₹20,00,000 for purchase of a new residential house on 15/4/21. No further investment was made.

Solution : LTCG for A/Y 21/22 : ₹41,00,000 – ₹1,00,000 – ₹[1,00,000 x 301/100] = ₹36,99,000

Exemption u/s 54 : ₹20,00,000 , Taxable LTCG : ₹36,99,000 -₹20,00,000 = ₹16,99,000

Case 2 : He invests ₹20,00,000 for purchase of a new residential house on 15/4/21. He has also deposited ₹5,00,000 on 31/7/2021 and ₹2,08,000 on 1/8/2021 in CGAS .Return is filed on 5/8/2021 [Due date of return 31/7/2021]

Solution : Exemption u/s 54 : ₹20,00,000 + ₹5,00,000 = ₹25,00,000

Taxable LTCG : ₹36,99,000 – ₹25,00,000 = ₹11,99,000

Illustration 19 : Mr. A has three agricultural lands as follows

1) **First Agricultural land :** This land is situated in Rural area and was purchased for ₹2,00,000 in 2005/06. It was sold for ₹6,00,000 on 15/12/2020
2) **Second Agricultural land :** This land is situated in Urban Area and was compulsory acquired by government on 15/12/2017.The compensation of ₹10,00,000 was received on 15/4/2020. This land was purchased for ₹2,00,000 on 15/12/2008.
3) **Third Agricultural land :** This land is situated in Urban Area & was sold for ₹20,00,000 on 15/3/2021. Land was purchased for ₹1,00,000 during P.Y. 07/08.

In order to claim exemption, Mr A has made the following investments :

a) ₹8,00,000 for purchase of agricultural land in Urban Area on 15/4/2021
b) ₹4,00,000 for purchase of agricultural land in Rural Area on 15/6/2021
c) ₹1,00,000 in CGAS on 15/7/2021

[Due date of return 31/7/2021]

Solution :

1) 1st Agricultural land is not a capital asset u/s 2(14). Therefore no capital gain arises.
2) 2nd agricultural land is compulsory acquired by government. The Capital gain is exempt u/s 10(37)
3) LTCG on 3rd Agricultural land for A/Y 21/22 :

   ₹20,00,000 – ₹1,00,000 x 301/129 = ₹17,66,667

Exemption u/s 54B : ₹8,00,000 + ₹4,00,000 + ₹1,00,000 = ₹13,00,000

Taxable LTCG : ₹17,66,667– ₹13,00,000 = ₹4,66,667

Illustration 20: From the following particulars compute Capital Gains in hands of Mr. X for A/Y 21/22.

Mr. X has LTCG from Sale of land of ₹80,00,000 on 15/1/20.He purchased NHAI bonds of ₹40,00,000 on 15/2/20 and another 40,00,000 of bonds of RECL on 15/4/20.Compute Capital Gains in hands of Mr. X for A/Y 21/22.

Solution : LTCG for A/Y 20/21 : ₹80,00,000 – Exemption u/s 54EC ₹50,00,000 = Taxable ₹30,00,000

Illustration 21 : Mr. X sold jewellery for ₹60,00,000 on 15/12/2020. Jewellery was purchased for ₹3,00,000 during P/Y 01/02.The expenditure on transfer is ₹1,00,000.Determine Capital Gain for A/Y 21/22. Mr. X purchased a new Residential house for ₹30,00,000 on 15/4/2021

Solution : LTCG for A/Y 21/22 : ₹60,00,000 - ₹1,00,000 - ₹3,00,000 x 301/100 = ₹49,97,000

Exemption u/s 54F : ₹30,00,000/₹59,00,000 x ₹49,97,000 = ₹25,40,847

Taxable LTCG : ₹49,97,000 – ₹25,40,847= ₹24,56,153

LESSON ROUNDUP

– Sections 45 to 55A of the Income-tax Act, 1961 deal with capital gains. Section 45 of the Act, provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, 54GA and 54H be chargeable to income-tax under the head "Capital Gains" and shall be deemed to be the income of the previous year in which the transfer took place.

– Section 2(14) of the Income-tax Act defines the term "capital asset" to means Property of any kind held by an assessee whether or not connected with his business or profession but does not include any stock-in-trade, personal effects , agricultural land in India, 6^ per cent Gold Bonds, Special Bearer Bonds , Gold Deposit Bonds.

– The essential requirement for the incidence of tax on capital gains is the transfer of a 'capital asset'.- Any capital gain arising as a result of transfer of a short-term capital asset is known as short-term capital gain. "Short term" capital asset means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. In the case of capital assets (being equity or preference share in a company) held by an assessee for not more than 12 months immediately prior to its transfer.

– Assets other than short-term capital assets are known as 'long-term capital assets' and the gains arising therefrom are known as 'long-term capital gains'. Section 48 of the Act provides that the income chargeable under the head 'capital gains' shall be computed by deducting from the full value of consideration received or accruing as a result of the transfer of the capital asset the f amount of expenditure incurred wholly and exclusively in connection with such transfer and the cost of acquisition of the capital asset and the cost of any improvement thereto.

– 'Cost of acquisition' of goodwill of a business or a right to manufacture, produce or process any article or thing, tenancy rights, stage carriage permits or loom hours is in the case of acquisition of such asset by the assessee by purchase from a previous owner, cost of acquisition means the amount of the purchase price; and in any other case cost of acquisition shall be Nil.

– Cost of improvement means all capital expenditure in making any additions or alterations by the assessee after it became his property and where the capital asset became the property of the assessee by any of the modes specified in Section 49(1) by the previous owner as the case may be.

– Under Sections 54, 54B, 54D, 54EC, 54F, 54G and 54H of the Act, capital gains arising from the transfer of certain capital assets are exempt from tax under certain circumstances.

TEST YOURSELF

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

1. What are the conditions for the taxability of income under the head Capital Gains?
2. Capital Gains are generally taxable in p/y of transfer of Capital Asset. Are there any exceptions of the same?
3. Indexation is done for long term capital asset. Are there any exception of the same?
4. Is conversion of capital asset into stock in trade chargeable to Capital Gains?
5. How will Capital Gain be computed when all the assets and liabilities of a division are sold for a lumpsum consideration without price being assigned for them individually**?**
6. On liquidation of company, who is liable to pay Capital Gains ,the company or the shareholder. Also how is full value of consideration computed in that case?
7. If stamp duty value is more than the sale consideration, what will be the full value of consideration in that case?
8. If full value of consideration is not ascertainable, whether Capital Gain is applicable and is yes what will the full value of consideration**?**
9. If compensation due to compulsory acquisition of capital asset is increased on order of court ,will it be taxable in p/y of order of court or p/y of receipt of compensation and also determine whether any expenditure is allowed as deduction from it?
10. Write a short note on computation of Capital Gain on transfer of bonus shares.

PRACTICAL QUESTIONS

1. Mr X had purchased 100 Shares of A Ltd on 01-01-10 @ ₹50/- Per share. The Company had announced a right issue in the ration of 1:1 in June 2019 of shares of paid up value of ₹10/- at a premium of ₹20/- per share. Mr. X had applied for the right issue and was allotted the right shares in July, 2019. Mr. X sells all the shares on 01-01-2020 @ ₹200/- per share. Determine Capital Gains.
2. Mr X had purchased 100 Shares of Y Ltd on 01-01-2008 for ₹100/- Per share. On 01-05-2019, Y Ltd has introduced a 1:1 right offer of shares of paid up value of ₹10/- at a Premium of ₹50/- per share. Mr X on 28-05-2019 renounced the right offer in favour of Mr Z for ₹75/- Per share. Determine Capital Gain in hands of Mr X.
3. Assume in Q7, Mr. Z had applied for 100 Shares on 30/5/2019 and was allotted the shares on 04-06-2019. These shares are sold by Mr. Z on 21-03-2020 @ ₹300/- Per share. Compute Capital Gain in hands of Mr Z.
4. **(a)** Mr X had Purchased 100 Shares of Y Ltd @ ₹50/- Per Share on 01-01-2013.Y Ltd allots one bonus share for every two shares on 31-05-2019. Mr X sells 150 shares on 01-01-2020 @ ₹150 per share.

   (b) Mr X had Purchased 500 Shares of Y Ltd @ ₹200/- Per Share on 01-01-1998. Y Ltd allots one bonus share for every two shares on 31-05-1999. Mr X sells all shares on 01-01-2020 @ ₹900 per share. Market value of share on 1-4-2001 is ₹300 per share.
5. Mr. X acquired a land on 1/1/2002 for ₹ 1,00,000. He enters into an agreement to sell his land to Mr Y on 1/1/2020 and received ₹40,000 as advance money. Mr.Y did not purchase the Land and therefore Mr. X forfeited the advance. Mr. X sell the land on 1/3/2020 for ₹10,00,000 to Mr. Z. Determine Tax Treatment.

Answer:

Solution 1: LTCG on Original shares for A/Y 20/21 : 100 x ₹200 – 100 x ₹50 x 289/148 = ₹10,236

STCG on Right shares for A/Y 20/21 : 100 x ₹200 – 100 x ₹30 = ₹17,000

Solution 2: STCG on renounced offer for A/Y 20/21= ₹75 x 100 = ₹7,500

Solution 3: STCG for A/Y 20/21 : 100 x ₹300 – [100 x (₹75 + ₹60)] = ₹16,500

Solution 4a : LTCG on original shares for A/Y 20/21 : 100 x ₹150 – [100 x ₹50 x 289/200] = ₹7,775

STCG on Bonus Shares for A/Y 20/21 : 50 x ₹150 – nil = ₹7,500

Solution 4b : LTCG on original shares for A/Y 20/21 : 500 x ₹900 – [500 x ₹300 x 289/100] = ₹16,500

LTCG on bonus shares for A/Y 20/21 : 250 x ₹900 – [250 x ₹300 x 289/100] = ₹8,250

Solution 5 : LTCG for A/y 20/21 : ₹10,00,000 – ₹[1,00,000 x 289/100] = ₹7,11,000

Income from Other sources for A/Y 20/21 : ₹40,000

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 6

Computation of Income from Other Sources

LESSON OUTLINE

- Charging Section [Section 56(1)]
- Impact of Section 115BAC under the Head Other Sources
- Taxation of Dividend
- Casual Income
- Interest Income
- Income from letting of Machines, Plant or Furniture belonging to assessee
- Sum received under Keyman Insurance Policy including Bonus
- Taxation of Gifts
- Other Misc. Provisions
- Deduction [Section 57]
- Deduction not allowed [Section 58]
- Deemed Income [Section 59]
- LESSON ROUNDUP
- TEST YOURSELF

LEARNING OBJECTIVES

Income which are not chargeable under the previous four heads and which are not exempt u/s 10, must be charged to tax as "Income from other sources". In addition to the taxation of income not covered by the other heads, Section 56(2) specifically provides certain items of incomes as being chargeable to tax under the head in every case.

At the end of this lesson, students will be able to understand:

- Which are the income chargeable under the head income from other sources,
- Determine taxability of dividend
- Determine taxability of casual incomes
- Determine taxability of Interest
- Know what are admissible deductions,
- Know which are the inadmissible deductions and
- Know what are the provisions of taxability of gift in kind or in cash from relative or unrelated persons.

KEY SECTIONS COVERED IN THIS CHAPTER

Section 56(1)	General Charging Section
Section 56(2)	Specific Charging Section
Section 57	Deductible expenses from Other Sources
Section 58	Non Deductible expenses from Other sources
Section 59	Deemed Income

CHARGING SECTION [SECTION 56(1)]

- Income of every kind
- Not Excluded from Total Income
- Not chargeable to tax under other four heads
- Shall be chargeable to Income Tax under Income from Other Sources.

Examples:

1. Rental Income from vacant land
2. Income from **sub-letting** of house property
3. Interest on loan/deposits.
4. Agricultural Income **outside India**
5. **Family** pension.
6. **Insurance** Commission
7. Income from **Undisclosed** sources
8. **Royalty**(If not covered under Business or Profession)
9. Receipt of **Life Insurance money**(If not exempt u/s 10(10D)
10. **Director Fees/Commission**
11. **Director salary** if not chargeable under salary
12. Salary to MP/MLA etc

Following Incomes SHALL BE chargeable under head Other Sources [Section 56(2)]

1. **Dividend** Income
2. Winnings from **Lotterie**s, cross word puzzles, card games etc.
3. Interest on **Securities** ,if not chargeable under Business or Profession
4. Income from **letting of Plant, Machinery or Furniture**, if income not chargeable under Business or Profession
5. Income from composite **letting of Building** together with Plant, Machinery or Furniture, which is inseparable from letting of such building, if such income not chargeable under Business or Profession

6. Sum received under **Keyman Insurance Policy**, if not chargeable under salary or Business or profession
7. Sum/***Property*** received as **Gifts**
8. Share premium in excess of fair market value received by Closely Held Company
9. **Interest received on compensation** or on **Enhanced compensation**
10. **Advance or other money** received in course of negotiations for transfer of a capital asset, if such sum is forfeited & negotiations do not result in transfer of such capital asset.
11. Any compensation or other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto.

Impact of Section 115BAC under the head Income from Other Sources [Amendment vide Finance Act, 2020]

Finance Act, 2020 has introduced a New Optional Tax System for Individuals and HUFs u/s 115BAC of the Income Tax Act, 1961 w.e.f. A/Y 21-22 to provide for concessional rate of Slab Rates to be applied on Total Income calculated without claiming specified deductions and exemptions.

Hence, from AY 2021-22 or FY 2020-21, there are two operative tax systems:

1. One is the Existing tax system where all the applicable deductions and exemptions are allowed and the tax rates are as per the Slab rates of tax specified in the Finance Act, 2020.
2. The second one is section 115BAC which is a Optional Tax System under which many deductions and exemptions have not been allowed but lower slab tax rates are provided in the section 115BAC itself.

Individual and HUF opting for concessional tax regime under section 115BAC: The deduction under Chapter VI-A other than the provisions of sub-section (2) of section 80CCD or section 80JJAA; not available to the Individual and HUF opting to pay tax under concessional tax regime under section 115BAC of the Income Tax Act, 1961.

Many exemptions & deduction are not allowed under the new tax system. The below chart contains the exemptions and deduction not available under the new system related to Income under the head Other Sources. Similarly, deductions & exemptions not available under the new tax system and which are related to other heads are provided in other chapters

Sr. No.	Nature of Exemption/Deduction Relating to Head Other Sources	New system of Tax u/s 115BAC	Existing system of Tax
1.	Deduction u/s 57	Allowed except Section 57(iia) i.e. Standard Deduction from Family Pension	Allowed

Method of Accounting [Section 145]

As per section 145, Income from other sources is to be calculated on basis of **Cash or Mercantile basis** of accounting **regularly employed** by the assessee.

TAXATION OF DIVIDEND

Taxability of Dividend upto AY 2020-21

Domestic company was liable to Pay Dividend Distribution (DDT) tax u/s 115-O on dividend declared or paid by it. Dividend included deemed dividend u/s 2(22).Therefore DDT was payable both on actual dividend as well as deemed dividend.

Actual and deemed dividend u/s 2(22)(a),(b),(c) & (d) was subject to DDT @ 15% plus surcharge @ 12% plus Health & education cess @ 4%. But deemed dividend u/s 2(22)(e) was liable to be DDT at higher rate of 30% plus surcharge @ 12% plus Health & Education cess @ 4%

Since Domestic company was liable to pay DDT, the dividend received by shareholder was exempt u/s 10(34) upto 10 lakhs on receipt of actual dividend and deemed dividend u/s u/s 2(22)(a),(b),(c) & (d). Dividend u/s 2(22)(e) was fully exempt in hands of the shareholder u/s 10(34).

Since Actual and Deemed dividend u/s u/s 2(22)(a),(b),(c) & (d) was chargeable to DDT at less rates as compared to 2(22)(e), they was also chargeable to additional tax @ 10% in hand of specified shareholder u/s 115BBDA in excess of Rs.10 lakhs.

Taxability of Dividend w.e.f. AY 2021-22

Finance Act 2020 has abolished Dividend Distribution Tax for dividend declared or paid w.e.f. 1/4/2020. Hence, implication is as follows:

Section 115-O is not applicable on Domestic company on dividend paid or declared w.e.f. 1/4/2020.Therefore domestic company not liable to pay Dividend Distribution Tax 'DDT' on dividend paid or declared w.e.f. 1/4/2020.

Since domestic company not liable to pay DDT, exemption u/s 10(34) shall also not be applicable in hands of shareholder for dividend received on or after 1/4/2020.Therefore now dividend received from domestic company will be taxable in hand of shareholders. Section 115BBDA will also be not be applicable w.e.f. 1/42020

Illustration: ABC Ltd. declared a dividend of INR 200,00,000 for the FY 2019-20 and distributed the same on 15th Jul'20. Mr. A holds 10% shares and therefore receives INR 20,00,000 as dividend. Mr B hold 4% shares and therefore receives INR 8,00,000 as dividend.

Solution:

The tax treatment would be as under:

- Mr. A would be taxed on the amount exceeding INR 10,00,000, that is, on INR 10,00,000 he would be taxed at 10% + SC (if any) + Cess
- Mr. B has received dividends < INR 10,00,000 and therefore this would entirely be exempt from tax under section 10(34)
- The company however would have to pay DDT on the dividend so distributed u/s 115O

Assume Dividend declared for FY 2020-21 on 15th March, 2021, the tax treatment would be as under:

- Mr. A would include full amount of Rs.20,00,000 as Income from other sources and the exemption u/s 10(34), & section 115BBDA would not apply. He will liable to pay tax at applicable slab rates.
- Mr. B would include full amount of Rs. 8,00,000 as Income from other sources and the exemption u/s 10(34),& section 115BBDA would not apply. He will liable to pay tax at applicable slab rates.
- The company would not be liable to pay Dividend Distribution Tax on the dividend distributed u/s 115-O as the same would be taxable in the hands of shareholders.

Illustration: X is holding 29% shares in a company and he took a loan of INR 20,00,000 from the Company on 15.07.2019 and on the date, the loan was granted, the accumulated profits stood at INR 12,00,000. Determine the tax treatment.

Solution: In case, the company is one, where the public is substantially interested, the loan would not be treated as deemed dividend. However, in case the company is a closely held company, X holds > 10% stake, this loan upto 12,00,000 would be treated as deemed dividend and company will be liable to pay Dividend Distribution Tax u/s 115-O.

X would not pay tax on such deemed dividend and Entire amount of 12 lakhs would be exempt in hands u/s 10(34).

Assume loan taken on 15.07.2020

In case, the company is one, where the public is substantially interested, the loan would not be treated as deemed dividend. However, in case the company is a closely held company, X holds > 10% stake, this loan upto 12,00,000 would be as deemed dividend and company will not be liable to pay DDT u/s 115O.

X would pay tax on such deemed dividend at applicable slab rates and entire amount of 12 lakhs would be included as Income under the head Other sources.

Meaning of the term "Dividend" [Section 2(22)] :The term "dividend" is ordinarily used to refer to any distribution made by a company to its shareholders out of its profits in proportion to the number of shares held by the shareholder concerned in the company.

Apart from that dividend paid by a company to its shareholders, the definition of dividend includes deemed dividend as laid down under section 2(22) of the Act, which is inclusive but not exhaustive. Accordingly, the following payments or distribution made by a company to its shareholders are deemed as dividends to the extent of accumulated profits of the company whether capitalised or not (i.e. bonus shares issued is the capitalisation of profit). It may be noted that these payments may not be covered as dividend under Companies Act, 2013.:

(a) Any distribution if such distribution entails the release of all or any part of the assets of the company. Such accumulated profits are distributed in cash or in kind. For in kind distribution, the market value of assets shall be the deemed dividend in hands of shareholders.

(b) Any distribution of debentures, debenture-stock, or deposit certificates in any form, whether with or without interest to Equity or Preference shareholders. Any distribution of bonus shares to its preference shareholders. However, bonus shares allotted to equity shareholders does not amount to deemed dividend.

(c) Any distribution made on liquidation of a company

(d) any distribution on the reduction of capital of a company

Deemed dividend under clause (c) and clause (d) does not include :

i. Any distribution by to shareholders on liquidation or reduction of capital of the company in respect of full cash consideration, where the shareholder is not entitled to participate in the surplus asset in the event of liquidation.

ii. Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act.

iii. Any distribution of shares made in accordance with the scheme of demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

(e) Any payments in the form of loans or advances to the extent of accumulated profits (excluding capitalised profit) made by a closely-held company (i.e. a company in which public are not substantially interested) to:

  i. its shareholder who is the beneficial owner of shares holding not less than 10% of voting power in such company.

  ii. to any concern (HUF, Firm, AOP, BOI or Company) in which such shareholder is a member or a partner and which he has a substantial interest (20% of voting power or share of profit)

  iii. any person on behalf of such shareholder for his/her individual benefit.

Deemed dividend under clause (e) does not includes:

- Any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off.
- Vide CBDT circular No. 19/2017, any trade advance in the nature of commercial transactions would not fall within the ambit of advance.

CIT v. Parle Plastics Ltd. 332 ITR 63 (Bom.)

If lending of money is a substantial part of the business of the lending company, the money given by it by way of advance or loan to the assessee could not be regarded as a dividend, as it had to be excluded from the definition of “dividend” by virtue of the specific exclusion in section 2(22).

CASUAL INCOME

Winnings from Lotteries, Crossword Puzzle, Races including horse races, Card games & other games of any sort or from gambling or betting of any form – Taxable

Special Points:

(a) Deduction u/s Section 80 C to Section 80 U will not be available from such Incomes

(b) Section 58: No Deduction shall be allowed from such incomes

(c) Amount to be included in Total Income is Gross amount & not Net amount received after TDS

$$\textit{Gross Amount to be included in Total Income} = \frac{\textit{Net Amount Received after TDS X 100}}{\textit{100 - TDS rate}}$$

Question 1 : Mr. X wins a lottery during p/y 20-21. Compute Income from other sources of Mr. X for A/Y 21-22 assuming winning received is ₹3,50,000.

Solution: Income from Other sources for A/Y 21-22 : ₹3,50,000/70 x 100 = ₹5,00,000

Question 2: Mr. X purchased a lottery ticket worth ₹10,000 on 4.6.2020. He wins a jackpot of ₹4,00,000 on his ticket. Mr. X has also made an expenditure of ₹10,000 for collection of winning amount. Deduction u/s 80C is ₹50,000. Compute Total Income of Mr. X for A/Y 21-22.

Solution: Income from Other sources for A/Y 21/22 : ₹4,00,000

Gross Total Income/Total income: ₹4,00,000

INTEREST INCOME

Income from Interest on Securities is chargeable under head other sources.(If not chargeable under Business or Profession)

Interest Exempt from Tax [Section 10(15)]

1. Interest on **Notified bonds/certificates**

- Post office Saving Bank account upto ₹3,500/ ₹7,000 in joint account in P/Y
- Post office Time deposit
- Special Bearer Bonds

2. – Notified Investment Bond
   – Notified Relief Bonds of RBI

3. Notified Bond/Debenture of **Public Sector Companies**. E.g. Rural Electrification Corporation Limited , Indian Railway Finance Corporation Limited

4. Bonds of **Local Authority**, i.e. Municipal Bonds.

5. Interest on Gold **Deposit Bonds** issued under Gold Deposit scheme 1999 or Deposit certificates issued under Gold Monetisation Scheme, 2015

Note:

1. **Section 14A:** Expenditure of any exempt income is not allowed as a deduction from taxable income
2. Amount to be included in Total Income is Gross amount & not Net amount received after TDS

$$\text{Gross Amount to be included in Total Income} = \frac{\text{Net Amount Received after TDS} \times 100}{100 - \text{TDS rate}}$$

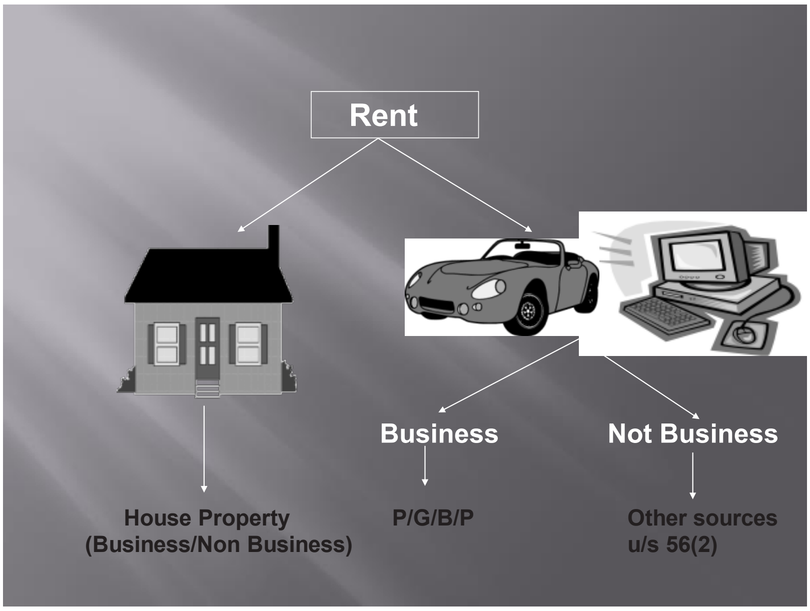
BOND WASHING TRANSACTIONS [SECTION 94(1)]

- If owner of security(Transferor)
- Sells security before record date &
- Acquires the same after record date
- Interest received by transferee
- Deemed as Income of transferor

*However Deeming provisions of section 94(1) is not applicable if there is **no avoidance** of Income tax **or** Avoidance of Income tax was **exceptional** & there was no avoidance during last **three preceding P/Y***

INCOME FROM LETTING OF MACHINERY, PLANT OR FURNITURE BELONGING TO ASSESSEE

If Plant and Machinery etc. is **NOT** let out as part of assessee's business activity than income arising from such hire will be taxable under other Sources. If letting is as part of his business activity than under BUSINESS OR PROFESSION



Question 3 : Mr. X has let out a car on a rent of ₹1,20,000 during p/y 20/21. The car was purchased on 15/4/2018 for ₹2,00,000.The repair and maintenance expenses incurred on car during previous year 20-21 is ₹30,000.Compute taxable income under other sources for AY 21-22

Solution: **<u>Taxable income from Other Sources for AY 21-22</u>**

Rent : ₹1,20,000 – Depreciation ₹27,750 – Repairs ₹30,000 = ₹62,250

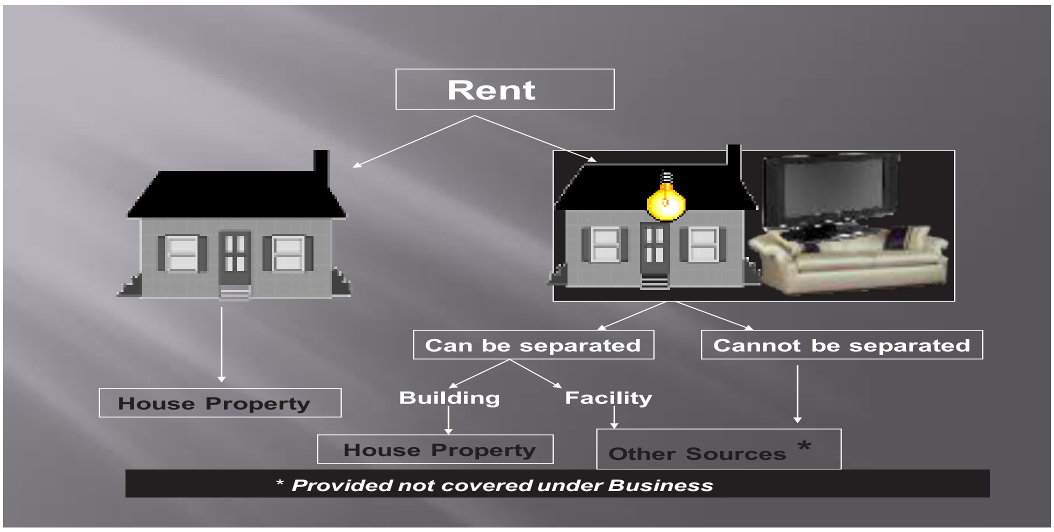
<u>Depreciation</u>

Cost of car : ₹2,00,000 – 7.5% depreciation for PY 19-20 i.e. ₹15,000 = ₹1,85,000

15% depreciation for P/y 20/21 = ₹27,750

Income from composite letting of machinery, plant furniture and buildings

If letting of building is inseparable from letting of P&M etc. and such letting is **NOT** as part of his business activity, than income arising from such letting will be taxable under other sources. If letting is as part of his business activity than under BUSINESS OR PROFESSION



Question 4 : Mr. X has let out a building on a rent of ₹2,40,000 during PY 2020-21 along with facilities of electricity, gas and water. The repair and maintenance expenses incurred during PY 2020-21 on building is 20,000 and ₹30,000 is incurred on payment of Electricity, gas and water bills of tenant. Compute taxable income under other sources for AY 2021-22

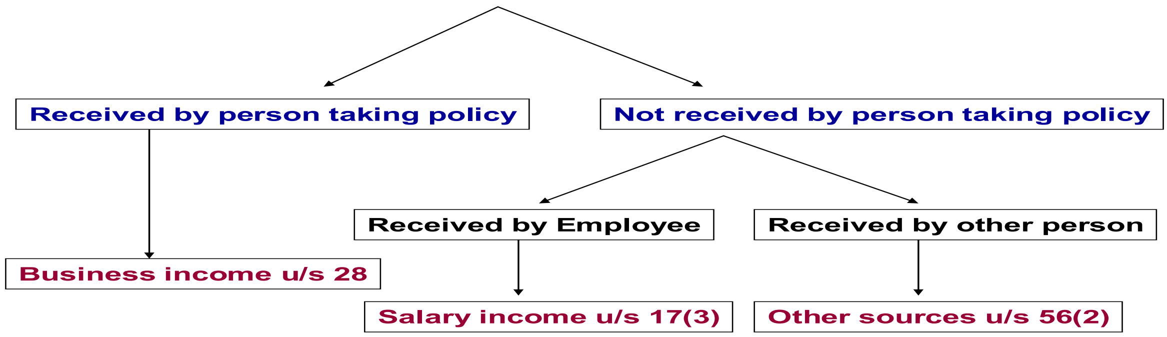
Solution : Taxable income from other sources for AY 2021-22

₹2,40,000 -₹20,000 -₹30,000 = ₹1,90,000

SUM RECEIVED UNDER KEYMAN INSURANCE POLICY INCLUDING BONUS

Any sum received under Key Man policy including bonus is taxable under other sources provided not chargeable under head Salary or Business or Profession

Sum received under Keyman Insurance Policy



TAXATION OF GIFTS

A. Taxation of Cash Gifts

- Sum of money received by ANY PERSON
- Without consideration
- In excess of ₹ 50,000/-
- in a previous year
- the whole of such sum
- Shall be included in income of receiver under head Other sources

B. Taxation of Property as Gift/Inadequate consideration

Property means following <u>Capital asset</u> of the assessee, namely

(i) Immovable property being land or building or both;

(ii) Shares and securities;

(iii) Jewellery;

(iv) Archaeological collections;

(v) Drawings;

(vi) Paintings;

(vii) Sculptures;

(viii) Bullion;

(ix) Any work of art

TAXATION OF IMMOVABLE PROPERTY

Where any person receives, in any previous year, from any person or persons on or after the 1st day of April, 2017, any immovable property,—

i. without consideration, the stamp duty value of which exceeds INR 50,000, the stamp duty value of such property is chargeable to tax;

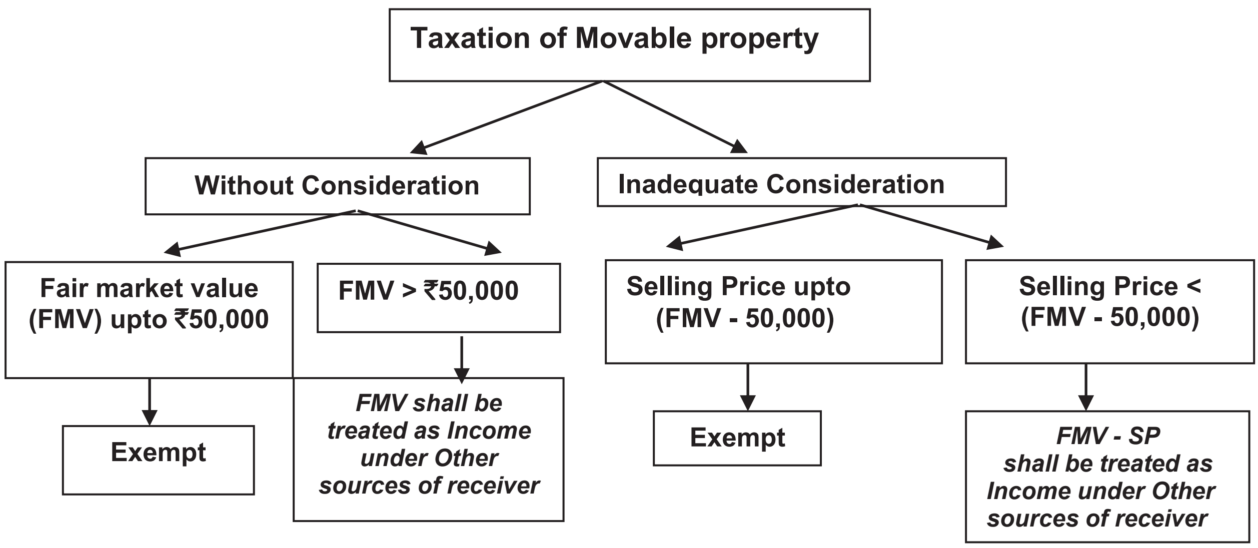
ii. for a consideration, the stamp duty value of such property as exceeds such consideration, if the amount of such excess is more than the higher of the following amounts, namely:—

  - the amount of INR 50,000; or
  - the amount equal to 10% per cent of the consideration [Increased from 5% to 10% by Finance Act, 2020]
  - then the difference between stamp duty value of such property and consideration is chargeable to tax.

Provided that where the date of agreement fixing the amount of consideration for the transfer of immovable property and the date of registration are not the same, the stamp duty value on the date of agreement may be taken for the purposes of this sub-clause.

Provided further that the provisions of the first proviso shall apply only in a case where the amount of consideration referred to therein, or a part thereof, has been paid by way of an account payee cheque or an account payee bank draft or by use of electronic clearing system through a bank account, or through such other electronic mode as may be prescribed [Inserted vide Finance Act, 2020] on or before the date of agreement for transfer of such immovable property.

Provided also that where the stamp duty value of immovable property is disputed by the assessee on grounds mentioned in sub-section (2) of section 50C, the Assessing Officer may refer the valuation of such property to a Valuation Officer, and the provisions of section 50C and sub- section (15) of section 155 shall, as far as may be, apply in relation to the stamp duty value of such property for the purpose of this sub-clause as they apply for valuation of capital asset under those sections.



Special Point:

1. Section 49(4) : If Property is taxable in hands of recipient under Other sources then its Stamp value / FMV will be taken as its Cost of Acquisition .
2. Sum of Money/Property received from following will not be included in Income
   - **a.** From **RELATIVE**
   - **b.** On **Marriage** of Individual.
   - **c.** Under **will** or **inheritance**.
   - **d.** Received in **contemplation of death** of payer/donor
   - **e.** From or by **Trust** registered **u/s 12A/12AA or Section 12AB**
   - **f.** From **Local authority u/s 10(20)**
   - **g.** From any **university /educational institution/hospital/trust/institution u/s 10(23C**)
   - **h.** By way of transaction **not regarded as transfer u/s 47(certain specific cases)**
   - **i.** From an individual by a trust created or established solely for the benefit of relative of the individual
   - **j.** From such class of persons and subject to such conditions, as may be prescribed.
3. **RELATIVE :** For above purpose "Relative " means

   In case of individual :

   (a) Spouse of the individual

   (b) Brother or sister of the individual

   (c) Brother or sister of spouse of the individual

   (d) Brother or sister of either of the parents of the individual

   (e) Any lineal ascendant or descendant of the individual

   (f) Any lineal ascendant or descendant of the spouse of the individual

   (g) Spouse of the persons referred to in clause (ii) to (vi)

   In case of HUF : Any member thereof

Question 4: Mr. X receives the following Gifts during PY 20-21

1. He gets a gift of ₹25,000 from his friend A.
2. He gets another Gift of ₹5000 from his friend A.
3. He gets a gift of ₹26,000 from C, who is cousin of his father.
4. He gets a gift of ₹5000 from D, who is elder brother of his grandfather.
5. He gets gift of ₹41,000 from his grandmother.
6. On the occasion of Marriage of X, he gets ₹1,90,000 as gift (out of which ₹1,00,000 is received from relatives and remaining amount is received from friends of Mr. X & Mrs. X)
7. He gets ₹80,000 from a notified public chartable institution.
8. He receives ₹5,40,000 under a will of a person known to him.
9. He received a house property from his friend as Gift (Stamp Value of the Property is ₹40,000)

10. He received shares from his friend for ₹65,000 (Fair market value on the date of receipt is ₹80,000)

Compute Income chargeable in hands of Mr. X under head Other sources for AY 21-22

Solution: Income Taxable Under Other Sources for AY 21-22

Particulars	Taxable Amount (₹)
1.He gets a gift of ₹25,000 from his friend A.	25,000
2.He gets another Gift of ₹5000 from his friend A.	5,000
3.He gets a gift of ₹26,000 from C, who is cousin of his father.	26,000
4.He gets a gift of ₹5000 from D, who is elder brother of his grandfather	5,000
5.He gets gift of ₹41,000 from his grandmother.	Exempt
6.On the occasion of Marriage of X, he gets ₹1,90,000 as gift (out of which ₹1,00,000 is received from relatives and remaining amount is received from friends of Mr. X & Mrs. X)	Exempt
7.He gets ₹80,000 from a notified public chartable institution	Exempt
8.He receives ₹5,40,000 under a will of a person known to him.	Exempt
9.He received a house property from his friend as Gift (Stamp Value of the Property is ₹40,000)	Exempt
10.He received shares from his friend for ₹65,000 (Fair market value on the date of receipt is ₹80,000)	Exempt
Taxable	61,000

OTHER MISC. PROVISIONS

INTEREST RECEIVED ON COMPENSATION FOR COMPULSORY ACQUISITION OF CAPITAL ASSET

- Interest received by an assessee on **Compensation** or on **Enhanced Compensation** shall be **deemed** to be the income of the **previous year in which it is received**.
- **Section 57:** A deduction of **50%** of such income shall be allowed & no deduction shall be allowed under any other clause of this section.

Question 8: Mr. X received interest during p/y 19/20 amounting to ₹50,000 on account of delayed receipt of compensation due to compulsory acquisition of capital asset by government. Determine the taxable amount under other sources for AY 21-22.

Solution: ₹50,000 – ₹25,000 = ₹25,000 taxable under other sources for AY 21-22

SHARE PREMIUM IN EXCESS OF FAIR MARKET VALUE TO BE TREATED AS INCOME OF CLOSELY HELD COMPANY

- Where a closely held company i.e. company not covered u/s 2(18),
- Receives, in any previous year

- From a resident
- Any consideration for issue of shares that exceeds
- Face value of such shares
- Excess of aggregate consideration received for such shares over fair market value of shares
- Shall be treated as income

For eg: ABC(P) ltd issues 10,000 shares at ₹14/share. The face value of each share is ₹10/share. The fair market value of each share is ₹12/share. In this case ₹10,000 x (₹16-₹14)= ₹20,000 shall be deemed as Income of ABC (P) Ltd under the head Other sources for AY 21-22

Exception : Above Provisions shall not apply where the consideration for issue of shares is received –

(i) by a venture capital undertaking from a venture capital company or a venture capital fund *or a specified fund* ; or

(ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.

Where the provisions have not been applied to a company on account of fulfilment of conditions specified in the notification issued under clause (ii) above and such company fails to comply with any of those conditions, then, any consideration received for issue of share that exceeds the fair market value of such share shall be deemed to be the income of that company chargeable to income-tax for the previous year in which such failure has taken place and, it shall also be deemed that the company has under-reported the income in consequence of the misreporting referred to in sub-section (8) and sub-section (9) of section 270A for the said previous year.

ADVANCE MONEY FORFEITED ON CAPITAL ASSET ON OR AFTER 1/4/2014

If Advance or other money is forfeited under negotiations for transfer of capital asset, it is included in Income of receiver under Other sources.

For e.g: Mr. X entered into an agreement to sell a building for ₹10,00,000 on 15/4/2020 and received an advance if ₹1,00,000 on the same day. The buyer was supposed to make the balance payment upto 30/6/2020. However the buyer defaulted in the payment and the seller forfeited the advance amount of ₹1,00,000.In this case the forfeited amount of ₹1,00,000 shall be treated as income of Mr.X under the head other sources for AY 21-22.

DEDUCTIONS AVAILABLE FROM INCOME UNDER OTHER SOURCES [SECTION 57]

1. Collection Charges against taxable Dividend/Interest: Any reasonable sum paid by way of commission or remuneration for realising such **dividend/interest**

2. Deduction against Income from letting of Plant,Machinery etc: Revenue Repair ,Insurance , Depreciation of Building ,Machinery, Plant or Furniture

3. Deduction against family pension: $1/3^{rd}$ of Pension **OR** ₹15,000/- , *whichever is less*

Note: Deduction u/s 57(iia) is not allowed to Assessee opting for Section 115BAC of the Income Tax Act, 1961.

4. Any other Expenditure: Any other expenditure (**not being a capital expenditure**) expended **wholly and exclusively** for the purpose of earning such income.

5. A deduction of 50% shall be allowed from interest received on compensation for compulsory acquisition of capital asset. No other deduction shall be allowed from such income

Special Points:

1. FAMILY PENSION

- Regular Amount payable by Employer,
- To Legal Heir of Deceased Employee
- Is Taxable under other sources
- Deduction u/s 57 is available against such pension

However following pension are exempt from tax

Section 10(18)	**Pension** received by Individual or **Family Pension** by family member ***if*** Individual has been in service of C/S Govt. & awarded Vir Chakra or Mahavir Chakra or Param Vir Chakra or other notified gallantry awards.
Section 10(19)	**Family pension** received by widow or children or heir on death of member of armed forces during duty

"Provided that no deduction shall be allowed from the dividend income, or income in respect of units of a Mutual Fund specified u/s 10(23D) or income in respect of units from a specified company defined in the Explanation to section 10(35), other than deduction on account of interest expense, and in any previous year such deduction shall not exceed 20% of the dividend income, or income in respect of such units, included in the total income for that year, without deduction under this section.". **[Inserted by Finance Act, 2020].**

The Supreme Court held in CIT v. Rajendra Prasad Moody [1978] 115 ITR 519, that in order to claim deduction under section 57 in respect of any expenditure, it is not necessary that income should in fact have been earned as a result of the expenditure. The Court held that the interest on money borrowed for investment in shares which had not yielded any taxable dividend was admissible as a deduction under section 57 under the head, "Income from other sources.

NO DEDUCTION OF FOLLOWING EXPENSES FROM INCOME FROM OTHER SOURCES [SECTION 58]

- Personal Expenses of Assessee.
- Interest paid outside India on which Tax not paid or deducted at source
- Income Tax
- Expenditure referred to in Section 40A(2),40A(3)
- Expenditure or allowance for earning income from Lottery, Crossword Puzzles etc., (except Income from owning & maintaining race horses)

Note: If an expense is allowed as deduction from Other sources in any previous year, recovery of any amount out of that expense shall be taxable under Other sources in previous year of receipt [Section 59]

DEEMED INCOME [SECTION 59]

Where any allowance or deduction has been provided in the assessment of Income under the head "Income From Other Sources" in any Assessment Year in respect of loss or expenditure or trading liability incurred by the assessee and later on during any previous year any amount or any remission or any benefit is obtained by assessee (whether in cash or otherwise) then such amount or remission or benefit shall be taxable under the head " Income From Other Sources" in the previous year in which it is so obtained.

QUESTIONS FOR PRACTICE

Question 1: Mrs. W who draws a salary of ₹20,000 p.m. received the following gifts during P/Y 2020-21:

(a) Gifts of ₹5,00,000 on from a friend.

(b) Gifts of jewellery worth ₹3,00,000 from her father

(c) Gifts of ₹51,000 each received from her 4 friends on the occasion of her marriage.

(d) Gifts of ₹1,00,000 from her mother's sister.

(e) Gifts of ₹60,00 from her father's brother.

(f) Gifts of ₹50,000 from her husband's friend

(g) Gifts of ₹21,000 from her mother's friend.

(h) Gifts of ₹26,000 from her brother's father in law.

(i) Gifts of ₹1,21,000 from her husband's brother.

(j) Gifts of ₹26,000 from her employer.

(k) Scholarship of ₹1,20,000 from a charitable institution registered under section 12AA.

Compute total income for the assessment year 2021-22.

Solution:

		₹	₹
Income under the head salary			
Salary 20,000 X 12		2,40,000	
Add: Cash gift from employer		26,000	
		2,66,000	
Less: deduction U/s 16(ia)		(50,000)	2,16,000
Income from other sources			
(i)	Gift from a friend is included	5,00,000	
(ii)	Gift of jewellery exempt as from relative	--	
(iii)	Gifts received from her 4 friends are exempt as they have Been received on the occasion of her marriage	--	
(iv)	Gift from her mother's sister is exempt as the donor is covered In the definition of relative	--	
(v)	Gift from her father's brother is exempt as the donor is Covered in the definition of the relative	--	
(vi)	Gift of ₹50,000 from her husband's friend is taxable	50,000	
(vii)	Gift of ₹21,000 from her mother's friend is includable	21,000	
(viii)	Gift from her brother's father in law is taxable as the donor is not covered in the definition of relative	26,000	

(ix)	Gift from her husband's brother is exempt as the donor is covered in the definition of the relatives	--	
(x)	Gift from her employer is taxable as income from salary	--	
(xi)	Gift in the from of scholarship from charitable institution registered u/s 12AA	Exempt	5,97,000
	Total income		**8,13,000**

Question 2 : Compute Gross interest / dividend and Net interest / dividend on securities and shares in the following cases:

1. 10% Unlisted Bonds of Industrial Development Bank of India: ₹3,20,000.
2. 10% Debentures of ABC Ltd. listed on Stock Exchange Purchased at ₹96 (face value ₹100) :₹1,34,400.
3. Interest received from debentures issued by L ltd. listed on stock exchange: ₹29,700.
4. Interest Received from debentures issued by a Ltd. company not listed on stock exchange :₹21,600.
5. Dividend received from Z Ltd. on 25-5-2019 : ₹2,400.
6. Dividend declared by the company on 5-7-2019 on shares of Y Ltd. @ 50% on 1,000 shares of ₹10 each. Which were purchased at ₹60 per share.
7. 10% Dividend on preference shares of ₹10 each amounting to ₹2,25,000 paid on 31-3-2020.

Solution :

Particulars	Gross Interest/ Dividends (₹)	Rate of TDS	TDS Amount	Net Interest After TDS (₹)
1. 10% Bonds of IDBI (Unlisted)	32,000	10%	3,200	28,800
2. 10% Debenture of ABC Ltd. (Listed)	14,000	NIL	NIL	14,000
3. Interest received of debentures of L Ltd. (Listed)	29,700	NIL	NIL	29,700
4. Interest received of debentures (Unlisted)	24,000	10%	2,400	21,600
5. Dividends received from Z Ltd.	2,400	Nil		2,400
6. Dividend on shares of Y ltd.	5,000	Nil		5,000
7. Preference shares dividends	22,500	Nil		22,500

Question 3 : In the above question, compute the income under the head other sources?

Solution:

		₹
1.	10% Bonds of industrial Development Bank of India of ₹3,20,000.	32,000
2.	10% Debentures of ABC Ltd. listed on Ahemdabad Stock Exchange Purchased at ₹96 (face value ₹100) ₹1,34,400.	14,000
3.	Interest received from debentures issued by X ltd. listed on stock exchange ₹29,700.	29,700
4.	Interest Received from debentures issued by a Ltd. Company not listed on stock	

	exchange ₹21,600.	24,000
5.	Dividend received from K Ltd.	Exempt
6.	Dividend shares of M ltd. @ 50% on 1,000 shares of ₹10 each. purchased at ₹60 per share (net dividend ₹5,000).	Exempt
7.	10% Dividend on preference shares of ₹2, 25,000.	Exempt
		99,700

Question 4 : X holds the following securities on April 1, 2020 :

₹ 86,000	7% securities of Gujarat Government (date of payment of interest :December 15 every year).
₹ 92,000	9% securities of M.P Government (date of payment of interest : March 31 every year).
₹ 80,000	6% securities of ABC Ltd. (date of payment of interest : July 31 every year).

On August 3, 2020, he sells ₹30,000 6% debentures of ABC Ltd. and invests the sale proceeds in Unlisted debentures of PQR Ltd. During the previous year 2020-21, he receives ₹5,760 (net) as interest on Unlisted debentures of PQR Ltd. Interest on 9% MP Government securities, which has accrued on March 31, 2021, is received by X on April 15, 2021. Calculate the taxable income of X for the assessment year 2021-22, assuming that his income from salary is ₹87,000. X maintains books of account on the basis of mercantile system of accounting.

Solution : Income from other sources for A/Y 21/22

	₹
7% securities of the Gujarat Government (i.e., ₹86,000 X 7/100)	6,020
9% of MP Government securities (i.e., ₹92,000 X 6/100)	8,280
6% debentures of ABC Ltd. (i.e., ₹80,000 X 6/100)	4,800
Debentures of PQR Ltd. :	
Net interest ₹5,760	
Gross interest ₹5,760 X 100 / 90	6,400
Income from other sources	25,500
Salary income	87,000
Gross total income	**1,12,500**
Less : deduction	Nil
Net income (rounded off)	**1,12,500**

Question 5 : Mr.X has taken a loan of ₹1,00,000 @ 10%. The amount was invested by him in the securities of one company. During the year he has received gross interest of ₹18,000 and has paid collection charges to the bank ₹500. He has paid interest ₹10,000 on the loan taken by him for investment and has long term capital gain of ₹2,00,000. Compute his tax liability for assessment year 2021-22.

Solution:	₹
Gross Interest	18,000
Less:	

(i) Bank Charges u/s 57	(500)
(ii) Interest paid for borrowing the amount u/s 57	(10,000)
Income under the head Other Sources	7,500
Income under the head Capital Gains (LTCG)	2,00,000
Total Income	2,07,500

Computation of Tax Liability

Tax on (₹2,00,000 -2,42,500) @ 20% u/s 112	Nil
Tax on ₹7,500 at slab rate	Nil

Question 6: Mrs.X is getting family pension of ₹7,000 p.m. and has incurred ₹50 p.m. as bank collection charges. She has long term capital gain of ₹3,89,000. Compute her tax liability for assessment year 2021-22.

	₹	₹
Solution:		
Family Pension	84,000	
(7,000 x 12)		
Less: Deduction u/s 57	(15,000)	69,000
1/3 of ₹84,000 or ₹15,000 whichever is less		
Income under the head other sources		**69,000**
Income under the head Capital Gains		
Long term capital gain		3,89,000
Gross Total Income		4,58,000
Less: Deduction u/s 80C to 80U		Nil
Total Income		4,58,000

Computation of Tax Liability

Tax on ₹208000 (₹3,89,000 – ₹1,81,000) @ 20% u/s 112	41,600
Less rebate u/s 87A	(12,500)
Add: Health & Education cess @ 4%	1164
Tax Liability	30,264
Rounded off u/s 288B	30,260

Question 7: Mr. X has one factory building along with machines and furniture in Mumbai which has been let out @ ₹50,000 p.m. Repair charges of the building is ₹7,000 and that of furniture fixtures are ₹4,000, insurance premium paid ₹3,000 and depreciation is ₹27,000.

Compute his income under the head other sources

Solution:	₹
Gross Rent (50,000 x 12)	6,00,000
Less: Repair of building	(7,000)
Less: Repair of Furniture and fixtures	(4,000)
Less: Insurance premium	(3,000)
Less: Depreciation	(27,000)
Income under the head Other Sources	5,59,000

Question 8 : Mr.X has one factory building with machines and furniture, which has been let out @ ₹50,000 p.m. and repair charges of the building are ₹10,000, insurance premium ₹ 7,000 and repair charges of plant & machinery is ₹3,000. Insurance premium ₹1,000 and depreciation with regard to building plant & machinery etc. is ₹12,000.

Compute his income under the head other sources.

Solution:	₹
Gross Rent (50,000 x 12)	6,00,000
Less: Repair of building	(10,000)
Less: Insurance premium	(7,000)
Less: Repair of plant and machinery	(3,000)
Less: Insurance premium	(1,000)
Less: Depreciation	(12,000)
Income under the head other sources	5,67,000

Question 9 : Mrs.X has received incomes as given below during the previous year 2020-21:

1. Interest on savings bank account with State Bank ₹ 15,500 (gross).
2. Interest from Government securities ₹1,000 on 01.01.2021 (collection charge paid to bank @ 1.5%).
3. Interest from ABC Ltd on non listed debentures ₹4,000 (gross) on 01.03.2021 (collection charge paid to the bank ₹30).
4. Interest credited to post office savings bank account during the year ₹ 230.
5. Interest credited to public provident fund during the year ₹ 12,000.
6. Interest received from XYZ Ltd on listed debentures ₹ 5,000 (gross). (Collection charge ₹30) The amount was invested by taking a loan of ₹1,00,000 @ 7% p.a.

Mrs.X has income from house property ₹2,30,000.

Compute her tax liability for the assessment year 2021-22

Solution :	₹
Income under the head other sources	
Gross interest from State Bank of India	15,500.00
Interest from Government securities {₹1,000 – ₹15}	985.00
Interest from ABC Ltd {₹4,000 – ₹30}	3,970.00
Interest on P.O.S.B [exempt]	Nil
Interest on PPF [exempt]	Nil
Interest from XYZ Ltd.	(2,030.00)
{Gross interest = ₹5,000	
Less: Collection charges = ₹30	
Less: Interest paid on loan = ₹7,000}	
Income under the head Other Sources	18,425.00
Income under the head House Property	2,30,000.00
Gross Total Income	2,48,425.00
Less: Deduction u/s 80TTA (₹15,500 or ₹10,000 whichever is less)	10,000.00
Total Income (rounded off u/s 288A)	2,38,430.00
Computation of tax liability	
Tax on ₹2,38,430 at slab rate	NIL

Question 10 : Mr. X has income from business of owning and maintaining race camels ₹60,000, loss from owning and maintaining race horses ₹7,000 and income from horse races ₹7,000. He has brought forward business loss of ₹7,000 of the assessment year 2005-06 and brought forward business loss of ₹7,000 of the assessment year 2017-18.

Compute his tax liability for the assessment year 2021-22.

Solution :	₹
Income under the head Business/Profession	60,000
Less: Brought forward business loss	(7,000)
Income under the head Business/Profession	53,000
Income under the head Other Sources (horse races)	7,000
Gross Total Income	60,000
Less: Deductions u/s 80C to 80U	Nil

Total Income	60,000
Computation of tax liability	
Tax on ₹7,000 @ 30%	2,100
Tax on ₹53,000 at slab rate	Nil
Less: Rebate u/s 87A	2,100
Tax after rebate	NIL

LESSON ROUND UP

- Income chargeable under Income-tax Act, which does not specifically fall for assessment under any of the heads discussed earlier, must be charged to tax as "income from other sources".
- Section 56(2) specifically provides for the certain items of incomes as being chargeable to tax under the head such as Dividend, Keyman Insurance policy, Winnings from lotteries, Contribution to Provident fund, Income by way of interest on securities, Income from hiring machinery etc., Hiring out of building with machinery, Money Gifts, Share premiums in excess of the fair market value to be treated as income, income by way of interest received on compensation.
- The entire income of winnings, without any expenditure or allowance or deductions under sections 80C to 80U, will be taxable. However, expenses relating to the activity of owning and maintaining race horses are allowable. Further, such income is taxable at a special rate of income-tax i.e., 30% + surcharge + cess @ 4%.
- Admissible Deductions : The income chargeable under the head "Income from other sources" is the income after making the deductions such as
  - (a) sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such interest;
  - (b) deduction shall be allowable in accordance with the provisions of Section 36(1)(va), i.e., if the employer has credited the employee's accounts in the respective funds;
  - (c) a sum equal to 33-1/3% of the income or Rs. 15,000, whichever is less, is allowable as a deduction from family pension;
  - (d) a deduction of a sum equal to 50% of from Interest on compensation or enhanced compensation, and
  - (e) any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income.
- Inadmissible deductions: The following amounts shall not be deducted in computing income chargeable under the head 'Income from other sources':
  - (a) Any personal expenses of the assessee.
  - (b) Any interest chargeable under the Income-tax Act which is payable outside India and from which income-tax has not been paid or deducted at source.
  - (c) Any payment which is chargeable under the head "Salaries" if it is payable outside India unless tax has been paid thereon or deducted therefrom at source.

(d) Any expenditure referred to in Section 40A of Income-tax Act.

TEST YOURSELF

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

1. When is income chargeable under Other Sources?
2. Discuss the taxability of dividend?
3. What are the cases where receipt of gift is exempt?
4. When is receipt of Keyman Insurance Policy amount taxable under Other Sources?
5. Discuss the taxability of interest received on delayed receipt of compensation on account of compulsory acquisition of capital asset. Are any expenditure allowed as deduction from it?
6. What are the cases where Interest is exempt u/s 10(15)?
7. Discuss the taxability of Family Pension?
8. Is advance money forfeited on capital asset chargeable under Other Sources?
9. When is letting out of plant and machinery chargeable under Other Sources?
10. Discuss the taxability of casual Income ?

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 7

Clubbing Provisions, Set Off and/or Carry Forward of Losses, Deduction, Rebate and Relief

LESSON OUTLINE

I. Clubbing Provisions [Section 60 – 64]
- Clubbing of Income
- Transfer of Income [Section 60]
- Revocable Transfer of Assets [Section 61]
- Income of Spouse
- Transfer for immediate / deferred benefit of son's wife [Section 64(1)(viii)]
- Income of spouse through a third person [Section 64(1)(vii)]
- Clubbing of Income of Minor Child [Section 64(1A)]
- Income from the converted property [Section 64(2)]
- Summary of the Clubbing Provisions
- Recovery of Tax

II. Set Off and / or Carry Forward of Losses
- Set-off and Carry-forward of Losses
- Set-off of losses from one source against income from another source under the same head of income [Section 70]
- Set-off of losses from one head against income from another head [Section 71]

III. Deductions
- Deduction u/s 80C to 80 U

– LESSON ROUND UP

– TEST YOURSELF

LEARNING OBJECTIVES

1. Clubbing Provisions: In addition to the general provisions which are applicable for computation of total income, there are special provisions in Sections 60 to 65 of the Income-tax Act which provide for inclusion of income of other persons in the total income of assessee. The special provisions contained in these sections are designed to counteract the various attempts of an individual for avoiding or reducing his liability to tax by transferring his assets or income to other person(s) while, at the same time, retaining certain powers or interest over the property or it's income. These provisions may also be termed as clubbing provisions. At the end of the lessons students will be able to understand When are clubbing provisions applicable.

2. Set Off and / or Carry Forward of Losses: In the second part of this lesson provisions for set-off and carry forward of losses are discussed. Sometimes the assessee incurs a loss from a source of income and unless such loss is set-off against any income, the net result of the assessee's activities during the particular accounting year cannot be ascertained and consequently the tax payable would also be incapable of determination. For this purpose, the Income-tax Act contains specific provisions (Sections 70 to 80) for the set-off and carry-forward of losses. At the end of the lessons students will be able to understand:

- What are the provisions of set off/carry forward and set off of losses
- How can losses be set off inter-head and intra-head.

- The conditions to be satisfied for carry forward and set off of loss from house property, business loss and unabsorbed depreciation.
- Up to what period can the loss be carried forward and set-off

3. Deductions: Sections 80C to 80U of the Income-tax Act lay down the provisions relating to the deductions allowable to assessees from their gross total income. At the end of the lessons students will be able to understand:

- The type of deductions allowable from gross total income
- What are the permissible deductions in respect of payments
- What are the permissible deductions in respect of incomes
- What are the deductions allowable in the case of a person with disability.

4. Rebate and Relief: At the end of the lessons students will be able to understand the provision related to Rebate & Relief available under the Income Tax Act, 1961.

I. CLUBBING PROVISIONS

KEY SECTIONS	
SECTION	**PARTICULARS**
60	Transfer of income where there is no transfer of assets.
61	Revocable transfer of assets.
62	Transfer irrevocable for a specified period.
63	"Transfer" and "revocable transfer" defined.
64	Income of individual to include income of spouse, minor child, etc.
65	Liability of person in respect of income included in the income of another person.

CLUBBING OF INCOME

Normally, a person is taxed in respect of income earned by him only. However, in certain special cases income of other person is included (i.e. clubbed) in the taxable income of the taxpayer and in such a case he will be liable to pay tax in respect of his income (if any) as well as income of other person too. The situation in which income of other person is included in the income of the taxpayer is called as clubbing of income. E.g., Income of minor child is clubbed with the income of his/her parent. Section 60 to 64 contains various provisions relating to clubbing of income.

The special provisions contained in these sections are designed to counteract the various attempts which an individual may make for avoiding or reducing his liability to tax by transferring his assets or income to other person(s) while, at the same time, retaining certain powers or interest over the property or it's income. These provisions are explained below.

TRANSFER OF INCOME [SECTION 60]

Section 60 of Income Tax Act, 1961 provides the provisions relating to clubbing of income where transfer of income is done without transferring the assets. Where a person transfers to any other person, income (whether revocable or not) from an asset without transferring that asset, the income shall be included in the total income of the transferor. "Transfer" includes any settlement, trust, covenant, agreement or arrangement. The transfer also includes a lease for inadequate consideration and the income derived by the lessee from the leased property is included in the income of the lessor.

These are applicable if the following conditions are satisfied:

a) The taxpayer owns an asset

b) The ownership of asset is not transferred by him.

c) The income from the asset is transferred to any person under a settlement, or agreement.

If the above conditions are satisfied, the income from the asset would be taxable in the hands of the transferor. If the transferor transfers the asset and keeps the income for himself, the income shall be included in the income of transferor.

Section 60 of the Act has no application where assets producing income are transferred along with the income C.I.T. v. Ram Prasad Mehta (1975) 100 ITR 468 (Bombay). There may be a field of operation of Sections 61 to 64 but certainly not of Section 60.

REVOCABLE TRANSFER OF ASSETS [SECTION 61]

'Revocable transfer' means the transferor of asset assumes a right to re-acquire asset or income from such an asset, either whole or in parts at any time in future, during the lifetime of transferee. It also includes a transfer which gives a right to re-assume power of the income from asset or asset during the lifetime of transferee.

Where a person transfers any asset to any person with a right to revoke the transfer, all income accruing to the transferee from the asset shall be included in the total income of the transferor.

The income under revocable transfer of asset shall be included in the income of transferor even when only a part of income from transferred asset has been applied for the transferor.

For this purpose assets include movable or immovable property whether situated in India or abroad.

As per Section 63, a transfer shall be deemed to be revocable if:

(i) it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor; or

(ii) it, in any way, gives the transferor a right to reassume power directly, or indirectly over the whole or any part of the income or assets.

Examples of revocable transfers

Some of the examples of revocable transfers are as follows:

(i) If there is an express clause of revocation in the instrument of transfer; or

(ii) If there is a sale with a condition of re-purchase; or

(iii) If the transfer is to a trust and if the transfer can be revoked with the consent of two or more beneficiaries; or

(iv) If the trustees are empowered in sole discretion to revoke the transfer; or

(v) If the transferor has power to change beneficiary or trustees.

“Transfer” includes any settlement, trust, covenant, agreement or arrangement.

Note: Re-transfer to the transferor must be in the same capacity in which he made the transfer or settlement. If a settlement is made by a Hindu undivided family and there is a re-transfer to one member of the family in his capacity as an individual and not in his capacity as a member of the family this cannot be termed a re-transfer for this purpose.

INCOME OF SPOUSE

The following incomes of the spouse of an individual shall be included in the total income of the individual:

(a) Income to spouse from a concern in which such individual has substantial interest [Section 64(1)(ii)]

All such income as arises directly or indirectly, to the spouse of an individual by way of salary, commission, fees or any other remuneration, whether in cash or kind from a concern in which such individual has a substantial interest, shall be included in the income of the individual.

Exception: However, where the spouse possesses technical or professional qualifications and the income is solely attributable to the application of his/her technical or professional knowledge and experience, the income shall not be included in the income of (other spouse) the assessee.

Substantial Interest: An individual shall be deemed to have a **substantial interest** in a concern -

(i) In a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 20% of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of his relatives;

(ii) In any other case, if such person is entitled, or such person and one or more of his relatives are entitled in the aggregate, at any time during the previous year, to not less than 20% of the profits of such concern.

When both husband and wife have substantial interest

Where both husband and wife have a substantial interest in the concern and both are in receipt of the remuneration in such concern, the remuneration from such concern is to be included in the total income of the husband or, as the case may be, the wife whose total income excluding the income referred to in that clause i.e. 64(1)(ii) is greater; (Circular No. 258, dated 14-6-79) and where any such income is once included in the total income of either spouse, any such income arising in any succeeding year shall not be included in the total income of the other spouse unless the Assessing Officer is satisfied, after giving that spouse an opportunity of being heard, that it is necessary so to do.

(b) Income to spouse from the assets transferred [Section 64(1)(iv)]

Where any individual transfers directly or indirectly any asset (other than a house property) to the spouse, the income from such asset shall be included in the income of the transferor.

In order to attract the provisions of this section, it is not necessary that the asset must have been transferred by the assessee to his spouse in the same form in which it stands at the time the income arises. Conversion of assets from one form to another would be totally immaterial and it is also not essential that the transfer must have taken place directly between the spouses.

Exception: However, there are exceptions to this rule:

(i) The transferor has received adequate consideration in money or money's worth. If the consideration was inadequate, proportionate income shall be included in the income of the transferor.

(ii) The transfer has been made in connection with an agreement to live apart. This separation can be either judicial or voluntary under circumstances in which a judicial separation can be granted.

(iii) The income from the assets transferred shall not be included in the income of transferor after the death of spouse, either transferor or transferee.

(iv) The income from assets transferred shall be included in the income of the transferor, only if the relationship as spouse exists on the two dates, i.e., the date of transfer and the date on which the income accrues or arises to the transferee. If any asset has been transferred before marriage, the income from such asset cannot be included in the income of the transferor.

(v) Only the direct income (including capital gains) earned with the help of the transferred assets shall be included in the income of the transferor. Any indirect income to the transferee from the transferred assets shall not be included in the income of the transferor.

Suppose, A transfers certain shares to his wife B. Dividends received on such shares are taxable in the hands of A. If B sells the shares and makes some capital gains, such gains are also taxable in A's hands. Now from the dividend money, B purchases some more shares and receives dividends on these new shares, such dividends are not taxable to A. In the same way, if B receives certain bonus shares on the shares transferred by her husband and later on she receives dividend on such bonus shares, the dividend shall not be included in the income of the transferor because the bonus shares were never transferred by her husband.

If some pin-money is given to wife by her husband neither the savings out of pin-money nor the income earned with the help of savings out of pin-money can be included in the income of husband.

TRANSFER FOR IMMEDIATE OR DEFERRED BENEFIT OF SON'S WIFE [SECTION 64(1)(VIII)]

Any income arising, directly or indirectly, to any person or association of persons from assets transferred directly or indirectly after June 1, 1973, otherwise than for adequate consideration to the person or association of persons by such individual shall, to the extent to which the income from such assets is for the immediate or deferred benefit of his son's wife be included in computing the total income of such individual.

Explanation: For the purpose of clauses (iv) and (vi), where the assets transferred directly or indirectly by an individual to his spouse or son's wife (hereafter in this Explanation referred to as "the transferee") are invested by the transferee -

(i) in any business, such investment being not in the nature of contribution of capital as a partner in a firm or, as the case may be, for being admitted to the benefits of partnership in a firm, that part of the income arising out of the business to the transferee in any previous year, which bears the same proportion to the income of the transferee from the business as the value of the assets aforesaid as on the first day of the previous year bears to the total investment in the business by the transferee as on the said day;

(ii) in the nature of contribution of capital as a partner in a firm, that part of the interest receivable by the transferee from the firm in any previous year, which bears the same proportion to the interest receivable by the transferee from the firm as the value of investment aforesaid as on the first day of the previous year bears to the total investment by way of capital contribution as a partner in the firm as on the said day, shall be included in the total income of the individual in that previous year.

INCOME TO SPOUSE THROUGH A THIRD PERSON [SECTION 64(1)(VII)]

Where a person transfers some assets directly or indirectly to a person or association of persons (trustee or body of trustees or juristic person) without adequate consideration for the immediate or deferred benefit of his or her spouse, all such income as arises directly or indirectly from assets transferred shall be included in the income of the transferor. If only a portion is reserved for the benefit of spouse and a portion is utilised for the benefit of others, only the portion reserved for the spouse shall be included in the income of the transferor.

The share of income of the spouse can be included in the income of the transferor provided the spouse has either received the income or the income has accrued to spouse or the spouse has a beneficial interest in the income. If an individual creates a life-interest in a property in favour of a third person and grants the remainder to his spouse, and so long as the third person is alive, she should not be getting any benefit out of transferred asset, such income cannot be included in the income of the transferor. If however, the benefit from the assets transferred is to be derived by the transferor himself, the transfer would be treated as revocable and would consequently fall within the purview of Section 61 which provides that the entire income arising from the assets so transferred shall be included in the total income of the transferor.

Where a trust was created by assessee's mother for the benefit of the assessee, his wife and the trustees were authorised to carry on business, the income from the business was held to be income of the trust and the share of wife could not be added to the income of the spouse because neither the trust was created by the assessee nor the business done in the partnership. *[K.T Doctor v. C.I.T (1980) 124 ITR 501 (Guj.)].*

CLUBBING OF INCOME OF MINOR CHILD [SECTION 64(1A)]

All income which arises or accrues to the minor child (not being a minor child suffering from any disability of the nature specified in Section 80U) shall be clubbed in the income of his parent. However, any income which is derived by the minor from manual work or from any activity involving application of his skill, talent or specialised knowledge and experience will not be included in the income of his parent. Further, the income of the minor shall be included in the income of that parent whose total income excluding income includible under this subsection is greater, where the marriage of minor's parents subsists, otherwise the income of the minor will be includible in the income of that parent who maintains the minor child in the relevant previous year.

Once the income of the minor is included in the total income of any one parent, clubbing of income of the minor with the same parent will continue in subsequent years also, unless the Assessing Officer is satisfied, after giving that parent an opportunity of being heard that it is necessary so to do.

In case the income of an individual includes any income of his minor child in terms of this section [i.e. Section 64(1A)], such individual shall be entitled to exemption of the amount of such income or Rs. 1,500 whichever is less.

INCOME FROM THE CONVERTED PROPERTY [SECTION 64(2)]

Where an individual, being a member of Hindu Undivided Family, transfers his self-acquired property after 31st December, 1969 to the family for the common benefit of the family, or throwing it into the common stock of the family, or transfers it directly or indirectly to the family otherwise than for adequate consideration, such property is known as converted property. The income derived from the converted property or any part thereof, shall be included in the income of the transferor.

For this section "property" includes any interest in property, movable or immovable the proceeds of sale thereof and any money or investment for the time being representing the proceeds of sale thereof and where the property is converted into any other property by any method, such other property.

Income from converted property to spouse after partition

Where the converted property has been the subject matter of total or partial partition amongst the members of the family, the income derived from such converted property as is received by the spouse of the transferor on partition shall be included in the income of the individual.

The income so included in the total income of the individual shall be excluded from the total income of the family or spouse, as the case may be.

The income from the above mentioned items shall first be computed under the appropriate heads in the hands of the transferee and after that it shall be included in the total income of the transferor under the head, "Income from other sources". However, the income from house property transferred to spouse shall be computed under the head 'Income from house property' in the hands of transferor and not in the hands of the transferee.

Explanation to the term 'income' used in Section 64 includes 'loss'. This amendment nullifies the decision in *Dayalbhai Madhavji Vadera* v. *C.I.T.* (1966) 60 ITR 551 of the Gujarat High Court that the term 'income' used in Sub-section (1) of Section 64 does not include a loss.

SUMMARY OF THE CLUBBING PROVISION

NATURE OF TRANSACTION	CLUBBED IN THE HANDS OF	CONDITIONS/ EXCEPTIONS	RELEVANT REFERENCE
Transfer of Income without transfer of Assets (Section 60)	Transferor who transfers the income	Irrespective of: 1. Whether such transfer is revocable or not. 2. Whether the transfer is effected before or after the commencement of IT Act.	1. Income for the purpose of Section 64 includes losses. [P. Doriswamy Chetty 183 ITR 559 (SC)] [also see Expl. (2) to Section 64] 2. Section 60 does not apply if corpus itself is transferred. [Grandhi Narayana Rao 173 ITR 593 (AP)]
Revocable transfer of Assets (Section 61)	Transferor who transfers the Assets.	Clubbing not applicable if: 1. Trust/transfer irrevocable during the lifetime of beneficiaries/ transferee or 2. Transfer made prior to 1-4-1961 and not revocable for a period of 6 years. Provided the transferor derives no direct or indirect benefit from such income in either case.	Transfer held as revocable 1. If there is provision to re transfer directly or indirectly whole/part of income/asset to transferor; 2. If there is a right to reassume power, directly or indirectly, the transfer is held revocable and actual exercise is not necessary. [S. Raghbir Singh 57 ITR 408 (SC)] 3. Where no absolute right is given to transferee and asset can revert to transferor in prescribed circumstances, transfer is held revocable. [Jyotendrasinhji vs. S. I. Tripathi 201 ITR 611 (SC)]

Salary, Commission, Fees or remuneration paid to spouse from a concern in which an individual has a substantial* interest. [Section 64 (1)(ii)]	Spouse whose total income (excluding income to be clubbed) is greater.	Clubbing not applicable if: Spouse possesses technical or professional qualification and remuneration is solely attributable to application of that knowledge / qualification.	1. The relationship of husband and wife must subsist at the time of accrual of the income. [Philip John Plasket Thomas 49 ITR 97 (SC)] 2. Income other than salary, commission, fees or remuneration is not clubbed under this clause
Income from assets transferred directly or indirectly to the spouse without adequate consideration [Section 64 (1)(iv)]	Individual transferring the asset.	Clubbing not applicable if: The assets are transferred; 1. With an agreement to live apart. 2. Before marriage. 3. Income earned when relation does not exist. 4. By Karta of HUF gifting co-parcenary property to his wife. L. Hirday Narain vs. ITO 78 ITR 26 (SC) 5. Property acquired out of pin money. R.B.N.J. Naidu vs. CIT 29 ITR 194 (Nag.)	1. Income earned out of Income arising from transferred assets not liable for clubbed. [M.S.S. Rajan 252 ITR 126 (Mad)] 2. Cash gifted to spouse and he/she invests to earn interest. [Mohini Thaper vs. CIT 83 ITR 208 (SC)] 3. Capital gain on sale of property which was received without consideration from spouse [Sevential M. Sheth vs. CIT 68 ITR 503 (SC)] 4. Transaction must be real. [O.N. Mohindroo 99 ITR 583 (Delhi)]
Income from the assets transferred to son's wife [Section 64(1)(vi)]	Individual transferring the Asset.	Condition: The transfer should be without adequate consideration.	Cross transfers are also covered [C.M.Kothari 49 ITR 107 (SC)]
Transfer of assets by an individual to a person or AOP for the immediate or deferred benefit of his: (vii) - Spouse (viii) - Son's wife [Section 64(1)(vii)&(vii)]	Individual transferring the Asset.	Condition: 1. The transfer should be without adequate consideration.	1. Transferor need not necessarily have taxable income of his own. [P. Murugesan 245 ITR 301 (Mad)] 2. Wife means legally wedded wife. [Executors of the will of T.V. Krishna Iyer 38 ITR 144 (Ker)]

Income of a minor child [Child includes step child, adopted child and minor married daughter] [Section 64 (1A)]	1. If the marriage subsists, in the hands of the parent whose total income is greater; or;	Clubbing not applicable for: – 1. Income of a minor child suffering any disability specified u/s. 80U. 2. Income on account of manual work done by the minor child. 3. Income on account of any activity involving application of skills, talent or specialized knowledge and experience.	1. Income out of property transferred for no consideration to a minor married daughter, shall not be clubbed in the parents' hands. [Section 27] 2. The parent in whose hands the minor's income is clubbed is entitled to an exemption up to Rs. 1,500 per child. [Section 10(32)]
	2. If the marriage does not subsist, in the hands of the person who maintains the minor child. 3. Income once included in the total income of either of parents, it shall continue to be included in the hands of same parent in the subsequent year unless AO is satisfied that it is necessary to do so (after giving that parent opportunity of being heard)		

Income of HUF from property converted by the individual into HUF property [Section 64 (2)]	Income is included in the hands of individual & not in the hands of HUF.	Clubbing applicable even if: The converted property is subsequently partitioned; income derived by the spouse from such converted property will be taxable in the hands of individual.	Fiction under this section must be extended to computation of income also. [M.K. Kuppuraj 127 ITR 447 (Mad)]

RECOVERY OF TAX

Dual Liability for Tax: The tax on the income of the other person which has been included in the income of the assessee can either be recovered from the assessee or from the other person. The liability of other person is limited to the portion of the tax levied on the assessee which is attributable to the income so included. His liability arises after the service of a notice of demand by the Assessing Officer in this behalf.

Where any such asset (the income from which has been included in that of the assessee) is held jointly by more than one person, they shall be jointly and severally liable to pay the tax which is attributable to the income from the assets so included.

II. SET OFF AND / OR CARRY FORWARD OF LOSS [SECTION 70 TO 80]

KEY SECTIONS

SECTION	PARTICULARS
70	Set off of loss from one source against income from another source under the same head of income.
71	Set off of loss from one head against income from another.
71A	Transitional provisions for set off of loss under the head "Income from house property".
71B	Carry forward and set off of loss from house property.
72	Carry forward and set off of business losses.
72A	Provisions relating to carry forward and set off of accumulated loss and unabsorbed depreciation allowance in amalgamation or demerger, etc.
72AA	Provisions relating to carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in scheme of amalgamation of banking company in certain cases.
72AB	Provisions relating to carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in business re-organisation of co-operative banks.
73	Losses in speculation business.
73A	Carry forward and set off of losses by specified business.
74	Losses under the head "Capital gains".
75	Losses of firms.
78	Carry forward and set off of losses in case of change in constitution of firm or on succession.
79	Carry forward and set off of losses in case of certain companies.
80	Submission of return for losses.

SET-OFF AND CARRY-FORWARD OF LOSSES

While one endeavors to derive income, the possibility of incurring losses cannot be ruled out. Based on the principles of natural justice, a set-off should be available for loss incurred. The income tax laws in India recognize this and provide for adjustment and utilization of the losses. For this purpose, the Income-tax Act, 1961 contains specific provisions (Sections 70 to 80) for the set-off and carry- forward of losses.

Income-tax is levied on the total income of the previous year of an assessee and it is necessary to ascertain the total income. Further, loss incurred by the assessee is to be set-off against any income, the net result of the assessee's activities during the particular accounting year cannot be ascertained and consequently the tax payable would also be incapable of determination.

SET-OFF OF LOSSES FROM ONE SOURCE AGAINST INCOME FROM ANOTHER SOURCE UNDER THE SAME HEAD OF INCOME [SECTION 70]

The process of adjustment of loss from a source under a particular head of income against income from other source under the same head of income is called intra-head adjustment, e.g. Adjustment of loss from business A against profit from business B.

Income of a person is computed under five heads. 'Sources' of income derived by an individual may be many but yet they could be classified under the same head. Consider a situation where Harish has two properties - one, occupied by him and the other, let out. Harish pays interest on loan of Rs 1.50 lakh on the property occupied and derives net rental income of Rs 1.50 lakh from the let-out property. In case of a self-occupied property, income is computed as nil and interest expenditure results in loss. The loss of Rs 1.50 lakh can be set off against rent income of Rs 1.50 lakh; the income chargeable under the head 'House property' will be 'Nil'.

Thus, in general, if the net result for any assessment year in respect of any source falling under any head of income is a loss, the assessee is entitled to set off the amount of such loss against his income from any other source under the same head.

However, the following are the **exceptions to general rule**:

1. Speculative Business Losses: Loss from speculation business cannot be set of against profit from an non speculation business however loss from non speculative business can be set-off against speculation income)

2. Long-term capital Loss: Long Term Capital Loss (LTCL) can only be set off against Long Term Capital Gain (LTCG) and cannot be set off against Short term Capital Gain (STCG) however STCL can be set off against LTCG)

3. Casual Income: No loss can be set-off against casual income i.e. Income from lotteries, crossword puzzles, race including horse race, card game, and any other game of any sort or from gambling or betting of any form or nature. No expenses can be claimed against casual income.

4. Income Losses from owning and maintaining race horses: Loss from the business of owning and maintaining race horses cannot be set off against any income other than income from the business of owning and maintaining race horses.

5. Loss from an exempted source cannot be set off against taxable Income: If income from a particular source is exempt from tax, then loss from such source cannot be set off against any other income which is chargeable to tax. E.g., Agricultural income is exempt from tax, hence, if the taxpayer incurs loss from agricultural activity, then such loss cannot be adjusted against any other taxable income.

6. Income Losses of specified Business: Loss from business specified under section 35AD cannot be set off against any other income except income from specified business (section 35AD is applicable in respect of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building a housing projects, etc.)

Income losses Intra-head Set off

(A) Loss from business or profession

Any loss from business or profession (other than speculation business or loss from the activity of owning and maintaining race horses) can be set off against the income from any other business or profession including the income from speculation business or income from the activity of owning and maintaining race horses.

If any business has been discontinued during the year, the loss from such business can also be set-off from the income of other business or profession.

The loss suffered by a wholly owned subsidiary company cannot be set-off by the parent company, since both are separate assessees. Similarly, where loss incurred by a wholly owned subsidiary company is reimbursed by the holding company, the subsidiary company does not use the right to carry forward and set-off the loss. *[C.I.T v. Handicraft Handloom Export Corporation (1982) 133 ITR 590 (Delhi)].*

(B) Loss from speculation business

Such loss can be set-off only against the income from speculation business. It is not essential that the nature of the other speculation transaction must be the same. Speculative transactions in different commodities and in different markets are to be treated as one business. However, a loss from an illegal speculation business cannot be set-off against income from any lawful speculation. *[C.I.T. v. K.J. Kotecha 107ITR 101* (SC)]. Similarly, where the assessee earns commission on speculative transactions, he is not entitled to set-off speculative loss against such commission because there is no element of speculation in the commission *[C.I.T. v. Pangal Vittal Nayak & Co. Pvt. Ltd. (1969) 74 I.T.R. 754* (S.C.)]. By virtue of an explanation to Section 73 where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads: “Interest on securities”, “Income from House Property”, “Capital gains”, “Income from other sources”, or a company the principal business of which is the business of banking or granting of loans and advances) consists of the purchase and sale of shares of other companies, such company shall for the purpose of this section (Section 73), be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

SET-OFF OF LOSS FROM ONE HEAD AGAINST INCOME FROM ANOTHER HEAD [SECTION 71]

After making intra-head adjustment (if any) the next step is to make inter-head adjustment. If in any year, the taxpayer has incurred loss under one head of income and is having income under other head of income, then he can adjust the loss from one head against income from other head, E.g., Loss under the head of house property to be adjusted against salary income.

A person may have various sources of income computed under different heads of income. Loss under one head of income is generally allowed to be set off against income under another head.

For instance, X has only one property, which is occupied by him and the loss is Rs 1.50 lakh. He derives salary of Rs 10 lakh during the year. Here, he can set off the loss of Rs 1.50 lakh against his salary income by making appropriate declarations to his employer, thereby making his net taxable income Rs 8.50 lakh.

The provision of Section 71 reads as under:

(a) an assessee not having any income under the head “Capital gains” and having loss from income under other heads (excluding capital gains) can set off such loss against his income under any other head (other than “capital gains”);

(b) loss under any head of income (other than “capital gains”) can be set off against income from any head of income, including “capital gains”;

(c) loss under the head “capital gains” cannot be set off against income under any other head. It must be set off only against income from “capital gains”.

(d) Loss under the head "Profits and gains of business or profession" cannot be set off against the head "income from Salaries".

(e) Where the assessee incurs any loss under the head income from house property it can be set off against the assessee's any other income under other head during the previous years where such loss is not fully adjusted under other heads of income in the same assessment year, then the balance loss shall be allowed to be carried forward and set off in subsequent years subject to a limit of eight assessment years against income from house property.

Section 71(3A) Inter head adjustment of loss under the head House Property (i.e. adjustment of loss under the head House Property against Income under any other head in the same year) cannot exceed Rs 2,00,000 for any assessment year. Remaining loss can be carried forward to be set off in future as per provisions of Section 71B. (There is no restriction of Rs. 2,00,000 in section 71B). **[Inserted vide Finance Act, 2017 w.e.f. AY 2018-19]**

(f) Loss incurred by an assessee from a source, income from which is exempt, cannot be set-off against income from a taxable source.

There are certain exceptions to the general rule that Loss under one head of income is allowed to be set off against income under another head.

a) Loss from speculative business cannot be set off against any other income. However, non-speculative business loss can be set off against income from speculative business. For Example: House property loss can be set-off against Speculative Incomes but speculation loss cannot be set off against House property)

b) Business loss cannot be set-off against salary income. (It can be set-off against other incomes)

c) Loss under the head Capital Gains (LTCL or STCL) cannot be set-off against any other head however Loss from other heads can be set-off against Capital Gains. For an instance, House Property loss can be set-off against CG but LTCL or STCL cannot be set off against HP, i.e., house property Income.

d) No loss can be set off against Casual income such as winnings from lotteries, crossword puzzles, race including horse race, card game, and any other game of any sort or from gambling or betting of any form or nature.

e) No expenses can be claimed against casual income.

f) Loss from the business of owning and maintaining race horses cannot be set off against any other income.

g) Loss from an exempted source cannot be set off (e.g. Share of loss of firm, agricultural income, cultivation expenses)

h) Loss from business specified under section 35AD cannot be set off against any other income (section 35AD is applicable in respect of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building housing projects, etc.)

It may be noted that before making inter-head adjustment, the taxpayer has to first make intra-head adjustment.

CARRY-FORWARD OF LOSSES

Many times it may happen that after making intra-head and inter-head adjustments, still the loss remains unadjusted. Such unadjusted loss can be carried forward to next year for adjustment against subsequent year(s)' income. Separate provisions have been framed under the Income-tax Law for carry forward of loss under different heads of income. Losses can be set-off against the income of following years provided that they have been suffered by assessee and determined in pursuance of a return filed by the asessee. Further, carry forward of losses (other than loss from house property and unabsorbed depreciation) is permissible if the return of income for the year, in which loss is incurred, is filed in time. The late filing of return should not impact the status of carry forward of loss of previous years.

The following losses could be carried forward:

(i) Loss in non-speculation business or profession.

(ii) Loss in speculation business.

(iii) Loss in transfer of capital assets [whether short-term or long-term].

(iv) Loss from activity of owning and maintaining of race horses.

(v) Loss under the head 'Income from House Property'.

However, losses suffered under the following heads are not allowed to be carried forward and set off:

(1) Losses under the head 'salaries'.

(2) Losses under the head 'Income from other sources' (excepting loss suffered from the activity of owning and maintaining race horses).

(A) LOSS IN NON-SPECULATION BUSINESS [SECTION 72]

It shall be set-off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year.

From this it follows that the loss from non-speculation business or profession can be set-off against the income of the business in which it was suffered or any other business or profession either old or new including speculation business income or from any other head, such as house property, or other sources, if the income under this head forms part of the trading activities of the assessee. *[Western States Trading Co. (P) Ltd. v. C.I.T. (1971) 80 ITR 21* (SC)].

The loss can be set-off against the business profits of the year provided such profits are asessable to tax. If the profits are exempt from tax for any reason, no set-off can be made by the income-tax officer against such profits.

Conditions for carry forward and set-off of business loss

(i) The right of carry-forward and set-off is available to the same assessee who has sustained the loss. A holding company however, cannot claim to carry forward the losses, if any, incurred by its wholly owned subsidiary company. Exceptions to this rule are (a) cases of succession by inheritance [a loss incurred by the father in the course of carrying on his business can be carried forward and set-off by his son, if the son succeeds to the business of his father on account of the father's death but not otherwise] (b) accumulated business loss of an amalgamating company under Section 72A (c) the share of loss of partnership taken over by one of its partners can also be set-off by the partner *[Dwarkadass Leeladhar v. CIT (1963) 47 ITR 619 (Ker.)]*

However, loss incurred by HUF cannot be carried forward and set-off after its partition against income of firm formed thereafter by certain coparceners *[Keshrichand Bhanabhai v. CIT(1951) 20ITR 201 (Bom.)].*

(ii) The loss can be carried forward to a maximum of eight consecutive assessment years immediately succeeding the assessment year for which the loss was first computed. In case of a business on which rehabilitation allowance has been allowed, the previous losses are allowed to be carried forward to the assessment year relevant to the previous year in which the business was so revived or re-established and are allowed to be set-off against the profits of that assessment year. Any balance of loss can be carried forward to the succeeding seven assessment years.

(iii) Where any unabsorbed depreciation or capital expenditure on scientific research has been brought forward alongwith business loss, the business loss shall first be set-off.

Order of Set-off of losses

In case where profits are insufficient to absorb brought forward losses, current depreciation and current business losses, the same should be deducted in the following order:

(a) Current scientific research expenditure [under Section 35(1)].

(b) Current Depreciation [under Section 32(1)].

(c) Brought forward business losses [under Section 72(1)].

(d) Unabsorbed family planning promotion capital expenditure [under Section 36(1)(ix)].

(e) Unabsorbed Depreciation [under Section 32(2)].

(f) Unabsorbed scientific research expenditure [under Section 35(4)].

(B) LOSS IN SPECULATION BUSINESS [SECTION 73]

Where, for any assessment year, any loss computed in respect of a speculation business has not been wholly set-off against the profits of another speculation business, it shall be carried forward to the following assessment year and shall be set-off against the profits of any speculation business carried on by him and assessable for the assessment year.

Speculative Business

Explanation to section 73 provides that where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company the principal business of which is the business of trading in shares or banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

Sub-section (5) of section 43 defines the term speculative transaction as a transaction in which a contract for purchase or sale of any commodity, including stocks and shares, is settled otherwise than by way of actual delivery. However, the proviso to sub-section (5) of section 43 exempts, *inter alia,* transaction in respect of trading in derivatives on a recognised stock exchange from its ambit.

Carry forward of losses in speculative business

In case of speculation loss even if the particular speculation business in which there is loss is discontinued, this loss can be carried forward to be set-off in the succeeding year against the profits of any other speculation business.

This loss can be carried forward to a maximum of **four consecutive assessment years** immediately succeeding the assessment year for which the loss was first computed.

However, the loss from an illegal speculation business or loss incurred in speculation business in banned items can be neither set-off against income from any lawful speculation business nor can it be carried forward for being set-off in the subsequent year against income even from an illegal speculation business because the law assumes that any illegal business dies with all its losses in the same year *[CIT v. Kurji Jinabhai Kotecha (1977) 107 ITR 101* (SC)].

Where any unabsorbed depreciation or capital expenditure on scientific research has been brought forward along with speculation loss, the speculation loss shall first be set-off.

Sometimes there may be brought-forward speculation loss and current year's non-speculation business loss. Now the problem arises whether the brought forward speculation loss should be adjusted first against the current year's speculation income or current year's non-speculative business loss should be set-off first against the current year's speculative income. Accordingly to the administrative instructions the Assessing Officer may allow the assessee:

(i) either to first set-off the speculation loss carried forward from an earlier year against the speculation profits of the current year and then to set-off the current year's losses against other sources and against the remaining part, if any, of the current year's speculation profits; or

(ii) to first set-off the current year's losses from non-speculation business and other sources against the current year's speculation profits and then to set-off the carried forward speculation losses of the earlier year against the remaining part, if any, of the current year's speculation profits, whichever is advantageous to the assessee.

Where an assessee has brought forward speculative loss from his individual business and during the current year he receives some speculative gains from a firm in which he is a partner, the brought forward loss can be set-off against the speculative profits received from the firm. Similarly, where a speculation business is carried on by sole proprietor and after his death the business is continued by legal heirs forming partnership, the firm is entitled to carry forward and set-off such loss. *[C.I.T. v. Madhukant M. Mehta (1981) 132 ITR 159 (Guj.)].*

Explanation to section 73 does not apply to shares acquired as investment. Moreover, loss from activity of trading in derivatives carried out in recognized stock exchange shall not be treated as Speculative loss. [Exception to section 43(5)]

(C) CARRY FORWARD AND SET OFF OF LOSSES BY SPECIFIED BUSINESS [SECTION 73A]

(1) Any loss of any specified business in section 35AD shall not be set off except against profits and gains of any other specified business.

(2) Where for any assessment year any loss computed of the specified business has not been wholly set off, the loss not set off shall be carried forward to the following assessment year, and

   (i) it shall be set off against the profits and gains of any specified business carried on by him and

   (ii) if the loss cannot be wholly set off, the amount of loss not set off shall be carried forward to the following assessment year and so on.

(D) SET-OFF AND CARRY FORWARD OF CAPITAL LOSSES [SECTION 74]

Where, in respect of any assessment year, the net result of the computation under the head "Capital gains" is a loss to the assessee, it can be carried forward to the following assessment year. The short-term and long-term losses shall be separately carried forward. In case of short-term capital loss it can be set off against income, if any, under the head "Capital gains" (whether short-term or long-term) assessable for that assessment year in respect of any other capital asset. But in case of long-term capital loss, it can be set off only against long-term capital gain.

While losses on transfer of capital assets, whether short-term or long-term cannot be set off against any other income of the assessee under other heads of income i.e. heads other than 'capital gains' in the previous year in which such loss was incurred, it can be carried forward to be set off against capital gains if any during the next eight assessment years.

(E) LOSS ON MAINTENANCE OF RACE HORSES [SECTION 74A]

Where an assessee who is the owner of race horses sustains a loss in the activity of owning and maintaining race horses, he can carry-forward and set-off such loss against his income (Prize money received on a race horse or race horses) from the activity of owning and maintaining race horses in subsequent years. This loss can be carried forward to a maximum of four assessment years immediately succeeding the assessment year for which the loss was first computed.

(F) LOSS UNDER THE HEAD "INCOME FROM OTHER SOURCES"

Except the loss from the activity of owning and maintaining of race horses, the unabsorbed loss from no other activity under the above head is permitted to be carried forward and set off against income of subsequent years.

Carry forward and set-off of Accumulated Business Loss and Unabsorbed Depreciation in certain cases of amalgamation or demerger etc. [Section 72A]

Section 72A provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance in case of:

(i) Amalgamation [Section 72A(1), (2) and (3)], or

(ii) Demerger [Section 72A(4) and (5), or

(iii) Reorganisation of business [Section 72A(6)]

(i) Carry forward and set off of accumulated loss and unabsorbed depreciation in case of amalgamation [Section 72A(1), (2) and (3)]

(1) Where there has been an amalgamation of a company owning an industrial undertaking or a ship or a hotel with another company or an amalgamation of a banking company referred to in Clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949) with a specified bank, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

(2) Notwithstanding anything contained in Sub-section (1), the accumulated loss shall not be set off or carried forward and the unabsorbed depreciation shall not be allowed in the assessment of the amalgamated company unless -

(a) the amalgamating company -

(i) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;

(ii) has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation;

(b) the amalgamated company -

(i) holds continuously for a minimum period of five years from the date of amalgamation at least three- fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;

(ii) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;

(iii) fulfils such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

Consequences if the above conditions are not satisfied [Section 72A(3)]: In a case where the conditions laid down under Clause (b) above are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be in the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

[**Note:** The carry forward and set off of loss and unabsorbed depreciation as per the above provisions shall be allowed only when amalgamation is as per the provisions of Section 2(1B) of the Income-tax Act, 1961].

(ii) Carry forward and set off of accumulated losses and unabsorbed depreciation in case of demerger [Sections 72A(4) and (5]

Notwithstanding anything contained in any other provisions of this Act in the case of a demerger, the accumulated loss and the allowance for absorbed depreciation of the demerged company shall -

(a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;

(b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

The Central Government may, for the purposes of this Act, by notification in the Official Gazette, specify such conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

[**Note**: The carry forward and set off of accumulated loss and unabsorbed depreciation as per the above provisions shall be allowed only when demerger is as per the provisions of Section 2(19AA) of the Income-tax Act.]

(iii) Carry forward and set off of accumulated losses and unabsorbed depreciation in case of reorganisation of business [Section 72A(6)]

Where there has been reorganisation of business, whereby, a firm is succeeded by a company fulfilling the conditions laid down in Clause (xiii) of Section 47 or a proprietary concern is succeeded by a company fulfilling the conditions laid down in Clause (xiv) of Section 47, then, notwithstanding anything contained in any other provisions of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor firm or the proprietary concern, as the case may be, shall be deemed to be the loss or allowance for depreciation of the successor company for the purpose of previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

Section 72(6A): Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

Consequences if the conditions laid down under Section 47(xiii), (xiv) and 47(xiiib) are not complied with [Proviso to Section 72A(6) & (6A)]

If any of the conditions laid down under Section 47(xiii) and (xiv) are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor company, shall be deemed to be the income of the company chargeable to tax in the year in which such conditions are not complied with.

If any of the conditions laid down in the proviso to clause (xiiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

Note: ***"Accumulated loss"*** means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place;

"Unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

Carry forward and set off of Accumulated Loss and Unabsorbed Depreciation allowance in scheme of amalgamation of banking company in certain cases [Section 72AA]

Section 72AA inserted by the Finance Act, 2005 provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance in scheme of amalgamation of banking companies.

Where there has been an amalgamation of a banking company with any other banking institution under a scheme sanctioned and brought into force by the Central Government under Sub-section (7) of Section 45 of the Banking Regulation Act, 1949, the accumulated loss and the unabsorbed depreciation of such banking company shall be deemed to be the loss or, as the case may be, allowance for depreciation of such banking institution for the previous year in which the scheme of amalgamation was brought into force and other provisions of this Act relating to set-off and carry forward of loss and allowance for depreciation shall apply accordingly.

The terms, "accumulated loss", "banking company", "banking institution" and "unabsorbed depreciation" for the purposes of this Section are defined as under:

(i) ***"accumulated loss"*** *means so much of the loss of the amalgamating banking company under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating banking company, would have been entitled to carry forward and set-off under the provisions of Section 72, if the amalgamation had not taken place.*

(ii) ***"banking company"*** *shall have the same meaning assigned to it in Clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949);*

(iii) ***"banking institution "*** *shall have the same meaning assigned to it in Sub-section (15) of Section 45 of the Banking Regulation Act, 1949 (10 of 1949);*

(iv) ***"unabsorbed depreciation"*** *means so much of the allowance for depreciation of the amalgamating banking company which remains to be allowed and which would have been allowed to such banking company if amalgamation had not taken place.*

In order to address the issue faced by the amalgamated public sector banks and public sector General Insurance Companies, An amendment has been made vide Finance Act, 2020 to extend the benefit of this section to amalgamation of,-

(i) 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.

This amendment will take effect from 1st April, 2020 and will, accordingly, apply in relation to the assessment year 2020-21 and subsequent assessment years.

TREATMENT OF CARRY-FORWARD OF LOSSES OF CERTAIN ASSESSEES

(1) Carry-forward and set-off of losses in case of change in constitution of firm [Section 78]

Where a change has occurred in the constitution of a firm, the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

(2) Carry-forward and set-off of losses in case of succession of business or profession

When a business or profession is succeeded by another person, the brought forward losses by the predecessor can be set-off against the income earned by the predecessor before the succession. The successor is not entitled to carry forward the losses sustained by the predecessor and set them off against the income earned by him. However, there is exception. If the succession is by inheritance, the heir-at-law is entitled to carry-forward and set-off the losses sustained by the predecessor provided the business in question continues to be carried on by the successor.

(3) Carry-forward and set-off of losses of companies in case of certain companies [Section 79]

Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place during the previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, unless 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:

Provided that even if the said condition is not satisfied in case of an eligible start up as referred to in section 80-IAC, the loss incurred in any year prior to the previous year shall be allowed to be carried forward and set off against the income of the previous year if all the shareholders of such company who held shares carrying voting power on the last day of the year or years in which the loss was incurred, continue to hold those shares on the last day of such previous year and such loss has been incurred during the period of seven years beginning from the year in which such company is incorporated. **(Date of Setting up of business is irrelevant)**

Nothing contained in sub-section (1) shall apply:

(a) to a case where a change in the said 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;

(b) to any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that 51% shareholders of amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company;

(c) to a company 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;

(d) to a company, and its subsidiary and the subsidiary of such subsidiary, 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) a change in shareholding of such 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.

Explanation. – For the purposes of this section:

(i) 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;

(ii) “Tribunal” shall have the meaning assigned to it in clause (90) of section 2 of the Companies Act, 2013.’

Section 79 substituted by Finance Act 2019

Points to be considered:

- The scheme of Section 79 has been modified w.e.f A.Y.2020-21, to facilitate ease of doing business in case of eligible start up so as to provide brought forward business loss of closely held eligible start up shall be carried forward and set off against income of previous years on satisfaction of either of two conditions mentioned under clause (a) or (b) of section 79.
- For other closely held companies, there would be no change, and loss incurred in any year prior to PY shall be carried forward and set off only on satisfaction of condition stipulated at clause (a).

SUBMISSION OF RETURN FOR LOSS [SECTION 80]

An assessee is not entitled to carry-forward a loss unless he has filed a return of loss to the Department in time and in the prescribed form. It is obligatory on the part of the assessee to file such return, otherwise he will be deprived of the benefit of carry-forward of losses. In fact, only that amount of loss is allowed to be carried-forward which has been computed by the Assessing Officer and not by the assessee.

Section 80 places restrictions on assessee from claiming set off and carry forward of losses of earlier years if return has been filed after due date, can’t be treated as straight jacket one which could be applied without reference to different provisions included in section 139 and elsewhere to be more extensive time for filling return. Chhattisgarh State Civil Supplies Corporation v CIT[2017] 396 ITR440(Chhattisgarh)

Where business loss has not been notified to assessee by AO, Assessee could not be allowed to carry forward and set off business losses of earlier years during AY in question. The assessee must have loss determined in subsequent year in which business loss is to be set off. CIT v Haryan Hotels Ltd [2005] (Punj. & Har.)

Section 80 of the Act provides that a loss which has not been determined in pursuance of return filed u/s 139(3) shall not be carried forward and set-off u/s 72(1), 73(2), 74(1), 74(3), 74A. Previously, it does not include Section 73A which provides that any loss, computed in respect of any specified business referred to in section 35AD.

Section 80 of the Act has been amended by Finance Act, 2016 to provide that the loss determined u/s 73A shall not be allowed to be carried forward and set off unless it is determined in pursuance of a return filed u/s 139(3).

These amendments effective retrospectively from 1st April, 2016 and accordingly apply in relation to the assessment year 2016-17 and subsequent years.

SUMMARY OF PROVISIONS REGARDING CARRY FORWARD AND SET-OFF OF LOSSES

SET-OFF OF LOSSES [SECTIONS 70, 71]

Loss	Set-Off
1. Loss from house property.	(a) Income from any other house property (b) Any other head of income upto maximum of Rs. 2,00,000
2. Loss from business or profession	(a) Income from any other business or Profession. (b) Any other head of income except under the head "Salaries"
3. Loss from speculation	(a) Income from speculation
4. Short-term capital loss	(a) Short-term capital gain (b) Long-term capital gain
5. Long-term capital loss	(a) Long-term capital gain
6. Loss from activity of owning and maintaining race horses	(a) Income from activity of owing and maintaining race horses.
7.Loss from a business specified under Section 35AD	Income from a specified business under Section 35AD

CARRY FORWARD AND SET-OFF OF LOSSES [SECTION 72]

Loss	Set-Off
1. Loss from house property.	In following eight years, income from house property.
2. Loss from business or profession	In following eight years, income from business or profession.
3. Loss from speculation	In following four years (w.e.f. A.Y. 2006-07), income from speculation.
4. Short-term capital loss	In following eight years : (a) Short-term capital gain (b) Long-term capital gain
5. Long-term capital loss	In following eight years, Long-term capital gain.
6. Loss from activity of owning and maintaining race horses	In following four years, Income from activity of owing and maintaining race horses.
7.Loss from specified business under Section 35AD	Income from a specified business under Section 35AD in future years.

III. DEDUCTIONS TO BE MADE IN COMPUTING TOTAL INCOME [SECTION 80C TO 80U]

The Income-tax Act provides various tax exemptions and deductions. The incomes which are exempt from tax, i.e. which are not included in total income are provided under Sections 10 to 13A. Chapter VI A contains deductions from gross total income under section 80C to 80U in respect of certain payments, investments, incomes and other deductions. Deduction helps in reducing the taxable income. It decreases the overall tax liabilities and helps to save tax. However, depending on the type of tax deduction claim, the amount of deduction varies.

The deductions are available only to the assessees where the gross total income is positive. If however, the gross total income is nil or negative, the question of any deduction from the gross total income does not arise. For this purpose, the expression 'gross total income' means the total income of the assessee computed in accordance with the provisions of the Income-Tax Act, before making any deduction under Chapter VIA, i.e., the aggregate income computed under each head, after giving effect to the provisions for clubbing of income and set off of losses, is known as "Gross Total Income". Sections 80C to 80U of the Income- tax Act lay down the provisions relating to the deductions allowable to assessees from their gross total income. The income arising after deduction under section 80C to 80U is called Total Income.

Amendment vide Finance Act, 2020

Finance Act, 2020 has introduced a New Optional Tax System for Individuals and HUFs u/s 115BAC of the Income Tax Act, 1961 and for Resident Co-operative Societies u/s 115BAD w.e.f. A/Y 21-22 to provide for concessional rate of Slab Rates to be applied on Total Income calculated without claiming specified deductions and exemptions.

Hence, from AY 2021-22 or FY 2020-21, there are two operative tax systems –

1. One is the Existing tax system where all the applicable deductions and exemptions are allowed and the tax rates are as per the Slab rates of tax specified in the Finance Act, 2020.
2. The second one is section 115BAC / 115BAD which is a Optional Tax System under which many deductions and exemptions have not been allowed but lower slab tax rates are provided in the section 115BAC / 115BAD itself.

Individual and HUF opting for concessional tax regime under section 115BAC: The deduction under Chapter VI-A other than the provisions of sub-section (2) of section 80CCD or section 80JJAA; not available to the Individual and HUF opting to pay tax under concessional tax regime under section 115BAC of the Income Tax Act, 1961.

Resident Co-operative Societies opting for concessional tax regime under section 115BAD: The deduction under Chapter VI-A other than the provisions of section 80JJAA; not available to the Resident Co-operative Society opting to pay tax under concessional tax regime under section 115BAD of the Income Tax Act, 1961.

Summary of Deductions under Chapter VI-A

Section	Nature of deduction	Who can claim
(1)	(2)	(3)
80C	• Life insurance premium • Sum paid towards notified annuity plan of LIC or other insurer, a contract for a deferred annuity	Individual/HUF (Not Available on opting for connectional tax regime u/s 115BAC)

Section	Nature of deduction	Who can claim
(1)	(2)	(3)
	• Contributions towards Employees' Provident Fund Scheme, Public Provident Fund Account, a recognised provident fund, an approved superannuation fund, notified unit-linked insurance plan of LIC Mutual Fund, participation in unit-linked Insurance Plan of UTI, any pension fund set up by any mutual fund which is referred to in section 10(23D) or by the UTI • Subscription to any notified security, notified deposit scheme of the Central Government, notified savings certificates, notified pension fund set up by National Housing Bank • Tuition fees paid by an individual to any university, college, school or other educational institution situated in India, for full time education of any 2 of his/her children • Certain payments for purchase/construction of residential house property • Subscription to notified schemes of (a) public sector companies engaged in providing long-term finance for purchase/construction of houses in India for residential purposes/(b) authority constituted under any law for satisfying need for housing accommodation or for planning, development or improvement of cities, towns and villages, or for both • Subscription to equity shares or debentures forming part of any approved eligible issue of capital made by a public company or public financial institutions, any units of any approved mutual fund referred to in section 10(23D), notified bonds issued by the NABARD. • Term deposits for a fixed period of not less than 5 years with a scheduled bank or post office • a contribution by central govt. employee to a specified account of the pension scheme referred to in section 80CCD for a fixed period of not less than three years; • Deposit in an account under the Senior Citizen Savings Scheme Rules, 2004	
80CCC	• Contributions to certain pension funds of LIC or any other insurer (up to Rs. 1,50,000)	Individual (Not Available on opting for connectional tax regime u/s 115BAC)

Section	Nature of deduction	Who can claim
(1)	(2)	(3)
80CCD	• Contribution to pension scheme notified by Central Government up to 10% of salary. • Contribution made by employer shall also be allowed as deduction under section 80CCD(2) while computing total income of the employee. However, amount of deduction could not exceed 10% of salary of the employee Note: The maximum limit of Rs. 1,50,000 is the aggregate of the deduction that may be claimed under sections 80C, 80CCC and 80CCD. However, additional deduction of maximum Rs. 50,000 be allowed under section 80CCD(1b) over and above the limit of Rs. 1,50,000.	Individual (Not Available on opting for connectional tax regime u/s 115BAC)
80D	Amount paid (in any mode other than cash) by an individual or HUF to LIC or other insurer to effect or keep in force an insurance on the health of specified person. Payment towards health scheme and/or on account of preventive health check-up	Individual/HUF (Not Available on opting for connectional tax regime u/s 115BAC)
80DD	Deduction of Rs. 75,000 (Rs. 1,25,000 in case of severe disability) to a resident individual/HUF where (a) any expenditure has been incurred for the medical treatment (including nursing), training and rehabilitation of a dependant, being a person with disability, or (b) any amount is paid or deposited under an approved scheme framed in this behalf by the LIC or any other insurer or the Administrator or the specified company for the maintenance of a dependent, being a person with disability	Resident Individual/HUF (Not Available on opting for connectional tax regime u/s 115BAC)
80DDB	Expenses actually paid for medical treatment of specified diseases and ailments subject to certain conditions	Resident Individual/HUF (Not Available on opting for connectional tax regime u/s 115BAC)
80E	Interest on loan taken from financial institution/approved charitable institution for pursuing higher education	Individual (Not Available on opting for connectional tax regime u/s 115BAC)
80EE	Interest payable on loan taken from any financial institution for the purpose of acquisition of a residential house property	Individual (Not Available on opting for connectional tax regime u/s 115BAC)
80EEA	Tax incentives for affordable housing	All assesses (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)

Section	Nature of deduction	Who can claim
(1)	**(2)**	**(3)**
80EEB	Tax incentives for electric vehicles	All assesses (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80G	Donations to certain approved funds, trusts, charitable institutions/donations for renovation or repairs of notified temples, etc.	All assesses (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80GG	Rent paid in excess of 10% of total income for furnished/unfurnished residential accommodation (subject to maximum of Rs. 5,000 p.m. or 25% of total income, whichever is less)	Individuals not receiving any house rent allowance (Not Available on opting for connectional tax regime u/s 115BAC)
80GGA	Certain donations for scientific, social or statistical research or rural development programme or for carrying out an eligible project or scheme or National Urban Poverty Eradication Fund	All assessees not having any income chargeable under the head 'Profits and gains of business or profession' (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80GGB	Sum contributed to any political party/electoral trust	Indian company
80GGC	Sum contributed to any political party/electoral trust	All assessees, other than local authority and artificial juridical person wholly or partly funded by Government (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80-IA	Profits and gains from industrial undertakings engaged in infrastructure facility, telecommunication services, industrial park, development of Special Economic Zone, power undertakings, etc.	All assesses (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)

Section	Nature of deduction	Who can claim
(1)	**(2)**	**(3)**
80-IAB	Profits and gains derived by undertaking/enterprise from business of developing a Special Economic Zone notified on or after 1-4-2005	Assessee being Developer of SEZ (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80-IB	Profits and gains from industrial undertakings, cold storage plant, hotel, scientific research & development, mineral oil concern, housing projects, cold chain facility, multiplex theatres, convention centres, ships, etc.	All assesses (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80-IC	Profits and gains derived by an undertaking or an enterprise in special category States (Himachal Pradesh, Uttaranchal, Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura)	All assesses (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80IAC	Deduction in respect of eligible Start-Up	All assesses (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80IBA	Deductions in respect of profits and gains from Housing Projects	All assesses (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80IC	Special provisions in respect of certain undertakings or enterprises in certain special category States	All assesses (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80JJA	Entire income from business of collecting and processing or treating of bio-degradable waste for generating power, or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas, making pellets or briquettes for fuel or organic manure	All assesses (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80JJAA	Additional wages paid to new regular workmen employed in the previous year for 3 assessment years	Assessee having profits and gains derived from manufacture of goods in a factory

Section	Nature of deduction	Who can claim
(1)	**(2)**	**(3)**
80LA	Certain incomes of Scheduled banks/banks incorporated outside India	Scheduled banks/ banks incorporated outside India having Offshore Banking Units in a Special Economic Zone/ Units of International Financial Services Centre (Not Available on opting for connectional tax regime u/s 115BAC/115BAD)
80M	Deduction in respect of certain inter-corporate dividends [Inserted vide Finance Act, 2020]	Domestic Company
80P	Specified incomes	Co-operative societies (Not Available on opting for connectional tax regime u/s 115BAD)
80PA	Specified incomes	Producer Company
80QQB	Royalty income of author of certain specified category of books (up to Rs. 3,00,000)	Resident Individual – Author (Not Available on opting for connectional tax regime u/s 115BAC)
80RRB	Royalty on patents up to Rs. 3,00,000	Resident individuals who is a patentee and is in receipt of income by way of royalty in respect of a patent registered on or after 1-4-2003 (Not Available on opting for connectional tax regime u/s 115BAC)
80TTA	Interest on deposits in savings bank accounts (up to Rs. 10,000 per year)	Individuals/HUFs (Not Available on opting for connectional tax regime u/s 115BAC)

Section	Nature of deduction	Who can claim
(1)	**(2)**	**(3)**
80TTB	Interest on deposits in case of senior citizens upto Rs. 50,000	Senior Citizen Individuals (Not Available on opting for connectional tax regime u/s 115BAC)
80U	Deduction of Rs. 75,000, in the case of a person with severe disability, allowable deduction is Rs. 1,25,000	Resident individuals who, at any time during the previous year, is certified by the medical authority to be a person with disability (Not Available on opting for connectional tax regime u/s 115BAC)

DEDUCTIONS UNDER CHAPTER VI-A

Deduction in respect of investments [Section 80C]

Section 80C provides deduction to (a) an individual; (b) a Hindu undivided family for investments made in specified assets subject to a maximum amount of' one lakh and fifty thousand rupees.

The specified Investments include:

a) Premium paid on life Insurance policy taken on the life of an individual assessee or spouse and any child of such individual, and any member of the Hindu Undivided Family subject to a maximum of 10% of the actual sum assured, if insurance policy is taken on or after 1.04.2012. But if, insurance policy is taken on or before 31.03.2012, then maximum limit is 20% of actual sum assured. Further, if insurance policy is taken on or after 01.04.2013 and the policy is on the life of a person with disability or severe disability mentioned in Section 80U or a person suffering from a disease or aliment mentioned in Section 80DDB, then 15% of actual sum assured.

   "actual sum assured" in relation to a life insurance policy shall mean the minimum amount assured under the policy on happening of the insured event at any time during the term of the policy, not taking into account--

   1. *the value of any premium agreed to be returned; or*
   2. *any benefit by way of bonus or otherwise over and above the sum actually assured, which is to be or may be received under the policy by any person.*

b) Amounts paid to effect or to keep in force a contract for a non-cumulative deferred annuity not being an annuity plan referred to in clause (j) below on the life of: (i) in the case of an individual, the individual, spouse or any child of such individual and

   However, such contract should not contain a provision for exercise of an option by the insured to receive cash payment in lieu of the payment of the annuity.

c) Deduction from the salary payable by or on behalf of the Government to any individual, in accordance with the conditions of his service, for securing to him a deferred annuity or making provision for his wife or children, to the extent of one-fifth of salary.

d) Contribution made by an individual to a Recognised provident fund; an approved superannuation fund; public provident fund; a ten-year account or a fifteen- year account under the Post Office Savings Bank (Cumulative Time Deposits) Rules, 1959

e) Purchase of notified securities or deposit scheme of the Central Government. Sukanya Samriddhi Account Scheme has been notified.

f) Subscription to other notified savings certificates defined in Section 2(c) of the Government Savings Certificates Act, 1959 [For this clause, National Savings Certificates (VIII) issue has been notified] and interest accured deemed to be reinvested also qualifies.

g) Contributions made by an individual or HUF, for participation in the Unit-Linked Insurance Plan, 1971, deemed to have been made under Section 19(8)(a) of the Unit Trust of India Act, 1963. [For this clause, Dhanaraksha-1989 plan of LIC Mutual Fund has been notified].

h) Contributions made in the name of an individual or HUF for participation in any notified Unit-Linked Insurance Plan of the LIC Mutual Fund.

i) Any contribution to effect or keep in force any notified annuity plan of the LIC or any other insurer.

j) Any subscription, to any units of any Mutual Fund or the Unit Trust of India under any notified plan formulated by the Central Government.

k) Any contribution to any pension fund set up by any Mutual Fund as notified by the Central Government.

l) Subscription to the notified deposit scheme of or contribution to any such pension fund set up by the National Housing Bank established under Section 3 of the National Housing Bank Act, 1987. [For this clause, Home Loan Account Scheme of National Housing Bank has been notified].

m) Only tuition fees (excluding any payment towards any development fees or donation or payment of similar nature), whether at the time of admission or thereafter, - (for full time education of any 2 children) to any university, college, school or other educational institution situated within India;

n) For purchase or construction of a residential house property, the income of which is chargeable to tax under the head "Income from House Property", where such payments are made towards or by way of:

   i. any instalment or part payment of the amount due towards the cost of the house property allotted or construction and sale of house property on ownership basis; or

   ii. E-payment of any loan taken for the purpose of purchase or construction of residential house property subject to some conditions.

o) Subscription to equity shares or debentures or units forming part of any eligible issue of capital i.e. issue made by a company registered in India or a public financial institution or an approved mutual fund for the purpose of developing, maintaining and operating an infrastructure facility as defined in the explanation to Sub-section (4) of Section 80-IA or for generation, or for generation and distribution of power or for providing telecommunication services whether basic or cellular.

p) Fixed deposits for a minimum period of 5 years in any Scheduled Banks

q) As subscription to such bonds issued by the National Bank for Agriculture and Rural Development, as the Central Government may, by notification in the Official Gazette specify in this behalf.

r) In an account under the Senior Citizens Savings Scheme Rules, 2004.

s) As five year time deposit in an account under the Post Office Time Deposit Rules, 1981.

t) Contribution as an employee of the Central Government, to a specified account of the pension scheme referred to in section 80CCD:

(a) for a fixed period of not less than three years; and

(b) which is in accordance with the scheme as may be notified by the Central Government in the Official Gazette for the purposes of this clause.

(u) a contribution by central govt. employee to a specified account of the pension scheme referred to in section 80CCD for a fixed period of not less than three years; and the scheme notified by Central Government.

Explanation : For the purposes of this clause, "specified account" means an additional account referred to in sub-section (3) of section 20 of the Pension Fund Regulatory and Development Authority Act, 2013. [Inserted by Finance Act, 2019]

Deduction for Contribution to Pension Fund [Section 80CCC]

Section 80CCC provides deduction with respect to amount deposited by an individual out of his taxable income to any annuity plan of the Life Insurance Corporation of India or any insurer approved by the IRDAI for receiving pension subject to a maximum of Rs. 1,50,000.

No deduction for this contribution will be available u/s 80C. The pension received by the assessee or his nominee is taxable in the year of receipt.

If the asseesee or his nominee surrenders the annuity before its maturity, then surrender value including bonus/ interest is taxable in the year of receipt.

Deduction in respect of Contribution to Pension Scheme of Central Government [Section 80CCD]

Section 80CCD provides deduction with respect to employers and employees contribution to pension scheme which is applicable to new employees of the Central Government employed on or after 01.01.2004 or being an individual employed by any other employer. It is mandatory for such employee to contribute 10% of salary every month towards the pension scheme. A matching contribution is required to be made by the employer also.

As per section 80CCD (1), employees contribution towards the notified pension scheme is deductible, but upto maximum of 10% of the salary of employee. As per section 80CCD (1B), an additional deduction of maximum Rs. 50,000 can also be availed. This deduction is out of the focus of section 80CCE. As per section 80CCD (2) if the employer contributes towards the notified pension scheme, then deduction can be claimed but upto maximum of 10% of the salary of employee. If employer is Central government then instead of 10%, Deduction shall be 14% of the salary of employee. This deduction is out of the focus of section 80CCE.

Salary here means basic salary plus dearness allowance (forming part) plus commission at a fixed percentage of turnover achieved by the employee. Self-employed individuals can also contribute to NPS and in such a case, maximum limit of deduction is 20% of his gross total income. Any amount received from pension fund, shall be taxable as income of the recipient (assessee or his nominee) in the year in which such amount is received.

Limit on Deductions under sections 80C, 80CCC and 80CCD(1) [Section 80CCE]

The aggregate amount of deductions under Sections 80C, 80CCC and 80CCD (1) shall not in any case, exceed Rs. 1,50,000.

Deduction in respect of Medical Insurance Premia [Section 80D]

Section 80D provides deduction to an individual or a Hindu undivided family towards medical insurance premium and preventive health check-up or contribution to *Central Government Health Scheme* (CGHS) or any scheme notified by the Central Government on the health of the assessee, his family, parents or members of the HUF.

Where the assessee is an individual, following expenditures are eligible for deduction:

(a) the whole of the amount paid to effect or to keep in force an insurance on the health of the assessee or his family or "any contribution made to the *Central Government Health Scheme"* or such other scheme as may be notified by the Central Government in this behalf *or any payment made on account of preventive health check-up of the assessee or his family* and the sum does not exceed in the aggregate Rs. 25,000; and

(b) the whole of the amount paid to effect or to keep in force an insurance on the health of the parent or parents of the assessee *or any payment made on account of preventive health check-up of the assessee or his family* as does not exceed in the aggregate Rs. 25,000.

(c) the whole of the amount paid on account of medical expenditure incurred on the health of the assessee or any member of his family, who is senior citizen or very senior citizen and not having medical insurance, as does not exceed in the aggregate Rs. 50,000.

(d) the whole of the amount paid on account of medical expenditure incurred on the health of any parent of the assessee who is senior citizen or very senior citizen and not having medical insurance, as does not exceed in the aggregate Rs. 50,000.

Explanation: family means the spouse and dependent children of the assessee.

Payment shall be made by any mode, including cash, in respect of any sum paid on account of preventive health check-up and by any mode other than cash in all cases other than preventive health check up.

Where the assessee is a Hindu undivided family, the expenditure eligible for deduction, shall be aggregate of the following namely:

(a) whole of the amount paid to effect or to keep in force an insurance on the health of any member of that Hindu undivided Family as does not exceed in the aggregate Rs. 25,000

(b) whole of the amount paid on account of medical expenditure incurred on the health of any senior citizen or senior citizen member of the Hindu undivided family as does not exceed in the aggregate Rs. 50,000 and no amount has been paid to effect or to keep in force and insurance on the heath of such a person:

Provided Further that the aggregate of the sum specified under the clause (a) and clause (b) shall not exceed Rs. 50,000

In case of a senior citizen the amount shall not exceed Rs.50,000.

Note:- where amount is paid in lump sum in the previous year to effect or to keep in force an insurance on the health of any person specified there in for more than a year, then, subject to the provisions of this section, deduction shall be allowed proportionately for each relevant previous year.

Explanation: For the purposes of this sub-section,

1. *Senior citizen means an individual resident in India who is of the age of sixty years or more at any time during the relevant previous year.*

Deduction in respect of maintenance including medical treatment of a dependant who is a person with disability [Section 80DD]

Section 80DD provides deduction to an individual or a Hindu undivided family, who is a resident in India, (a) for expenditure incurred during the previous year for the medical treatment (including nursing), training and rehabilitation of a dependent, being a person with disability; or (b) paid or deposited any amount under a scheme framed in this behalf by the Life Insurance Corporation or any other insurer or as specified in the section. The amount deduction shall be Rs. 75000 (flat deduction irrespective of the expenditure incurred or amount paid or deposited). However, in case of severe disability (disability of at least 80%) the deduction shall be Rs. 1, 25,000 flat.

The deduction under clause (b) shall be allowed only if the following conditions are fulfilled, namely: -

(a) the scheme provides for payment of annuity or lump sum amount for the benefit of a dependant, being a person with disability, in the event of the death of the individual or the member of the Hindu undivided family in whose name subscription to the scheme has been made;

(b) the assessee nominates either the dependant, being a person with disability, or any other person or a trust to receive the payment on his behalf, for the benefit of the dependant, being a person with disability.

If the dependant, being a person with disability, predeceases the individual or the member of the Hindu undivided family, an amount equal to the amount paid or deposited under Clause (b) shall be deemed to be the income of the assessee of the previous year in which such amount is received by the assessee and shall accordingly be chargeable to tax as the income of that previous year.

The assessee, claiming a deduction under this section, shall furnish a copy of the certificate issued by the medical authority in the prescribed form and manner, along with the return of income under Section 139, in respect of the assessment year for which the deduction is claimed:

For the purpose of this section

a) *"dependent"* means -

(i) in the case of an individual, the spouse, children, parents, brothers and sisters of the individual or any of them;

(ii) in the case of a Hindu undivided family, a member of the Hindu undivided family, dependant wholly or mainly on such individual or Hindu undivided family for his support and maintenance, and who has not claimed any deduction under Section 80U in computing his total income for the assessment year relating to the previous year;

b) *"disability"*shall have the meaning assigned to it in clause (i) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);

Deduction in respect of medical treatment of certain specified disease or ailment [Section 80DDB]

Section 80DDB provides deduction to an individual or a Hindu undivided family, who is a resident in India for amount actually paid during the previous year, for the medical treatment of such disease or ailment as may be specified in the rules made in this behalf by the Board -

(a) for himself or a dependent, in case the assessee is an individual; or

(b) for any member of a Hindu undivided family, in case the assessee is a Hindu undivided family,

subject to a maximum of Rs. 40,000 (in case of senior citizen Rs. 1,00,000)

Deduction is allowed only when a certificate in Form No. 10-I (issued by neurologist, oncologist, urologist, haematologist, immunologist or any such specialist as may be specified working in a Government Hospital) is furnished.

Provided further that the deduction under this section shall be reduced by the amount received, if any, under an insurance from an insurer, or reimbursed by an employer, for the medical treatment of the person referred to in Clause (a) or Clause (b).

For the purposes of this section, “dependent” means -

(a) in the case of an individual, the spouse, children, parents, brothers and sisters of the individual, dependant wholly or mainly on such individual for support and maintenance;

(b) in the case of a Hindu undivided family, any member of the Hindu undivided family, dependant wholly or mainly on Hindu undivided family for support and maintenance;

Deduction in respect of repayment of loan taken for Higher Education [Section 80E]

Section 80E provides deduction to an individual for amount actually paid during the previous year out of his income chargeable to tax by way of an interest on loan, taken by him from any financial institution or any approved charitable institution for the purpose of pursuing higher education of self or any of the relative (i.e. spouse, children of the assessee or student for whom the individual is the legal guardian). The deduction will be available in computing the total income in respect of initial assessment year and the seven assessment years immediately succeeding the initial assessment year or until the interest thereon is paid by such individual in full, whichever is earlier. The expression “initial assessment year” means the assessment year relevant to the previous year, in which the assessee starts paying the interest on the loan.

For the purposes of this section, the expression “higher education” is being defined to mean any course of study pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorised by the Central Government or State Government or local authority to do so.

The expression “financial institution” is being defined to mean a banking company to which the “Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in Section 51 of the Act) or any other financial institution which the Central Government may, by notification in the Official Gazette, specify in this behalf.

The expression “approved charitable institution” is being defined to mean an institution specified in, or as the case may be, an institution established for charitable purposes and notified by the Central Government under Section 10(23C) or an institution referred to in Section 80G(2)(a).

Deduction in respect of interest on loan taken for Residential House Property [section 80EE]

Section 80EE provides deduction to an individual for interest payable on loan taken by him from any financial institution for the purpose of acquisition of a residential house property for the assessment year beginning on 1st day of April, 2017 and subsequent assessment year, subject to maximum of Rs. 50,000.

The deduction under section shall be subject to the following conditions, namely

(i) the loan has been sanctioned by the financial institution including housing finance company during the period beginning on the 1st day of April, 2016 and ending on the 31st day of March, 2017;

(ii) the amount of loan sanctioned for acquisition of the residential house property does not exceed 35 lakh rupees;

(iii) the value of the residential house property does not exceed 50 lakh rupees;

(iv) the assessee does not own any residential house property on the date of sanction of the loan.

Where a deduction under this section is allowed for any interest, deduction shall not be allowed in respect of such interest under any other provisions of the Act for the same or any other assessment year. Therefore, this deduction is other than the deduction u/s 24(b) under the head “Income from house property”. If in case, the amount of interest exceeds Rs. 50,000 then the individual can claim the balance deduction u/s 24(b), if relevant conditions are satisfied.

For the purposes of this section,

a) "financial institution" means a banking company to which the Banking Regulation Act, 1949 (10 of 1949) applies including any bank or banking institution referred to in section 51 of that Act or a housing finance company;

b) "housing finance company" means a public company formed or registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes.

Tax incentives for affordable housing [Section 80EEA]

New Section 80EEA of the Income Tax Act, 1961 has been introduced vide Finance Act, 2019 as per which an Additional tax deduction up to 1.5 Lakh is available for interest paid on loans taken up to 31st March 2021. It is an additional benefit on the top of 2 Lakh benefit extended by section 24. The maximum tax deduction on interest amount paid for home loan will be 3.5 Lakhs i.e. 2 Lakh under section 24 and 1.5 Lakh under section 80EEA. The deduction will be available on loans taken up to 31st March 2021. The benefit will be given only on the interest component of the home loan.

Eligibility conditions for claiming a deduction

- This benefit will be extended only to the first time homeowner i.e. the assessee should not be owner of any other house at the time of sanction to avail this benefit.
- The stamp duty value of a home should be 45 Lakhs or less.
- The deduction under this scheme is available only to the individuals. HUF, company or any other kind of taxpayer cannot claim benefit under this section.
- In order to claim this benefit the property should be self-occupied and affordable.
- To claim this benefit, the individual must have taken the loan from the financial institution or bank. The loan sanction should be between 1st April, 2019 to 31st March, 2021. [Amended vide Finance Act 2020]
- This tax deduction can be claimed for by individual as well as joint home loan borrower. The joint home loan borrower can individually claim this benefit.
- The above benefit is not applicable for the commercial properties.

Maximum Tax Deduction benefit on Home Loan Interest = 2 Lakh (Section 24) + 1.5 Lakh (Section 80EEA)

Example : Rakesh works in pune in IT Company. He lives in pune in a rented house. He purchased property in Surat. His father and family members live in a newly purchased house. He is buying a home for the first time, so he can take benefit of section 80EEA. The cost of a home is 45 Lakh and. He purchased this home by taking a home loan of 40 Lakh in May 2020.

The monthly EMI of this property is Rs.37000. The total of EMI for FY2020-21 will be 4.07 Lakh. This includes principal payment of 0.3 Lakh and 3.77 Lakh of interest component.

As it is self occupied house and fulfilling condition of section 80EEA, Rakesh can claim 3.5 Lakh as tax deduction while filing Income tax return.

Tax incentives for electric vehicles [Section 80EEB]

In computing the total income of an assessee, being an individual, there shall be deducted, in accordance with and subject to the provisions of this section, interest payable on loan taken by him from any financial institution for the purpose of purchase of an electric vehicle.

The deduction under sub-section (1) shall not exceed one lakh and fifty thousand rupees and shall be allowed in computing the total income of the individual for the assessment year beginning on the 1st day of April, 2020 and subsequent assessment years.

The deduction under sub-section (1) shall be subject to the condition that the loan has been sanctioned by the financial institution during the period beginning on the 1st day of April, 2019 and ending on the 31st day of March, 2023.

Where a deduction under this section is allowed for any interest referred to in sub-section (1), deduction shall not be allowed in respect of such interest under any other provision of this Act for the same or any other assessment year.

For the purposes of this section, –

(a) "electric vehicle" means a vehicle which is powered exclusively by an electric motor whose traction energy is supplied exclusively by traction battery installed in the vehicle and has such electric regenerative braking system, which during braking provides for the conversion of vehicle kinetic energy into electrical energy;

(b) "financial institution" means a banking company to which the Banking Regulation Act, 1949 applies, or any bank or banking institution referred to in section 51 of that Act and includes any deposit taking non-banking financial company or a systemically important non-deposit taking non-banking financial company as defined in clauses (e) and (g) of Explanation 4 to section 43B.'

Deduction in respect of donations to certain funds, charitable institutions, etc. [Section 80G]

Section 80G provides deduction to all assessee's for donations to specified organizations or institutions or funds. However, any donation of any sum exceeding Rs. 2,000 shall not be allowed as deduction under the section unless such sum is paid by any mode other than cash. Further, where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not again qualify for deduction under any other provision of the Act for the same or any other assessment year. Donations in kind is not eligible as per the Supreme Court Ruling (Vijaipat Singhania v. CIT).

The quantum of deduction under this section is the aggregate of deduction permissible under clauses (A), (B), (C) & (D) mentioned below. Together for (C) and (D) below, there is a qualifying limit which is 10% of adjusted Gross Total Income.

Adjusted Gross total income means the "Gross Total Income" as reduced by:

I. Long-term Capital gains, if any which have been included in the "Gross Total Income".

II. All deductions permissible under Sections 80C to 80U excepting deduction under Section 80G.

III. Exempted Income.

IV. Income of NRIs and Foreign Companies under Sections 115A, 115AB, 115AC, 115ACA or 115AD.

(A) 100% Deduction without any qualifying limit:

(i) National Defense fund.

(ii) Prime Minister's National relief fund or Prime Minister's Citizen Assistance and Relief Emergency situations Funds (PM Cases Fund) [Amendment vide Finance Act, 2020].

(iii) Prime Minister's Earthquake relief fund.

(iv) Africa fund.

(v) National Trust for welfare of persons with autism, cerebral palsy, mental retardation and multiple disabilities.

(vi) National cultural fund set up by the Central Government.

(vii) The Chief Minister's relief fund or the lieutenant Governor's relief fund.

(viii) National Illness Assistance fund.

(ix) The Andhra Pradesh Chief Minister's Cyclone Relief Fund, 1996.

(x) The Army/Air force Central welfare fund or the Indian Naval Benevolent fund.

(xi) Any fund set up by a State Government to provide medical relief to poors.

(xii) The National/State Blood transfusion Council.

(xiii) Zila Saksharta Samiti constituted in any district.

(xiv) Any fund set up by the State Government of Gujarat, exclusively for providing relief to the victims of earthquake in Gujarat.

(xv) Maharashtra Chief Minister's Earthquake Relief Fund.

(xvi) University/Educational Institute of National Eminence approved by the prescribed authority.

(xvii) National foundation for communal harmony.

(xviii) Fund for technology development and application, set up by the Central Government.

(xix) National sports fund set up by the Central Government.

(xx) National Children's Fund.

(xxi) the Swachh Bharat Kosh, set up by the Central Government, other than the sum spent by the assessee in pursuance of Corporate Social Responsibility under sub-section (5) of section 135 of the Companies Act, 2013 (18 of 2013);

(xxii) the Clean Ganga Fund, set up by the Central Government, whereas such assessee is a resident and such sum is other than the sum spent by the assessee in pursuance of Corporate Social Responsibility under sub-section (5) of section 135 of the Companies Act, 2013

(xxiii) the National Fund for Control of Drug Abuse constituted under section 7A of the Narcotic Drugs and Psychotropic Substances Act, 1985 (61 of 1985);

(B) 50% Deduction without any qualifying limit:

(i) Jawaharlal Nehru Memorial Fund.

(ii) Indira Gandhi Memorial Trust.

(iii) Rajiv Gandhi Foundation.

(iv) Prime Minister's Drought Relief Fund.

(C) 100% Deduction subject to qualifying limit:

(i) Any sum to Government or any approved local authority, institution or association to be utilized for promoting family planning.

(ii) Any sum paid by the assessee, being a company, in the previous year as donation to Indian Olympic Association or to any other association established in India and notified by the Central Government for:

I. Development of infrastructure for sports and games or

II. Sponsorship of sports and games in India.

(D) 50% Deduction subject to qualifying limit:

(i) Donation to Government or any approved Local Authority, Institution or Association to be utilized for any Charitable purpose other than promoting family planning.

(ii) Any other Fund or Institution, which satisfies the conditions of Section 80G(5).

(iii) Notified Temple, Mosque, Gurudwara, Church or any other place notified by the Central Government to be of historic, as chorological or artistic importance, for renovation or repair of such place.

(iv) Any corporation established by the Central or State Government specified under Section 10(26BB) for promoting interests of the members of a minority community.

(v) Any authority constituted in India by or under any law for satisfying the need for housing accommodation or for the purpose of planning development or improvement of cities, towns and villages or for both.

Deduction in respect of Rent Paid [Section 80GG]

Section 80GG provides deduction to an individual for rent paid if in case the individual does not receive HRA exempt u/s 10(13A) or rent free accommodation from his employer. The accommodation should be occupied by the assessee for the purpose of his own residence. Further, the individual/spouse/minor child/HUF of which he or she is member does not own a residential accommodation at a place where the individual resides, performs the duties of his office or employment or carries on his or her business or profession. For the purpose of this section, the individual will give declaration in Form 10BA. The amount of deduction admissible under this Section is lower of:

– Actual rent paid less 10% of 'Adjusted Total Income'.

– 25% of such 'Adjusted Total Income'.

– Amount calculated at Rs. 5,000 p.m.

Where Adjusted Total Income means the Gross total income as reduced by long term capital gain if included in the gross total income and income referred to in section 115A to 115D and the amount of deduction under section 80C other than deduction under this section.

Deduction in respect of certain donations for Scientific Research or Rural Development [Section 80GGA]

Section 80GGA provides 100% deduction to any assessee (other than an assessee whose gross total income includes income chargeable under the head "profits and gains of business or profession") in respect of the following payments/donations:

a) Sums paid to a research association which has, as its object the undertaking of scientific research, or to a university, college or other institution to be used for scientific research where such association, university, college or institution has been approved by the prescribed authority for the purpose of Section 35(1)(ii).

b) any sum paid by the assessee in the previous year to a research association which has as its object the undertaking of research in social science or statistical research or to a University or college or other institution to be used for social science or statistical research where such association or university college or institution is for the time being approved by the prescribed authority for the purpose of Section 35(1)(iii).

c) Sums paid to an approved association or institution which has as its object the undertaking of any programme of rural development, to be used for the purposes of carrying out any programme of rural development approved for the purposes of Section 35CCA provided the assessee furnishes the certificate referred to in Section 35CCA(2).

d) Sums paid to an approved association or institution which has as its object the undertaking of any programme of rural development provided the assessee furnishes a certificate referred to in Section 35CCA(2A).

e) any sum paid by the assessee in the previous year to a public sector company or a local authority or an association or institution approved by the National Committee for carrying out any eligible project or scheme, provided the assessee furnishes a certificate referred to in Section 35AC(2)(a).

f) For the purposes of this clause, 'National Committee' means the committee constituted by the Central Government from amongst persons of eminence in public life, in accordance with the rules made under Income-tax Act, 1961 and "eligible project or scheme" means such project or scheme for promoting the social and economic welfare of, or the uplift of, the public as may be notified by Central Government on the recommendations of the National Committee.

g) Sums paid before April 1, 2002 to an approved association or institution which has as its object the undertaking of any programme of conservation of natural resources or afforestation to be used for carrying out any programme of conservation of natural resources or of afforestation approved under Section 35CCB(2).

h) Sums paid to the National Fund for Rural Development set up and notified by the Central Government for the purpose of carrying out rural development. This section also provides that where deduction under this section is claimed and allowed, deduction will not be allowed in respect of the same payment under any other provision of the Act for the same or any other assessment year.

i) any sum paid by the assessee in the previous year to the National Urban Poverty Eradication Fund set up and notified by the Central Government.

No deduction shall be allowed under this section in respect of any sum exceeding two thousand rupees unless such sum is paid by any mode other than cash. [Amendment vide Finance Act, 2020].

Deduction in respect of contributions given by Companies to Political Parties or an Electoral Trust [Section 80GGB]

Section 80GGB provides 100 % deduction for any sum contributed by an Indian Company in the previous year to any political party or to an electoral trust while computing its total income by a mode other than cash.

Deduction in respect of contributions given by any person to Political Parties or an Electoral Trust [Section 80GGC]

Section 80GGC provides 100 % deduction for any sum contributed by an assessee being any person to a political party or an electoral trust except local authority and every artificial juridical person wholly or partly funded by the Government while computing its total income by a mode other than cash.

Deduction in respect of profits and gains from industrial undertakings or enterprise engaged in infrastructure development [Section 80-IA]

Section 80IA provides a deduction to an assessee in respect of profits and gains derived from any business of:

(1) ***Infrastructure facility***: The enterprise is carrying on the business of operating any infrastructure facility which fulfills the following conditions:

(a) It is owned by an Indian company or consortium of companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act registered in India;

(b) It enters into an agreement with the Central or State Government or a local authority or any other statutory body for (i) developing, (ii) operating and maintaining, (iii) developing, operating and maintaining, a new infrastructure facility.

(c) It transfer such infrastructure facility after the period stipulated in the agreement to such Government or authority or body concerned;

(d) It starts operating and maintaining the infrastructure facility on or after 1st April, 1995.

It has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for developing a special economic zone and maintaining a new infrastructure facility.

Where an infrastructure facility is transferred after 31.3.1999 by an enterprise which has developed it to another enterprise for operating and maintaining it on its behalf, in accordance with the agreement with person mentioned in (b), the transferee will get the benefit of deduction for the unexpired period.

Explanation - For the purposes of this clause, "infrastructure facility" means:

(a) a road including toll road, a bridge or a rail system;

(b) a highway project including housing or other activities being an internal part of the highway project;

(c) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system;

(d) a port, airport, inland waterway or inland port.

W.e.f. Assessment year 2001-02, infrastructure facility shall also include water treatment system and solid waste management system.

The benefit of deduction to housing and other development activities which are an internal part of a highway project shall be allowed if the following conditions are satisfied:

(a) Such profits are transferred to a special reserve account.

(b) Such profits are utilised for highway project, excluding housing and other activities, before the expiry of three years following the year in which the amount was transferred to the reserve account.

The amount remaining unutilised shall be chargeable to tax as income of the year in which it was transferred to the reserve account.

(2) ***Telecommunication services****:* Any undertaking which has started or starts providing telecommunication services whether basic or cellular including radio-paging, domestic satellite service or network of trunking and electronic data interchange services at any time after 31.3.1995 but before 31.3.2005. Domestic Satellite Service means a satellite owned and operated by an Indian Company for providing telecommunication services.

(3) ***Industrial park****:* Any undertaking which develops a special economic zone and operates an industrial park (notified by the Central Government) after 31.3.1997 but before 1.4.2006 and in case of SEZ, it should begin on or after 1.4.2001 but before 1.4.2006.

Where an undertaking develops industrial park after 31.3.1999 and transfers the operations and maintenance of it to another undertaking, the transferee will get the benefit of deduction for the unexpired period. However, Investments made to develop industrial park has been extended from 31.3.2006 to 31.3.2011.

(4) **Generation and distribution of power:** An undertaking which:

(a) is set-up in any part of India for the generation or generation and distribution of power if it begins to generate power at any time during the period beginning on the 1st day of April, 1993 and ending on the 31st day of March 2017.

(b) starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period beginning on the 1st day of April, 1999 and ending on the 31st day of March 2017.

(c) undertakes substantial renovation and modernization of the existing network of transmission or distribution lines at any time during the period beginning on the 1st day of April, 2004 and ending on the 31st day of March, 2017.

Provided that the deduction under this section to an industrial undertaking under sub-clause (b) shall be allowed only in relation to the profits derived from laying of such network of new lines for transmission or distribution.

Quantum and period of deduction:

(1) First five assessment years - 100% of such profits.

(2) Next five assessment years - In case of companies 30% of such profits. In case of other assessees 25% of such profits.

The deduction under (4) above shall be allowed if the following conditions are satisfied:

(a) It is not formed by the splitting up, or the reconstruction, of a business already in existence;

(b) it is not formed by the transfer to a new business of machinery or plant (exceeding 20%) previously used for any purpose.

(5) **Re-construction or revival of a power generating plant**

(a) Such undertaking must be owned by an Indian Company, formed before 30.11.2005 with majority equity participation by public sector companies for the purpose of enforcing the security interest of the lenders to the company owning the power generation plant.

(i) Such Indian Company is notified before 31.12.2005 by the Central Government for the purposes of this clause and begins to generate or transmit or distribute power before 31.3.2011 (w.r.e.f 1st April 2008 by Finance Act 2009.

Option to claim deduction: The assessee, at his option, can claim deduction in any ten consecutive assessment years out of fifteen years beginning from the year in which it begins operations.

If the assessee is engaged in infrastructure facility mentioned in (b) above he can claim deduction in any ten consecutive assessment years out of twenty years instead of out of fifteen years.

Computation of Income for Deduction: For the purpose of computing the deduction at the specified percentage for the assessment year immediately succeeding the initial assessment year and any subsequent assessment year, the profits and gains will be computed as if such business were the only source of income of the assessee in all the assessment years for which the deduction at the specified percentage under this section is available.

It means if the loss or any allowance (e.g. depreciation allowance) of such business is set-off against any other income in an earlier assessment year to find out the income of the current year for deduction under this section the loss so set-off shall be deducted from the current year's income and on the balance so arrived, the deduction shall be computed.

Where goods held for the purpose of eligible business are transferred to any other business of the assessee, or vice-versa, such transfer is required to be done at the market value of such goods. If such goods are not transferred at market value on the date of transfer, then the profits and gains of such eligible business shall be recomputed as if transfer has been made at the market value of such goods, as on that date.

If in the opinion of the Assessing Officer, such recomputation presents exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit.

Market Value in relation to any goods or services, means

(i) the price that such goods or services would ordinarily fetch in the open market; or

(ii) the arm's length price as defined in clause (ii) of section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.

Where deduction to an industrial undertaking or an enterprise for profit and gains is allowed under this section for any assessment year, deduction to that extent shall not be allowed under any other provision of chapter VIA under the heading deductions in respect of certain incomes.

The deduction shall not exceed the profit and gains of such eligible business of industrial undertaking or enterprise. If the profit shown for the eligible business under this section, appears to the assessing officer as more than the ordinary profits which might be expected to arise in such eligible business, owing to some close connection with a person with whom business transactions are so arranged to yield higher profit, the assessing officer may take the amount of profits as may be reasonably derived therefrom.

Where any undertaking of an Indian company which is entitled to deduction under this section is transferred, before the expiry of the period of tax holiday, to another Indian company in a scheme of amalgamation or demerger, then the deduction will be available as follows:

(i) No deduction shall be admissible under this section to the amalgamating company/demerged company for the previous year in which amalgamation/ demerger takes place.

(ii) The amalgamated company or resulting company will be entitled to claim deduction under this section for the unexpired period of tax holiday (including for the previous year in which the amalgamation/ demerger takes place). The provisions of the section shall, as far as may be, apply to the amalgamated or resulting company as they would have applied to the amalgamating or demerged company as if the amalgamation or demerger had not taken place.

Provided that in a case where an undertaking develops an industrial park on or after the 1st day of April, 1999 or a special economic zone on or after the 1st day of April, 2001 and transfers the operation and maintenance of such industrial park or such special economic zone, as the case may be, to another undertaking (hereafter in this section referred to as the transferee undertaking), the deduction under Sub-section (1) shall be allowed to such transferee undertaking for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee undertaking.

The provisions contained in this section shall not apply to any special economic notified on or after the 1st day of April, 2005 in accordance with the scheme referred to in sub-clause (iii) of clause (c) of Sub-section (4).

Deduction in respect of profit and gains by an undertaking or an enterprise engaged in development of Special Economic Zone [Section 80-IAB]

Section 80IB provides a deduction to an assessee which develops Special Economic Zone (SEZ), notified on or after 1.4.2005 under the Special Economic Zones Act, 2005 equal to 100% of the profit and gains derived from such business for 10 consecutive assessment years, out of 15 years beginning from the year in which a SEZ has been notified by the central government, at option of the assessee. Such assesse would not be eligible to claim deduction u/s 80-IA.

Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings [Section 80-IB]

Section 80IB provides deduction to an assessee whose gross total income includes profits and gains derived from the following business. The deduction equal to such percentage and for such number of assessment years as given below:

Deduction under Section 80-IB is available to different industrial undertakings as follows:

(i) business of an industrial undertaking

(ii) operation of ship

(iii) Hotels

(iv) Scientific research

(v) production of mineral oil

(vi) Developing and building housing projects.

(vii) Cold Chain facility for agriculture produce..

(viii) Multiplex theatres.

(ix) Convention Centre

(x) Hospital in Rural area.

(xi) Hospital anywhere in India.

An industrial undertaking should be mainly engaged in the business of construction of ships or in the manufacture or processing of goods or in mining. Construction of dam, bridge, road or building cannot be characterised as manufacture or production of articles.

The Industrial undertaking claiming deduction under this section, however need to fulfill the following conditions:

1. It is not formed by splitting up, or the reconstruction, of a business already in existence. This condition is not violated, where the business is re-established, reconstructed or revived by the same assessee after the business of any industrial undertaking carried on by him in India is discontinued due to extensive damage to or destruction of, any building, machinery, plant or furniture owned by the assessee (and used for the purpose of such business) as a direct result of (i) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature, or (ii) riot or civil disturbance, or (iii) accidental fire or explosion, or (iv) action by any enemy or action taken in combating an enemy (whether with or without a declaration of war).
2. It is not formed by the transfer to a new business of machinery or plant previously used for any purpose. However, plant and machinery, already used for any purpose, can be transferred to the new industrial undertaking, provided value of such plant and machinery does not exceed 20% of the total value of plant and machinery of the new industrial undertaking.
3. It manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India. However, a small scale industrial undertaking or an industrial undertaking located in an industrially backward state specified in the Eighth Schedule shall be eligible for the deductions, even if it manufactures or produces any article/thing which is specified in the Eleventh Schedule.
4. The undertaking employs ten or more workers in a manufacturing process carried on with the aid of power or employs twenty or more workers in a manufacturing process carried on without the aid of power.

I. The amount of deduction to industrial undertaking shall be as follows:

Sl. No.	Industrial Undertaking	Period within which production should start	Period of deduction (commencing from initial assessment year)	%age of profit eligible for deduction
(1)	(2)	(3)	(4)	(5)
(i)	Any industrial undertaking Owned by a company Owned by a co-operative society	1.4.1991 to 31.3.1995* (or any further notified period)	Ten consecutive assessment year Twelve consecutive assessment year	30% 25%
	Any other assessee		Ten consecutive assessment year	25%

*However where it is an industrial undertaking being a small scale industrial undertaking, it begins to manufacture or produce article or things or to operate its cold storage plant (other than those specified below) the period shall be construed as the period beginning on 1.4.95 and ending on 31.3.2002.			
(ii) Industrial undertaking set up in an industrial backward state specified in Eighth Schedule*			
Owned by a company	1.4.1993 to 31.3.2002 (extended to 31.3.2012 only in J&K)	First five years	100%
		Next five years	30%
Owned by a co-operative society		First five years	100%
		Next seven years	25%
Any other assessee		First five years	100%
		Next five years	25%
*However in case of notified industries in the North-Eastern Region, the amount of deduction shall be hundred percent of profits for a period of ten assessment years.			
(iii) Industrial undertaking located in notified industrially backward districts of Category A			
Owned by a company	1.10.1994 to 31.3.2004	First five years	100%
		Next five years	30%
Owned by a co-operative society		First five years	100%
		Next seven years	25%
Any other assessee		First five years	100%
		Next five years	25%
(iv) Industrial undertaking located in notified industrially backward districts of Category B			
Owned by a company	1.10.1994 to 31.3.2004	First three years	100%
		Next five years	30%
Owned by a co-operative society		First three years	100%
		Next nine years	25%
Any other assessee		First three years	100%
		Next five years	25%

I. Deduction under this section shall also be available in the case of the business of a ship @ 30% of the *profits and gains derived from such ship for a period of ten consecutive assessment years including the initial assessment year.*

However, to claim deduction it is required that the ship -

(i) is owned by an Indian company and is wholly used for the purposes of the business carried on by it.

(ii) was not, previous to the date of its acquisition by the Indian company, owned or used in Indian territorial waters by a person resident in India.

(iii) is brought into use by the Indian company at any time during the period beginning on the 1.4.1991 and ending on 31.3.1995.

Sl. No.	Type of Hotel	Period within which functioning should start	Period of deduction (commencing from initial assessment year)	Profit eligible for deduction
(i)	Hotel located in a hilly area or a rural area or a place of pilgrimage or any other place notified by Central Government having regard to the need for development of infrastructure for tourism in any place and other relevant consideration.	1.4.1990 to 31.3.1994	Ten consecutive years	50%
(ii)	Hotel located in a hilly area or a rural area or a place of pilgrimage or any other place notified by Central Government. However, such hotel should not be located within Municipal Jurisdiction of Calcutta, Chennai, Delhi and Mumbai. Such hotel should however be approved by the prescribed authority.	1.4.1997 to 31.3.2001	Ten consecutive years	50%
(iii)	Hotel located in any place other than those mentioned in (i) above	1.4.1991 to 31.3.1995	Ten consecutive years	30%
(iv)	Hotel located in any other place other than those mentioned in (i) above. However, such hotel should not be located within Municipal Jurisdiction of Calcutta, Chennai, Delhi and Mumbai.	1.4.1997 to 31.3.2001	Ten consecutive years	30%

However, the following conditions need to be satisfied by a hotel in order to claim deduction:

(i) The business of the hotel is not formed by the splitting up; or the reconstruction of a business already in existence or by the transfer to a new business of a building previously used as a hotel or of any machinery or plant previously used for any purpose.

(ii) The business of hotel is owned and carried on by a company registered in India with a paid up capital of not less than Rs. 5 lakhs.

(iii) The hotel is for the time being approved by the prescribed authority. Any hotel approved before 1.4.99 shall be deemed to have been approved for the purpose of this section.

IV. Deduction in the case of any company carrying on scientific research and development is *available @ 100% of the profits and gains of such business for a period of five assessment years beginning from the initial assessment year. However, to claim deduction under this section, it is required that such a company -*

(i) is registered in India.

(ii) has the main object of scientific and industrial research and development.

(iii) is for the time being approved by the prescribed authority at any time before 1.4.1999.

Further, the amount of deduction in the case of any company carrying on scientific research and development shall be hundred per cent of the profits and gains of such business for a period of ten consecutive assessment years, beginning from the initial assessment year, if such company -

(i) is registered in India;

(ii) has its main object the scientific and industrial research and development;

(iii) is for the time being approved by the prescribed authority at any time after the 31st day of March, 2000, but before the 1st day of April, 2007;

(iv) Fulfills such other conditions as may be prescribed.

IV. ***Industrial undertaking producing or refining mineral oil in the North Eastern Region or in any part of India:***

The amount of deduction to an undertaking shall be 100% of the profits for a period of seven consecutive assessment years, including the initial assessment year, if such undertaking fulfils any of the following conditions:

(i) is located in North-Eastern Region and has begun or begins commercial production of mineral oil before the 1st day of April, 1997;

(ii) is located in any part of India and has begun or begins commercial production of mineral oil on or after the 1st day of April, 1997;

Provided that the provisions of this clause shall not apply to blocks licensed under a contract awarded after the 31st day of March, 2011 under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated the 10th February, 1999 or in pursuance of any law for the time being in force or by the Central or a State Government in any other manner;

(iii) is engaged in refining of mineral oil and begins such refining on or after the 1st day of October, 1998 but not later than 31st day of March 2012..(w.e.f Assessment year 2001-02) (the words "but not later than the 31st day of March, 2012" shall be inserted w.r.e.f 1st April 2009);

(iv) is engaged in commercial production of natural gas in blocks licensed under the VIII Round of bidding for award of exploration contracts (hereafter referred to as "NELP-VIII") under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG. DO.VL, dated 10th February, 1999 and begins commercial production of natural gas on or after the 1st day of April, 2009.

(v) is engaged in commercial production of natural gas in blocks licensed under the IV round if bidding for award of exploration contracts for Caol Bed Methane blocks and begins commercial production of natural gas on or after the 1st day of April 2009.

Explanation: All blocks licensed under a single contract, which has been awarded under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February, 1999 or has been awarded in pursuance of any law for the time being in force or has been awarded by Central or a State Government in any other manner, shall be treated as a single undertaking.

V. ***Deduction of 100% of the profits of an undertaking engaged in developing and building housing projects*** **approved before the 31st day of March, 2008 by a local authority provided** that:

(a) such undertaking has commenced or commences development and construction of the housing project on or after 1st day of October, 1998 and completes such construction -

(i) in case where a housing project has been approved by the local authority before the 1st day of April, 2004, on or before 31st day of March, 2008;

(ii) in a case where a housing project has been or, is approved by the local authority on or after the

1st day of April, 2004 but not later than the 31st March 2005, within four years from the end of financial year in which the housing project is approved by the local authority.

(iii) In a case where a housing project has been approved by the local authority on or after the 1st day of April, 2005, within five years from the end of the financial year in which the housing project is approved by the local authority.

(b) the project is of the size of a plot of land which has minimum area of one acre;

(c) the residential unit has a maximum built-up area of one thousand square feet where such residential unit is situated within the cities of Delhi or Mumbai or within twenty-five kilometers from the municipal limits of these cities and one thousand and five hundred square feet at any other place; and

(d) the build-up area of the shops and other commercial establishments included in the housing project does not exceed three of the aggregate built-up area of the housing project or five thousand square feet whichever is higher.

(e) not more than one residential unit in the housing project is allotted to any person not being an individual; and

(f) in a case where a residential unit in the housing project is allotted to a person being an individual, no other residential unit in such housing project is allotted to any of the following persons,

(i) the spouse or the minor children of such individual,

(ii) the Hindu undivided family in which such individual is the karta,

(iii) any person representing such individual, the spouse or the minor children of such individual or the Hindu undivided family in which such individual is the karta.

VI. ***Hundred percent of the profits and gains derived by an industrial undertaking from the business of setting up and operating a cold chain facility*** **for agricultural produce shall be deductible:**

Industrial Undertaking	Period within which production should start	Period of deduction (commencing from initial assessment year)	%age of profit eligible for deduction
For a company	1.4.1999 to 31.3.2003	First five years	100%
		Next five years	30%
For a co-operative society		First five years	100%
		Next seven years	25%
Any other assessee		First five years	100%
		Next five years	25%

Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger -

(a) no deduction shall be admissible under this section to the amalgamating or the demerged company for the previous year in which the amalgamation or the demerger takes place; and

(b) the provisions of this section shall as far as may be apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the amalgamation or demerger had not taken place.

Further, the amount of deduction in a case of an undertaking deriving profit from the integrated business of handling, storage and transportation of foodgrains, shall be hundred per cent of the profits and gains derived from such undertaking for five assessment years beginning with the initial assessment year and thereafter, twenty-five per cent (or thirty per cent, where the assessee is a company) of the profits and gains derived from the operation of such business in a manner that the total period of deduction does not exceed ten consecutive assessment years and subject to fulfillment of the condition that it begins to operate such business on or after the 1st day of April, 2001.

In the case of an undertaking engaged in the integrated business of handling, storage and transportation of foodgrains, means the assessment year relevant to the previous year in which the undertaking begins such business.

VII. ***Deduction in the case of any multiplex theatre***

Fifty per cent of the profits and gains derived, from the business of building, owning and operating a multiplex theatre, for a period of five consecutive years beginning from the initial assessment year in any place. Multiplex theatre should not be located at a place within the municipal jurisdiction of Kolkata, Chennai, Delhi or Mumbai. Such multiplex theatre should be constructed at any time during the period beginning on the 1st day of April, 2002 and ending on the 31st day of March, 2005. The business should not be formed by splitting up or the reconstruction, of a business or any plant and machinery previously used for any purpose, and assessee should furnish alongwith the return of income, the report of an audit in Form No. 10CCBA.

VIII. **Deduction in the case of any convention centre:**

Fifty per cent of the profits and gains derived, by the assessee from the business of building, owning and operating a convention centre, for a period of five consecutive years beginning form the initial assessment year. Such convention centre is constructed at any time during the period beginning on the 1st day of April, 2002 and ending on the 31st day of March, 2005. The business should not be formed by splitting up or the re-construction of a business or any plant and machinery previously used for any purpose.

IX. ***100% deduction in case of an undertaking deriving profits from the business of operating and maintaining a hospital in a rural area*** for a period of five consecutive assessment years beginning with the initial assessment year if (w.e.f. A.Y. 2005-06) -

(i) such hospital is constructed at any time during the period from 1.10.2004 to 31.3.2008.

(ii) the hospital has atleast one hundred beds for patients.

(iii) construction of hospital is in accordance with the regulations, for the time being in force, of the local authority; and

(iv) the assessee furnishes alongwith the return of income the report of audit in such form and containing such particulars as may be prescribed and duly signed and verified by a chartered accountant that the deduction has been correctly claimed.

X. ***The amount of deduction in the case of an undertaking deriving profits from the business of operating and maintaining a hospital located anywhere in India,*** other than the excluded area, shall be hundred per cent of the profits and gains derived from such business for a period of five consecutive assessment years, beginning with the initial assessment year, if -

(i) the hospital is constructed and has started or starts functioning at any time during the period beginning on the 1st day of April, 2008 and ending on the 31st day of March, 2013;

(ii) the hospital has at least one hundred beds for patients;

(iii) the construction of the hospital is in accordance with the regulations or bye-laws of the local authority; and

(iv) the assessee furnishes along with the return of income, a report of audit in such form and containing such particulars, as may be prescribed, and duly signed and verified by an accountant, as defined in the Explanation to sub-section (2) of section 288, certifying that the deduction has been correctly claimed.

ILLUSTRATION

1. Deduction under Section 80-IB is available to:

(a) Charitable Trust

(b) Tour and Travels

(c) Industrial Research

(d) Convention Centre

2. Which of the following gets 50% deduction on the profits and gains derived from its business for a period of five consecutive years beginning from the initial assessment year in any place?

(a) Multiplex Theatre

(b) Convention Centre

(c) Hospital

(d) Charitable Trust

Deduction in respect of eligible Start-Up [Section 80IAC]

Section 80IAC provides a deduction to an assessee who is a Company or LLP incorporated after 31st March, 2016 but before 31st March, 2021, engaged in an eligible business (means a business carried out by an eligible start up engaged in innovation, development or improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation) , whose gross total income includes any profits and gains derived from eligible start up equal to 100% of the profit and gains derived from such business for 3 consecutive assessment years, at the option of the assessee out of ten years beginning from the year in which the eligible start-up is incorporated. The Eligible Start-up should not be formed by splitting up, or the reconstruction, of a business already in existence and should not formed by the transfer to a new business of machinery or plant previously used for any purpose. Annual turnover of Company or LLP should not exceed Rs 100 crore during the previous year in which such deduction is claimed.

Deductions in respect of profits and gains from Housing Projects [Section 80IBA]

Section 80IBA provides deduction to an assessee whose gross total income includes any profits and gains derived from the business of developing and building housing projects, subject to the provisions of this section, of an amount equal to 100% of the profits and gains derived from such business.

A housing project shall be a project which fulfils the following conditions:

(a) the project is approved by the competent authority after the 1st day of June, 2016, but on or before the 31st day of March, 2021 [Finance Act, 2020];

(b) the project is completed within a period of 5 years from the date of approval by the competent authority:

(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

(d) the project is on a plot of land measuring not less than one thousand square metres, where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai ; or two thousand square metres, where the project is located in any other place;

(e) the project is the only housing project on the plot of land as specified in clause (d);

(f) the carpet area of the residential unit comprised in the housing project does not exceed, thirty square metres, where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai ; or sixty square metres, where the project is located in any other place

(g) 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;

(h) the project utilises not less than ninety per cent 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, where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai, or not less than eighty per cent of such floor area ratio where such project is located in any place other than the place referred to in sub-clause (i); and

(i) the assessee maintains separate books of account in respect of the housing project.

'Provided that for the projects approved on or after the 1st day of September, 2019, the provisions of this sub-section shall have effect as if for clauses (d) to (i), the following clauses had been substituted, namely [Inserted by Finance Act, 2019]

(d) the project is on a plot of land measuring not less than one thousand square metres, where such project is located 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); or two thousand square metres, where such project is located in any other place;

(e) the project is the only housing project on the plot of land as specified in clause (d);

(f) the carpet area of the residential unit comprised in the housing project does not exceed sixty square metres, where such project is located 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); or ninety square metres, where such project is located in any other place;

(g) the stamp duty value of a residential unit in the housing project does not exceed forty-five lakh rupees;

(h) 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;

(i) the project utilises, not less than ninety percent 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, where such project is located 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); or not less than eighty percent of such floor area ratio where such project is located in any place other than the place referred to in sub-clause (I); and

(j) the assessee maintains separate books of account in respect of the housing project."

Special provisions in respect of certain undertakings or enterprises in certain special category States [Section 80-IC]

Section 80IC provides deduction from such profits and gains as specified in Sub-section (3) to an assessee whose gross total income includes any profits and gains derived by an undertaking or an enterprise from any business referred to in Sub-section (2), in accordance with and subject to the provisions of this section.

(1) This section applies to any undertaking or enterprise, -

(a) which has begun or begins to manufacture or produce any article or thing, not being any article or thing specified in the Thirteenth Schedule, and undertakes substantial expansion during the period beginning –

(i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in any specified areas, in the State of Sikkim; or

(ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in any specified areas, in the State of Himachal Pradesh or the State of Uttaranchal; or

(iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any specified areas, in any of the North-Eastern States;

Specified area means any Export Processing Zone or Integral Infrastructure Development Centre or Industrial Growth Centre or Industrial Park or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the central government in this regard.

(b) which has begun or begins to manufacture or produce any article or thing, specified in the Fourteenth Schedule or commences any operation specified in that Schedule, and undertakes substantial expansion during the period beginning -

(i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in the State of Sikkim; or

(ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in the State of Himachal Pradesh or the State of Uttaranchal; or

(iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any of the NorthEastern States.

(2) The deduction referred to in Sub-section (1) shall be -

(i) in the case of any undertaking or enterprise referred to in Sub-clauses (i) and (iii) of Clause (a) or Subclause (i) and (iii) of Clause (b), of Sub-section (2), 100% of such profits and gains for ten assessment years commencing with the initial assessment year;

(ii) in the case of any undertaking or enterprise referred to in Sub-clause (ii) of Clause (a) or Sub-clause (ii) of Clause (b), of Sub-section (2), 100% of such profits and gains for five assessment years commencing with the initial assessment year and thereafter, 25% (or 30% where the assessee is a company) of the profits and gains.

(3) This section applies to any undertaking or enterprise which fulfils all the following conditions, namely:

(i) it is not formed by splitting up, or the reconstruction, of a business already in existence;

Provided that this condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in Section 33B, in the circumstances and within the period specified in that section;

(ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Explanation. - The provisions of Explanations 1 and 2 to Sub-section (3) of Section 80-IA shall apply for the purposes of Clause (ii) of this sub-section as they apply for the purposes of Clause (ii) of that sub-section.

(4) Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee, no deduction shall be allowed under any other section contained in Chapter VIA or in Section 10A or Section 10B, in relation to the profits and gains of the undertaking or enterprise.

(5) Notwithstanding anything contained in this Act, no deduction shall be allowed to any undertaking or enterprise under this section, where the total period of deduction inclusive of the period of deduction under this section, or under the second proviso to Sub-section (4) of Section 80-IB or under Section 10C, as the case may be, exceeds ten assessment years.

(6) The provisions contained in Sub-section (5) and Sub-sections (7) to (12) of Section 80-IA shall, so far as may be, apply to the eligible undertaking or enterprise under this section.

(7) For the purposes of this section, -

(i) "Industrial Area" means such areas, which the Board, may by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(ii) "Industrial Estate" means such estates, which the Board may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(iii) "Industrial Growth Centre" means such centres, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(iv) "Industrial Park" means such parks, which the Board, may by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(v) "initial assessment year" means the assessment year relevant to the previous year in which the undertaking or the enterprise begins to manufacture or produce articles or things, or commences operation or completes substantial expansion;

(vi) "Integrated Infrastructure Development Centre" means such centres, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;

(vii) "North-Eastern States" means the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura;

(viii) "Software Technology Park" means any park set up in accordance with the Software Technology Park scheme notified by the Government of India in the Ministry of Commerce and Industry;

(ix) "substantial expansion" means increase in the investment in the plant and machinery by at least fifty per cent of the book value of plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken;

(x) "Theme Park" means such parks, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government.

Deduction in respect of profits and gains from the Business of collecting and processing Bio-Degradable Waste [Section 80-JJA]

Section 80 JJA provides deduction to an assessee whose gross total income includes any profits and gains derived from the business of collecting and processing or treating of bio-degradable waste for generating power, or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas, making pellets or briquette for fuel or organic manure, of an amount equal to the whole of such profit and gains for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which such business commences.

Deduction in respect of Employment of New Workmen [Section 80-JJAA]

New provisions of Section 80JJAA w.e.f. AY 2017-18 are as under:-

Conditions

1. Assessee has income from business and is subject to tax audit u/s 44AB.
2. The business of assessee is not formed by splitting up , or the reconstruction , of an existing business (other than establishment, reconstruction or revival of business under section 33B)
3. Business is not acquired by the assessee by way of transfer from any other person or as a result of business reorganisation.

Quantum of Deduction: 30% of additional employee cost is allowed as deduction for 3 assessment years starting from the assessment year relevant to assessment year in which such additional employee cost is incurred. Books of accounts should be audited and audit report should be submitted with return of income. Deduction should be claimed in return of income otherwise it is not allowed.

Notes:

1. 'Additional employee cost' means total emoluments paid or payable to additional employees employed during the previous year.

2. In case of existing business, additional employee cost shall be nil, if-

   a) There is no increase in number of employees from the total number of employees employed on the last day of preceding year.

   b) If emoluments are paid otherwise than an account payee cheque or account payee bank draft or by use of ECS, through bank account or through such other electronic mode as prescribed [Inserted by Finance (No.2) Act, 2019].

3. In the first year of a new business, emoluments paid or payable to employees employed during that previous year shall be deemed to be the additional employee cost.

4. " Additional employees" does not include;

   a) An employee whose total emoluments are more than 25000 per month; or

   b) An employee whose entire contribution is paid by the Government under the Employees Pension Scheme notified in accordance with the provisions of Employees Provident fund and Miscellaneous provisions Act, 1952.

   c) An employee employed for a period of less than 240 days(**150 days in case of employee working in apparel, shoes or leather industry**) during the previous year; or

   d) An employee who does not participate in RPF.

5. "Emoluments" does not include employer's contribution to employees pension/provident fund etc. And also it does not include terminal benefits such as leave encashment, retrenchment compensation, gratuity etc.

6. Where an employee is employed during the previous year for a period of 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 and the provisions of this section shall apply accordingly.

7. Provisions of old 80JJAA shall apply to an assessee who is eligible to claim any deduction under section 80JJAA for the assessment year 2016-17(or any earlier assessment year).

Note: The deduction under this section is not available unless the assessee furnishes report of the accountant, as defined in the Explanation below sub-section (2) of section 288, before the specified date referred to in section 44AB giving such particulars in the report as may be prescribed [Amendment vide Finance Act, 2020]

Deduction in respect of certain incomes of Offshore Banking Units [Section 80LA]

(1) Where the gross total income of an assessee, being a scheduled bank, or, any bank incorporated by or under the laws of a country outside India; and having an Offshore Banking Unit in a Special Economic Zone, includes any income referred to in sub-section (2), there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such income, of an amount equal to—

(a) 100% of such income for five consecutive assessment years beginning with the assessment year relevant to the previous year in which the permission, under clause (a) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 or permission or registration under the Securities and Exchange Board of India Act, 1992 or any other relevant law was obtained, and thereafter;

(b) 5% of such income for five consecutive assessment years.

(1A) Where the gross total income of an assessee, being a Unit of an International Financial Services Centre, includes any income referred to in sub-section (2), there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such income, of an amount equal to one hundred per cent. of such income for any ten consecutive assessment years, at the option of the assessee, out of fifteen years, beginning with the assessment year relevant to the previous year in which the permission, under clause (a) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 or permission or registration under the Securities and Exchange Board of India Act, 1992 or any other relevant law was obtained.

Conditions to be satisfied: No deduction under this section shall be allowed unless the assessee furnishes along with the return of income, -

(i) in the prescribed form (Form No. 10CCF), i.e., the report of a accountant as defined in the Explanation below Sub-section (2) of Section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this section; and

(ii) a copy of the permission obtained under Clause (a) of Sub-section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949), in case of a offshore Banking Unit.

Explanation - For the purposes of this section:

(a) "convertible foreign exchange" shall have the same meaning assigned to it in clause (a) of the Explanation below Sub-section (4C) of Section 80HHC;

(b) "Offshore Banking Unit" means a branch of a bank in India located in the special economic zone and has obtained the permission under Clause (a) of Sub-section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949);

(c) "scheduled bank" shall have the same meaning assigned to it in Clause (e) of Section 2 of the Reserve Bank of India Act, 1934 (2 of 1934);

(d) "special economic zone" shall have the same meaning assigned to it in Clause (viii) of the Explanation 2 to Section 10A."

Deduction in respect of certain inter-corporate dividends [Section 80M]

Where the gross total income of a domestic company in any previous year includes any income by way of dividends from any other domestic company or a foreign company or a business trust, there shall, in accordance with and subject to the provisions of this section, be allowed in computing the total income of such domestic company, a deduction of an amount equal to so much of the amount of income by way of dividends received from such other domestic company or foreign company or business trust as does not exceed the amount of dividend distributed by it on or before the due date.

Where any deduction, in respect of the amount of dividend distributed by the domestic company, has been allowed under sub-section (1) in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.

Explanation: For the purposes of this section, the expression "due date" means the date one month prior to the date for furnishing the return of income under sub-section (1) of section 139. [Inserted vide Finance Act, 2020]

Deduction in respect of Income of Co-Operative Societies [Section 80P]

Section 80P provides deduction to cooperative societies in respect of following incomes, which are included in gross total income:

A. 100% of the profits of a primary society engaged in supplying milk, oilseeds, fruits or vegetables raised or grown by its members to

   – The government or a local authority; or

   – A government company or a statutory corporation; or

   – A federal co-operative society, engaged in the business of supplying the above-said products.

B. 100% of the profits of co-operative society engaged in any one of the following activities:

   – Carrying on the business of banking or providing credit facilities to its member, or

   – A cottage industry, or

   – The marketing of agricultural produce grown by its members, or

   – The purchase of agricultural implements for the purpose of supplying them to its members, or

   – The processing, without the aid of power, of agricultural produce of its members, or

   – The collective disposal of the labour of its member, or

   – Fishing or allied activities for the purpose of supplying them to its members.

   Provided, in the case of last two types of co-operative societies, the deduction, is available subject to the condition that the rules and bye-laws of the society restrict the voting rights to the members like, State Government, Co-operative Credit Society which provide financial assistance to the society and individual, who contributes their labours.

   W.e.f. Assessment Year 2007-08 this exemption is not be available to co-operative banks other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

C. Profits and gains of co-operative society other than those specified in A and B above is exempt up to the specified limits:

   – is case of a consumer co-operative society - Rs. 1,00,000

   –- is any other case - Rs. 50,000

D. All profits by way of interest or dividend from its investment with any other co-operative society.

E. 100% of income or profit of a Co-operative Society from the letting of godowns or warehouse for storage, processing or facilitating the marketing of commodities.

F. A co-operative society, not being a housing society or an urban consumers society or a society carrying on transport business or a society engaged in the performance of any manufacturing operation with the aid of power, where the gross total income does not exceeds Rs. 20,000. The amount of any income by way of interest on securities or any income from house property chargeable under Section 22 will also be allowed as deduction.

Deduction from income of Farm Producer Company [Section 80PA]

Deduction is allowed to a Producer company from its gross total income if following conditions are satisfied;

1) Producer Company is having a total turnover of less 100 crore rupees in during the previous year.
2) Its gross total income includes any profits and gains derived from eligible business.
3) Deduction is available in respect of profits of such eligible business from PY 2018-19 to PY 2024-25

Deduction:

A deduction of an amount equal to one hundred per cent. of the profits and gains attributable to such business is allowed.

If any deduction is available and availed in respect of such profit under any other section of chapter VI-A, then only the profit after allowing deduction under such other sections is eligible for deduction under this section.

Explanation. – For the purposes of this section, –

(*i*) "eligible business" means –

  (*a*) the marketing of agricultural produce grown by the members; or

  (*b*) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to the members; or

  (*c*) the processing of the agricultural produce of the members;

(*ii*) "Member" shall have the meaning assigned to it in clause (*d*) of section 581A of the Companies Act, 1956;

(*iii*) "Producer Company" shall have the meaning assigned to it in clause (*l*) of section 581A of the Companies Act, 1956.

Deduction in respect of Royalty Income, etc., of authors of certain books other than text books [Section 80QQB]

Section 80 QQB provides deduction to a resident individual who is an author or a joint author of a book whose income includes income derived from such profession, received either as a lump sum consideration for the assignment or grant of any of his interests in the copyright of any book or royalty of books other than text books. The amount of deduction is the lower of eligible income or Rs. 3, 00,000. Eligible income (before deducting expenditure incurred) is lower of

1. Lump sum consideration for the assignment or grant
2. Royalty not exceeding 15%
3. If such income is earned outside India, the part of the income brought to India in convertible foreign exchange within 6 months from the end of the previous year or the extended period by the RBI will be considered.

Books exclude brochures, diaries, guides, journals, magazines, newspapers, pamphlets, text books for schools, tracts, commentaries or any such publication whatever name may be. No deduction under this section shall be allowed unless an assessee furnishes a certificate in the prescribed form 10CCD/10H.

Deduction in respect of Royalty on Patents [Section 80RRB]

Section 80RRB provides deduction to resident individual, a patentee who is in receipt of income by way of royalty in respect of a patent registered on or after the 1st day of April, 2003 under the Patents Act, 1970, and his gross total income of the previous year includes royalty, subject to the provisions of this section. 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. The amount of deduction is lower of 100% of such income or Rs. 300,000. In case, any such income is earned from any sources outside India, so much of the income, shall be taken into account for the purpose of this section as is brought into India by, or on behalf of, the assessee in convertible foreign exchange within a period of six months from the end of the previous year in which such income is earned or within such further period as the competent authority may allow in this behalf.

Provided that where a compulsory licence is granted in respect of any patent under the Patent Act, 1970, the income by way of royalty for the purpose of allowing deduction under this section shall not exceed the amount of royalty under the terms and conditions of a licence settled by the Controller under that Act:

No deduction under this section shall be allowed unless the assessee furnishes a certificate in the prescribed form (Form No. 10CCD), duly signed by the prescribed authority, along with the return of income setting forth such particulars as may be prescribed.

No deduction under this section shall be allowed in respect of any income earned from any source outside India, unless the assessee furnishes a certificate in the prescribed form (Form No. 10H), from the authority or authorities, as may be prescribed, along with the return of income.

Explanation. - For the purposes of this section, -

(a) "Controller" shall have the meaning assigned to it in clause (b) of Sub-section (1) of Section 2 of the Patents Act, 1970;

(b) "lump sum" includes an advance payment on account of such royalties which is not returnable;

(c) "patent" means a patent (including a patent of addition) granted under the Patents Act, 1970;

(d) "patentee" means the person, being the true and first inventor of the invention, whose name is entered on the patent register as the patentee, in accordance with the Patents Act, 1970, and includes every such person, being the true and first inventor of the invention, where more than one person is registered as patentee under that Act in respect of that patent;

(e) "patent of addition" shall have the meaning assigned to it in clause (q) of Sub-section (1) of Section 2 of the Patents Act, 1970;

(f) "patented article" and "patented process" shall have the meanings respectively assigned to them in clause (o) of Sub-section (1) of Section 2 of the Patents Act, 1970;

(g) "royalty", in respect of a patent, means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains" or consideration for sale of product manufactured with the use of patented process or of the patented article for commercial use) for -

   (i) the transfer of all or any rights (including the granting of a licence) in respect of a patent; or

   (ii) the imparting of any information concerning the working of, or the use of, a patent; or

   (iii) the use of any patent; or

   (iv) the rendering of any services in connection with the activities referred to in Sub-clauses (i) to (iii);

(h) "true and first inventor" shall have the meaning assigned to it in Clause (y) of Sub-section (1) of Section 2 of the Patents Act, 1970.

Deduction in respect of interest on deposits in Savings Account [Section 80TTA]

Section 80TTA provides deduction to an assessee (other than referred to section 80TTB) individual or a Hindu undivided family whose gross total income includes any income by way of interest on deposits (not being time deposits) in a savings account with -

(a) a banking company to which the Banking Regulation Act, 1949 (10 of 1949), applies (including any bank or banking institution referred to in section 51 of that Act);

(b) a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank); or

(c) a Post Office as defined in clause (k) of section 2 of the Indian Post Office Act, 1898 (6 of 1898)

The maximum amount of deduction is Rs. 10,000.

Further, where the income referred to in this section is derived from any deposit in a savings account held by, or on behalf of, a firm, an association of persons or a body of individuals, no deduction shall be allowed under this section in respect of such income in computing the total income of any partner of the firm or any member of the association or any individual of the body.

For the purposes of this section - "Time deposits" means the deposits repayable on expiry of fixed periods.

Note: Under Section 10(15) (i), post office savings bank interest is exempt up to Rs. 3,500.

Deduction in respect of Interest income to senior citizen [Section80TTB]

Where the gross total income of an assessee, being a senior citizen, includes any income by way of interest on deposits 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 as defined in clause (*k*) of section 2 of the Indian Post Office Act, 1898

Then, least of the following shall be allowed as deduction:-

1) aggregate amount of interest in (a), (b), (c) above, or

2) Rs. 50,000.

Where the income such interest income is derived from any deposit held by, or on behalf of, a firm, an association of persons or a body of individuals, no deduction shall be allowed under this section in respect of such income in computing the total income of any partner of the firm or any member of the association or any individual of the body.

Also no deduction shall be allowed to such senior citizen under section 80TTA who have availed deduction under this section.

Deduction in case of a Person with Disability [Section 80U]

Section 80U provides deduction to a resident individual who suffers from 40% or more of any of the disabilities, namely, blindness, low vision, leprosy-cured, hearing impairment, locomotor disability, mental retardation and mental illness.

The amount of deduction is Rs. 75,000 (flat in case of disability) and Rs. 1, 25,000 (flat in case of severe disability, being disability of at least 80%). To claim deduction under this section, a certificate issued by the medical authority in the form and manner, as may be prescribed, to be a person with disability is required to be furnished along with the return of income under Section 139, in respect of the assessment year for which the deduction is claimed.

Provided that where the condition of disability requires reassessment of its extent after a period stipulated in the aforesaid certificate, no deduction under this section shall be allowed for any assessment year relating to any previous year beginning after the expiry of the previous year during which the aforesaid certificate of disability had expired, unless a new certificate is obtained from the medical authority in the form and manner, as may be prescribed, and a copy thereof is furnished along with the return of income under Section 139.

Explanation - For the purposes of this section, -

(a) "disability" shall have the meaning assigned to it in clause (i) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 and includes "autism", "cerebral palsy" and "multiple disabilities" referred to in clauses (a), (c) and (h) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999;

(b) "medical authority" means the medical authority as referred to in clause (p) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995, or such other medical authority as may, by notification, be specified by the Central Government for certifying "autism", "cerebral palsy", "multiple disabilities", "person with disability" and "severe disability" referred to in clauses (a), (c), (h), (q) and (o) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999;

(c) "person with disability" means a person referred to in clause (t) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995, or clause (j) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999;

(d) "Person with severe disability" means:

   (i) a person with eighty per cent or more of one or more disabilities, as referred to in Sub-section (4) of Section 56 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995; or

   (ii) a person with severe disability referred to in clause (o) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999.

IV. REBATE [SECTION 87A]

REBATE OF INCOME-TAX IN CASE OF CERTAIN INDIVIDUALS [SECTION 87A]

Section 87A provides rebate of income tax to resident individual, whose total income does not exceed ₹ 5,00,000. The amount of rebate is ₹ 12,500 or 100% of income tax whichever is less. It is deductible from income tax before calculating health and education cess. [Amendment by Finance (No.2) Act, 2019]

V. RELIEF [SECTION 89]

RELIEF WHEN SALARY IS PAID IN ARREARS OR IN ADVANCE [SECTION 89]

Section 89 provides relief to an individual who receives any portion of his salary in arrears or in advance or receives profit in lieu of salary during the previous year. The assessee may apply to the Assessing Officer who is been empowered to grant relief in appropriate cases in accordance with Rule 21AA of the Income-tax Rules, 1962. However, no such relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or in the case of a public sector company referred to in sub clause (i) of clause (10C) of section 10, a scheme of voluntary separation, if an exemption in respect of any amount received or receivable on such voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee under clause (10C) of section 10 in respect of such, or any other, assessment year.

Relief under Section 89 is provided in the following cases :

- in respect of salary received in advance or in arrears;
- in respect of arrears of family pension;
- in respect of gratuity;
- in respect of compensation on termination of employment;
- in respect of commutation of pension;
- in respect of other payment.

Such relief shall be computed as per rule 21A/21AA in the manner given below:

1. Compute tax liability for the previous year in which the arrear or advance of salary has been received including the amount of such arrear or advance.
2. Compute tax liability for the previous year in which the arrear or advance has been received excluding such arrear or advance.
3. Tax at step no. 1 minus tax at step no. 2 shall be the tax on such arrear or advance.
4. Compute tax liability of the previous year to which the arrear or advance relates including such arrear or advance
5. Compute tax liability of the previous year to which arrear or advance relates excluding such arrear or advance.
6. Tax at step no. 4 minus tax at step no. 5 shall be tax on the arrears or advance in the year to which such arrear or advance relates.
7. Tax at step no. 3 minus tax at step no 6. shall be the relief under section 89(1).

If there is no excess, no relief is admissible.

CASE STUDIES ON CLUBBING OF INCOME

1. INCOME ON ACCRETION NOT TO BE CLUBBED

Commissioner of Income-Tax vs M.S.S. Rajan on 20 June, 2001

FACTS OF THE CASE: The assessee transferred a flat which was in his name to that of his wife. There was no consideration for such transfer. The rental income from the flat was taxed in the hands of the assessee. Despite the transfer, the rental income realised from the flat was treated as the income of the assessee by reason of Section 64(1)(iv) of the Income-tax Act, 1961.

The wife being prudent, instead of spending the rental income, chose to save the same and the savings so effected were put in a fixed deposit in her name.

CONTENTION OF REVENUE: Assessing officer was of the view that such interest accruing to the wife is should be clubbed in the hands of assessee u/s 64(1)(iv), therefore, interest accruing to her from those deposits was regarded by the Income-tax Officer as the income of the assessee for the assessment year 1979-80.

VIEW OF TRIBUNAL: The correctness of that view was questioned by the assessee in appeal. The Appellate Assistant Commissioner agreed with the assessee. The Revenue's appeal to the Tribunal against that order in appeal having proved unsuccessful.

HIGH COURT'S OBSERVATIONS:

- Section 64(1)(iv) of the Income-tax Act refers to "such income as arises directly or indirectly to the spouse of such individual" "from the 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". The income from the asset transferred to the spouse for inadequate consideration is, by reason of Section 64, made taxable in the hands of the spouse who transferred the asset. What is made taxable in the hands of the transferor-assessee is the income from the asset. The manner in which the income realised from the asset is applied--whether it is spent or saved is a matter which falls outside the purview of Section 64. This section merely treats the income from the asset transferred for inadequate consideration as taxable in the hands of the assessee-transferor and nothing more.
- The source of the interest income derived by the assessee's wife who had saved the rental income and made the fixed deposit is not the flat that was transferred to her. The source is the money which she had deposited in the bank. There was no direct nexus between the interest which she received on her deposit and the flat which had been transferred to her name by her husband for inadequate consideration.
- The scope of Section 64 is limited to income which is directly or indirectly received from the transferred asset and does not include income received from the savings effected from the income realised from the transferred assets.
- Therefore, Tribunal was right in deleting the assessee's wife's interest income included in the income of the assessee, in favour of the assessee and against the Revenue.

2. PROFESSIONAL QUALIFICATION OR KNOWLEDGE NOT NECESSARILY A DEGREE

Commissioner of Income-Tax vs Smt. R. Bharathi on 10 June, 1998 1999 240 ITR 697 Mad

FACTS OF THE CASE: The question Raised at the instance of the Revenue was as to whether the salary paid to the husband of the assessee for the services rendered by him as a jeweller in the jewellery shop owned by her is required to be clubbed with the income of the assessee and the benefits of the proviso to Section 64(1)(ii) of the Income-tax Act, 1961, should be denied to the husband of the assessee.

Department had contended that the experience of the husband of the assessee in the line of business in evaluating the jewellery could not be equated to the professional and technical qualifications referred to in the proviso to Section 64(1)(ii) of the Act and that the possession of professional knowledge and experience was not a substitute for the possession of technical qualifications.

CONTENTION OF THE REVENUE: Revenue contended that Parliament has advisedly used the expression, “professional or technical qualifications” in the proviso to Section 64(1)(ii) of the Act and that unless one possesses professional or technical qualifications, mere application of his technical or professional knowledge and experience would not be sufficient to render his income immune from being clubbed with that of other spouse.

HIGH COURT’S OBSERVATIONS:

- The proviso to Section 64(1)(ii) is meant to be applied to all assessees irrespective of their qualification or the nature of the trade or business carried on by them. The spouse of such an assessee would be governed by the proviso to Section 64(1)(ii) . The proviso in terms does not limit its application to the professions such as medicine, law, engineering or accountancy. All those professions are governed by the proviso

- It is a fact that Universities do not offer courses for every avocation in life. There are numerous avocations for which courses of study in the University are not readily available. There are numerous avocations which are not regulated by professional bodies. Nevertheless such professions are carried on, and they constitute the source of livelihood for those who engage in such professions. Cobblers, tailors, or jewellers to cite a few of such professions, carry on their avocation after having acquired experience in that line of work and gathered knowledge on their way and by exercising their skill they are able to derive income to sustain themselves. The fact that there is no course of study prescribed for such avocations and there are no professional bodies to regulate their entry into these and conferment of right to practise such professions, cannot have the effect of denying to those who are engaged in such trade or profession their right to receive income without having the same clubbed with the income of the spouse solely on the ground that there is no prescribed course of study in the Universities for such trade or profession,

- The words “technical or professional qualification” do not necessarily connote a qualification conferred by a recognised University after examining the candidate who has undergone a course of study in the technical subject or a course of study preparing him for a profession like law, accountancy, etc. 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 varieties of occupation . In the context in which the words, “professional qualifications” are used in the Act, it is not possible to hold that Parliament intended to confine the scope of the proviso only to the professions such as medicine, law, engineering or accountancy, A large number of occupations that are being practised, and which form a source of livelihood are capable of being regarded as professions as long as they require a degree of skill. The degree of skill required is a matter for examination in each case. A person having skill, experience and competence in that line of work can be regarded as professionally qualified for the purpose of Section 64(1)(ii), proviso.

- Revenue did not contend that the husband of the assessee did not have any knowledge of jewellery or he was incapable of rendering any assistance in the running of the jewellery business or that he did not have the expertise in appraising gold items of jewellery. All that was contended was that he did not have a degree or diploma in that subject conferred by a recognised University or equivalent institution. Having regard to the object of the section and the liberal interpretation required to be given to the expressions used in the proviso, we find that the spouse of the assessee did possess technical or professional qualification, knowledge and experience in the business run by the assessee. The remuneration paid to him for his services is therefore not to be clubbed with the income of the assessee.

CASE STUDY ON CARRY FORWARD AND SET OFF

1. CAN LOSS SUFFERED BY FIRM CAN BE CARRIED ON BY AN INDIVIDUAL

Pramod Mittal vs CIT 2013

FACTS OF THE CASE: Assessee was a partner in a firm. Firm was duly dissolved by a dissolution deed and assessee took over the firm as a sole proprietor. Assessee took over the entire business in his individual capacity by taking over all the assets and liabilities and paying all the dues to the other partner. Thereafter he ran the business as sole proprietor. He claimed the set off of the losses of erstwhile firm against the income earned by him as an individual sole proprietor, relying on section 78(2) and decision of Supreme Court in CIT vs Madhukant M. Mehta (2001), considering his case as inheritance of a business.

CONTENTION OF REVENUE: Only the person who has suffered the loss is entitled to carry forward and set off. Therefore, the claim of the assessee was rejected by the Assessing officer. Same view was upheld by the Tribunal on assessee's appeal.

HIGH COURT'S OBSERVATIONS: On the dissolution of partnership firm, the firm ceased to exist and taking over of business of firm in Individual capacity does not amount to inheritance of business on the death of the person as per law of succession.

Section 78(2) dealing with carry forward and set off of losses states that loss can be carried forward and set off by the same person who actually has suffered it. An exception to it given in section 78(2) is of succession by inheritance.

Also the decision of CIT vs Madhukant M. Mehta (2001), (in this case business of a sole proprietor was carried on by his legal heirs as partnership firm and since all the partners were legal heirs therefore it was treated as succession by inheritance) cannot be applied as it was not a case of succession by inheritance.

Therefore, the loss suffered by erstwhile firm cannot be carried forward and set off by a partner taking over the business after the dissolution of firm as it does not amount to succession by inheritance.

2. Whether the Tribunal was right in law in holding that there was succession by inheritance as contemplated by section 78(2) of the Act and, therefore, the assessee is entitled to carry forward and set off the deceased's loss in business against the income for these years ?

CIT v Madhukant Mehta [2001] SC

FACTS OF CASE: Assessee was carrying on proprietary business of speculation in shares, cotton and other commodities and he died. he Three heirs of assessee entered into a partnership and executed a partnership deed wherein they agreed to carry on the said business of speculation. The assessee sought to carry forward and set off the losses incurred by the deceased in his proprietary business against the income from the speculation business of the partnership firm. The Income-tax Officer disallowed such set-off on the ground that there was no succession to the business of the deceased.

COURT'S OBSERVATIONS & DECISION: The High Court has observed that during the interval of time between the death of the deceased and the formation of the partnership the outstanding recoveries were effected and the subsisting transactions were cleared and the assets of the business were utilised in clearing the liabilities by the three heirs in the process of carrying on the business as successors. Hence, it has been held that where business is succeeded by inheritance, legal heirs as assessable as Body of Individuals are entitled to get benefit of loss of predecessor. Even if the legal heirs constitute themselves as partnership firm, the benefit of carry forward and set off loss of predecessor should be made available to firm.

3. Can benefit under section 72A be available if amalgamation is followed by closure of business unit?

Indian Metals and Ferro Alloys vs Union of India [2003] 262 ITR 553 (Ori.)

FACTS OF CASE: The cited case related with aggregation of income and set-off or carry forward of loss in the Income-tax Act, Section 72A was introduced by the Finance (No. 2) Act, 1977, with effect from April 1, 1978. It was further observed the amalgamating company was not financially viable by reason of its liabilities, losses and other relevant factors immediately before such amalgamation. The scheme of amalgamation along with the detailed revival and rehabilitation package had been submitted by the petitioner.

HIGH COURT'S OBSERVATIONS & DECISION: Section 72A of the Act seeks to achieve the main object of ensuring that an Unviable industry in the hands of the amalgamating company would not allowed to be closed down and revived by framing a scheme of amalgamation with the amalgamated company, with a view to the continuance of the business or industry in public interest and in the interests of employment of the workers involved. It was further observed that concession under section 72A is given to ensure that the company is revived or rehabilitated not for the amalgamation is followed by a Closure of the business, sending out most of the workmen and the amalgamated company or a subsidiary of the amalgamated company starts a new business or industry of its own altogether with practically a new work force. Hence it was held that benefit under section 72A is not available if amalgamation is followed by closure of business unit.

4. Carry forward and set off losses incurred by the amalgamating societies.

Rajasthan R.S.S. & Ginning Mills vs Dy.CIT[2014]

FACTS OF CASE: The State Government had substantial shareholding in four co-operative societies and decision was taken by the state Government to amalgamate all the four co-operative societies into the appellant co- operative society stating reason that of four societies were not sound financially and they had substantial accumulative losses. In the cited case deals with set off accumulated losses of the amalgamating societies against the profits of the amalgamated society.

High Court's Observations & Decision: Section 72 and 72A of the Act clearly states that the co-operative societies cannot get the benefit of carrying forward and setting off accumulated losses if the said societies were not in existence. Benefit is only available in case of a 'company', the benefit of set off could be availed by an amalgamated company, if the amalgamating company had accumulated losses which could have been carried forward and adjusted against the profits of the amalgamated company in accordance with the provisions of the Act. It was further observed that non-existent person cannot file an income tax return and therefore they cannot carry forward its losses after its existence comes to an end. All those four societies, upon their amalgamation into the appellant society, had ceased to exist and registration of those societies had been cancelled. Under these circumstances, those societies had no right under the provisions of the Act to file a return to get their earlier losses adjusted against the income of a different legal personality i.e. the appellant society. But in case of company there is specific provision by virtue of Section 72 A of the Act upon amalgamation of one company with another, losses of the amalgamating companies can be carried forward and the amalgamated company can get those losses set off against its profits subject to the provisions of the Act. Hence, High court has held that as there is no provision under the Act for setting off accumulated losses of the amalgamating societies against the profits of the amalgamated society, the appellant society could not have got the benefit of carrying forward losses of the erstwhile societies which were not in existence during the relevant Assessment Year.

5. Can carry forward of losses be allowed on ground of change in shareholding due to merger?

CIT v Select Holiday resorts (P) ltd [2013]

FACTS OF CASE: Assessing Officer stated that assessee had received exempted income (Tax free Income) during the year and found that assessee had allocated expenditure of towards tax free income. Assessing Officer further stated that assessee has claimed set off brought forward loss and unabsorbed depreciation and asked assessee to explain and justify the conditions laid down in section 79 of the Income Tax Act in regard to change in the shareholding after the amalgamation by submitting a list of directors on the Board of the two companies prior to merger as well as the directors on the Board of merged company.

HIGH COURT'S OBSERVATIONS & DECISION: It has been held that every change in shareholding need not fall within the provision of section 79. In closely held company 51% shareholding is considered to be the requirement for retaining control and management over the company. It was further stated that the reason for change in shareholding of more than 51% was the merger of two companies. There was however no change of control and management. Hence, it is clear that there is no change in the management of the Company which remained with the same family (set of persons) who was earlier exercising control as it was clear from a list of directors submitted on the Board of the two companies prior to merger as well as the directors on the Board of merged company and remained in same hands. Hence it was held that carry forward of losses can't be denied on ground of change in shareholding due to merger and that to remain with same set of people.

CASE STUDY ON DEDUCTIONS

1. IS INCREASE IN GTI DUE DISALLOWANCE U/S 40(a)(ia) ELIGIBLE FOR DEDUCTION UNDER CHAPTER VI-A

CIT V SUNIL VISHWAMBHARNATH TIWARI 2016

FACTS OF THE CASE: The assessee whose eligibility to claim deduction under Section 80IB (10) of the Income Tax Act, 1961 is not in dispute, filed a return in Assessment Year 2006-07 for accounting period 01.04.2005 to 31.03.2006, claiming deduction of Rs. 16,82,121/- under that provision. It was taken up for scrutiny, and an order under Section 143(3) of the Act came to be passed, dis-allowing the expenses under Section 40[a][ia] of the Act for not deducting TDS at source. Thus, payment of Rs.83,00,738/- under the head Subcontract payment; Rs. 1,75,000/- as Commission payments and Rs.7,96,375/- as Advertisement Payment was dis-allowed. The Assessing Officer though allowed deductions under Sections 80IB(10) of the Act, assessed total income of Rs.92,71,375/- on account of above dis-allowance. The assessee filed an appeal before the CIT (Appeals), which held that there could not have been such separate treatment to income and deductions under Section 80IB of the Act needed to be allowed on gross total income of the assessee. Income Tax Department preferred further appeal before the ITAT, which rejected that appeal.

CONTENTION OF REVENUE: Department submits that the correctness or otherwise of dis-allowance is not in dispute before this Court. Violation of Section 194C and 194H of the Act is accepted, and as such, the dis-allowance was not arising out of eligible business. He states that the word "derived from" cannot have such wide impact, so as to include any income which can in some manner be attributed to the business. It is further submitted that in present matter, the assessee can claim these expenses as per the provisions in Section 40[a][ia], if TDS is paid in later year. Thus, in subsequent assessment years, the assessee would be able to claim deduction from his profit, on account of these expenses, hence, purpose of having Section 40[a][ia] itself gets defeated.

HIGH COURT'S OBSERVATIONS: Court observed that TDS was not effected by the respondent assessee, is not in dispute. In view of the scheme of Section 40 of the Act, as TDS is not effected, payment to contractors cannot be deducted, as those expenditure become inadmissible.

The expenditures therefore are added back to the income, which is nothing but, eligible income. This income which is eligible for deduction in terms of Section 80IB(10) of the Act, therefore, only increases by said figure of disallowed expenditure. Deduction allowable under Section 80IB(10) of the Act is with reference to the respondents gross total income. Hence, dis-allowance under Section 40[a] cannot be treated separately and it gets added back to the gross total income of the assessee.

Therefore, Increase in Gross total income due to disallowance under section 40(a)(ia), is eligible for deduction under section 80-IB.

2. WHETHER DEDUCTION UNDER SECTION 80-IB IS ALLOWED IN REMAINING YEARS OF ELIGIBILITY IF NOT CLAIMED IN INITIAL YEAR

PRAVEEN KUMAR SONI vs CIT (2011) 333 ITR 324 (Delhi)

FACTS OF CASE: Assessee was engaged in manufacturing and exporting of readymade garments. He started manufacturing unit on 01.07.1997. He did not claim the deduction under section 80-IB in initial assessment year i.e. 1998-99 though he satisfied all the conditions of Section 80-IB. Assessee claimed the deduction first time in Assessment year 2004-05. He was denied deduction by assessing officer.

CONTENTION OF REVENUE: Deduction is not allowed for AY 2004-05 as it was not claimed in initial year i.e. AY 1998-99 (relevant to previous year in which manufacturing was started.

COURT'S OBSERVATION: Deduction is allowed to the assessee as allowance of deduction is dependent upon of conditions of Section 80-IB in the relevant Previous year. It is not relevant whether in the past conditions were satisfied or not; deduction was claimed or not. Also it is no where mentioned in the Section 80-IB that deduction is to be claimed from first year of qualification for deduction otherwise deduction shall not be allowed. Therefore, deduction is allowed to the assessee for the remaining period during which he is entitled to claim deduction subject to fulfilment of conditions.

3. WHETHER ENGINEERS EMPLOYED BY THE ASSESSEE FALLING UNDER THE CATEGORY OF WORKMEN AS PER THE DEFINITION PROVIDED UNDER SECTION 80JJAA?

Texas Instruments (India) (P) Ltd v CIT [2017] (Bang.)

FACTS OF CASE: The TPO has denied the deduction under Section 80JJAA of the Act on the ground that the engineers employed by the assessee are not falling under the category of workmen as per the definition provided under Section 80JJAA. There is no dispute regarding the objects for which this provision of Section 80JJAA was inserted in the Act vide Finance Act, 1998 w.e.f. 1.4.1999.

HIGH COURT'S OBSERVATIONS & DECISION: It was observed that in order to generate more employment particular section 80JJAA was inserted to provide an incentive in the form of Special Deduction (over and above the expenditure of wages or salaries which is otherwise allowable as business expenditure) equivalent to 30% of the aggregate charges or salary paid to new workmen on satisfaction of the IT(TP)A Nos.1478/Bang/2010 & 1603/Bang/2014 conditions provided under the said provision. It was further observed that "workman" shall have the meaning assigned to it in clause (s) of section 2 of the Industrial Disputes Act, 1947 (14 of 1947). It was stated towards explanation to section defines regular workmen which do not include:-

a) Casual Worker

b) Any other workmen employed for a period of less than 300 days during the previous year.

c) A workmen employed through contract labour.

Hence it was held that issue regarding the engineers can be considered as workmen as per the provisions of section 80JJAA of the Act is decided in favour of the assessee.

4. Can royalty received on book on income-tax be eligible for deduction under section 80QQB?

Dilip Loyalka V CIT [2015]

FACTS OF CASE: The assessee has authored book entitled "How to handle income tax problems" in Q&A

format and received royalty for his book and claimed deduction under section 80QQB of the Act. The Assessing Officer disallowed deduction on the ground that the book on income-tax is not a literary work and held that in view of the above exclusion of printed material the assessee's claim of the book that is in ''question and answer'' format cannot be taken as literary works.

Observations & Decision

It has been observed that the word literary work has not defined under the Act but has been defined by section 2(o) of the Copyright Act, 1957. The expression literary work covers which are expressed in printing or writing irrespective of the question whether the quality or style is high or whether there is any literary merit or not. The expression literary work means not only such work which deals with any particular aspect of literature in poetry but also indicates a work which is literature i.e. anything in writing which could be said to come within the ambit of literary work. Hon'ble Kerala High Court has dealt on this issue in the case of Infoseek Solutions & Anr. Vs. Kerala Law times (2007) 34 PTC 231 (Ker) and observed that a law report is a composite document and its head notes, editorial comments, footnotes, setting, layout, presentation etc. From the above facts and circumstances of the case, the definitions and the precedents of Hon'ble Supreme Court and Kerala High Court, cited in I. T. A. N o. : 5 3 6 / KO L / 2 0 1 3 Assessment year : 2005-2006, it was held that the assessee's authored book is a literary work in term of section 80QQB of the Act and accordingly, assessee is entitled to deduction u/s. 80QQB of the Act.

5. Can Interest on loan taken for higher education outside India be allowed as deduction under section 80E?

Nitin Shantilal Muthiyan v. Dy. CIT [2015] (Pune)

Assessee claimed deduction under section 80E for interest on loan taken for higher education of his son pursuing MS Electrical Engineering in USA after completing his Secondary Education or its equivalent. AO disallowed the same by stating that deduction under section 80E is allowable only in case of higher education pursued in Indian Educational Institutes duly authorized in India and not for higher education pursued in abroad or Foreign Educational Institutes. It was held that there is no requirement that higher education should be in India only. Hence, it was held that interest expenditure was not in dispute, therefore, assessee was entitled to deduction under section 80E for interest expenditure on loan taken for higher education.

6. Disallowing the deduction claimed under Section 80IB on the ground that the Assessee was not involved in the activity of manufacture when the Assessee was converting raw 24 carat gold into 22 carat gold ornaments?

CIT V Lakesh Handa [2017] (J&K)

FACTS OF CASE: Assessee engaged in business of converting raw 24 carat gold into 22 carat gold ornaments and treated such activity amount to manufacture and claimed deduction under section 80IB. wherein the Assessing Officer took the view that the activity of the assessee did not amount to manufacture and consequently held that the assessee was not entitled to any deduction, as claimed under Section 80IB of the said Act.

HIGH COURT'S OBSERVATIONS & DECISION: In that case, a Division Bench of the Delhi High Court was considering as to whether the conversion of standard gold into ornaments or jewellery amounted to manufacture. Though the said question was considered in the context of Section 10A/10B of the said Act, the Division Bench, relying upon various decisions of the Supreme Court as also the definition of manufacture in Section 2(f) of the Central Excise Act, 1944, came to the conclusion that such an activity whereby standard gold is converted into ornaments/jewellery, would amount to manufacture. In addition to that the definition of manufacture had been inserted in the Income Tax Act itself under section 2 (29BA) which refers

"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."

It was observed that the above case false under clause (a) of Section 2(29BA) of the said Act because standard 24 carat gold being a non-living physical object is changed through the processes employed by the assessee, into a new and distinct object or article or thing having a different name, character and use in the form of 22 carat gold jewellery. Moreover high court has further observed that the essential character has clearly undergone a change and this is the determinative factor. Gold in the raw form cannot be classified as jewellery or as an ornament. One of the main distinctive features being that raw gold or standard gold does not have the ability and character of being wearable whereas jewelery/ornaments are made for that specific purpose. Hence, finished product of the process employed by the assessee is of a different and distinct commodity, commercially known as such in the market having a different name, character and use. Consequently it was held that the processes employed by the assessee amount to manufacture and benefit claimed under Section 80IB of the said Act cannot be denied to the assessee. The Income Tax Appellate Tribunal has accordingly correctly decided in favour of the assessee and against the revenue.

7. Whether the learned ITAT was right in law in holding that the income from sale of scrap was eligible for deduction under section 80IC of the Income Tax Act?"

CIT v Micro Turners [2012] (Punj. & Har.)

FACTS OF THE CASE: The assessee is a manufacturing unit at Parwanoo. The assessee claimed deduction under Section 80-IC of the Act to the tune of transfer sales and scrap sales. The Assessing Officer found that the scrap sales and stock transfer to sister concern is not an income derived from manufacturing process and, therefore, not liable to deduction as contemplated under Section 80-IC of the Act.

HIGH COURT'S OBSERVATIONS & DECISION: It has been observed that the assessee is engaged in the manufacturing of automobile shafts' accessories where scrap is generated and which has direct link with the manufacturing process. Hence it was held that generation of scrap has direct link with manufacturing process carried out by assessee and income arising from sale of scrap is eligible for deduction under section 80IC.

8. Allowability processing of bio-degradable waste under section 80JJA

CIT v/s Padma S. Bora [2010]

FACTS OF CASE: Assessee was engaged in business of manufacturing fuel briquettes from bagasse and such collected bagasse had been used by assessee to make briquette for fuel. Assessee has claimed deduction under section 80JJA which was disallowed by AO. However, CIT (A) and Tribunal, however, allowed deduction under section 80JJA on ground that assessee had fulfilled all conditions precedent and bagasse was a waste and purchased for price and generated by sugar industries

HIGH COURT'S OBSERVATIONS & DECISION: It was observed by CIT (A) as well as Tribunal that bagasse is a biodegradable waste used for making briquettes for fuel by the assessee. It was further observed that Bagasse is a waste of the sugar factory. This waste is a bio-degradable waste and the same is collected on consideration by the respondent assessee from the factory. It is an admitted/undisputed position that the respondent assessee has collected bagasse from sugar factories after having made payment for the same. Therefore, the aforesaid requirement of collecting as provided under section 80JJA is satisfied. Hence, it was held that business of biodegradable waste should be done by assessee as a part of his business and that the reason that he is allowed to take deduction under section 80JJA but if such activity is done by job work customers, he would not be entitled to deduction.

PRACTICAL PROBLEMS

Illustration 1: Mr. Raman has gifted a house property valued at Rs. 45 lakh to his wife, Renu. Renu has gifted the same to Suman, their daughter-in-law. House is let out on monthly rent of Rs. 18000 throughout the year. Compute total Income of Mr. Raman and Ms. Suman. What would have been the tax consequences if property was gifted his Son Mr. Sandeep (Husband of Suman).

Solution: When Property is ultimately gifted to Suman:- It will be treated as indirect Transfer by Mr. Raman(father-in-law) to Ms. Suman(daughter-in-law). Property income shall be calculated in the hands of Ms. Suman and It would be included in income of Mr. Raman. From the given information Property income shall be:

GAV	18000x12 = 2,16,000
Municipal taxes	nil
NAV	2,16,000
Deduction u/s 24(a)	
@30%of NAV	64,800
Deduction u/s 24(b)	Nil
Income from property	1,51,200

Therefore, Rs. 1,51,200 shall be included in Income of Mr. Raman as Income under the head House Property by virtue of Section 64(1)(vi). Ms. Suman shall not be taxable for this Income.

When Property is Gifted to his son Mr. Sandeep:

If the property is gifted by Mr. Raman to his wife Ms. Renu and ultimately gifted by Ms. Renu to their Son Mr. Sandeep, it shall be treated as Indirect Transfer by Mr. Raman to His Son Mr. Sandeep and it does not attract clubbing provisions. Therefore, property income of Rs. 1,51,200 shall be taxable in hands of Mr. Sandeep and Mr. Raman shall not be Taxable for it.

Note: The solution has been made assuming the assessee has not opted to pay tax under section 115BAC of the Income tax Act, 1961.

Illustration 2: Ram gifted an amount of Rs. 5,00,000 to Mrs. Shyam (wife of his brother Shyam), which was used by Mrs. Shyam for purchasing a house and simultaneously on the Same day Shyam gifted shares owned by him in a foreign company worth Rs. 5,00,000 to the minor son of Ram. What would be the tax consequences of these transfers in the hands of transferors and transferees.

Solution: It will be treated as indirect transfer by Ram to his minor son and by Shyam to Mrs. Shyam. Dividend from shares of foreign company shall be taxable in hands of Mr. Ram or Mrs. Ram whose income is higher[exemption upto Rs. 1500 shall be allowed to the person who is taxable from such dividend income under section 10(32)].

Income from House property shall be in hands of Mr. Shyam.

Illustration 3: Mr. A transferred 2000 debentures of Rs. 100 each of X Ltd. to Mrs. A, without adequate consideration. X Ltd. paid the Interest of Rs. 30,000 during the previous year which was deposited by Mrs. A in Bank as fixed deposit. Mrs. A received Interest of Rs. 3,000 on such fixed deposit during the previous year. What would be the tax treatment of such Interest Income ?

Solution: Interest of Rs. 30,000 on debentures of X Ltd. shall be taxable in hands of Mr. A by virtue of Section 64(1). However, Interest income of Rs. 3,000 from fixed deposit shall not be taxable in hands of Mr. A as this income does not arise from the transferred asset. Such interest shall be taxable in hands of Mrs. A.

Illustration 4:

If Mr. 'A' had income against the following heads,

Taxable salary income	40,000
Income from house property	75,000
Income from other sources	20,000
Interest on securities of DCM Ltd. (Gross)	8,000
	1,43,000

He made following payments:

Contribution to P.F. (recognised)	2,000
Donation to the Prime Minister's National Relief Fund	2,500
Donation to the Indira Gandhi Memorial Trust	4,000
Donation to an approved association for promoting family planning	4,000
Donation to approved charitable trust	10,000

Compute Mr. A's taxable income for assessment year 2021-22.

Solution :

His taxable income for assessment year 2021-22 will be computed as follows:

Net income from salary	40,000
Income from house property	75,000
Income from other sources	28,000
Gross Total Income	1,43,000
Less: Deduction under Section 80C	(2,000)
Less: Deduction permissible: Donation under Section 80G	(13,500)
(as worked out below)	
Taxable income	1,27,500
Income-tax on Rs. 1,27,500	NIL
Net tax payable	NIL

Note: Under Section 80G the various items of donations will be dealt with as under:

1. Prime Minister's National Relief Fund deductible in full without any restrictions.
2. Donation to Indira Gandhi Memorial Trust is deductible to the extent of 50% of donation without any restrictions.
3. Donation to approved family planning association is deductible in full so long as it is within the 10% limit imposed by Section 80G(4).
4. Donation to an approved charitable trust is deductible to the tune of 50% so long as it is also within the limit imposed by Section 80G(4).

Calculation of deduction under Section 80G:

Gross total income	1,43,000
Less: Deduction under Sections 80C to 80U	(2,000)
Adjusted gross total income	1,41,000
(i) Donation on which qualifying limit is not applicable:	
Allowed @ 100%	
Prime Minister's National Relief Fund	2,500
Allowed @ 50%	
I. Indira Gandhi Memorial Trust (4000)	2,000
(ii) Donation to which qualifying limit is applicable:	
(1) For promotion of family planning	4,000
(2) Charitable trust	10,000
Total(Subject to maximum of 10% of Adjusted GTI)	14000
Deduction (4000+5000)	9,000

Total deduction allowed under Section 80G = 2500+2000+9000=13500

Note: The solution has been made assuming the assessee has not opted to pay tax under section 115BAC of the Income tax Act, 1961.

Illustration 5:

Mr. 'A' had income against the following heads

Professional income	6,40,000
Income from STCG (covered under section 111A)	5,000
Income from LTCG	12,000
Income from other sources	10,000
Contribution to P.P.F.	70,000
Payment of Rent	84,000

Compute Mr. A's taxable income for assessment year 2020-21

Solution :

His taxable income for assessment year 2021-22 will be computed as follows:

Professional income	6,40,000
Income from capital gains	17,000
Income from other sources	10,000
Gross Total Income	6,67,000
Less : Deduction under Section 80C	(70,000)
Less : Deduction under Section 80GG (as worked out below)	(26,000)

Taxable income	571,000

Working Note:

Least of the following is deductible under section 80GG

– 84,000 – (10% of 5,80,000) = 26,000

– 25% of 5,80,000 = 1,45,000.

– Rs. 5,000 * 12 = 60,000

Deduction under Section 80GG is lower of three above Rs. 26,000.

Adjusted Total Income = 6,67,000-17,000-70,000= 5,80,000.

Note: The solution has been made assuming the assessee has not opted to pay tax under section 115BAC of the Income tax Act, 1961.

Illustration 6: Following are the particulars of income of Mr. Ram, who is 70 years old resident in India, for the Assessment year 2021-22:

Gross Total Income Rs. 8,12,000 which includes long-term capital gain of Rs. 2,55,000, Short-term capital gain of Rs. 88,000, interest income of Rs. 12,000 from savings bank deposits with banks and Rs 30000 from bank FD. Mr. Ram invested in PPF Rs. 1,40,000 and also incurred medical expenditure (no medical insurance) Rs. 61,000. Compute the total income of Mr. Ram.

Solution: Computation of Total Income for the Assessment Year 2021-22

	Rs.
Gross total income	8,12,000
Less: Deductions:	
Under section 80C	1,40,000
Under section 80D	50,000
Under section 80TTB	42,000
Total income	5,80,000

Note: The solution has been made assuming the assessee has not opted to pay tax under section 115BAC of the Income tax Act, 1961.

Illustration 7: Mrs. X, wife of X, is a partner in a firm. Her capital contribution to the firm as on April 1, 2020 is Rs. 5 lakh, out of which Rs. 3 lakh is contributed out of her own sources and Rs. 2 lakh is contributed out of gift from her husband. As further capital is needed by the firm, she further invests Rs. 2 lakhs on May 1, 2020 out of the funds gifted by her husband. The firm pays interest on capital of Rs. 80,000 and share of profit of Rs. 60,000 for the financial year 2020-21. Advise X as to the applicability of the provision of section 64(1 (iv) and the manner thereof in respect of the above referred transactions.

Solution:

First day of the previous year 2019-20 : April 1, 2020

(a)	Total investment in the firm by Mrs. X on April 1, 2020	5,00,000
(b)	Out of which how much is financed by taking gift from X	2,00,000
(c)	How much is contributed by Mrs. X out of her own sources	3,00,000

Amount Taxable in hands of X and Mrs. X

	Share of profit	Interest
Amount taxable in hands of X[(b)/(a)X Rs. 80,000]	Exempt	32,000
Amount taxable in hands of Mrs. X [(c)/(a)X Rs. 80,000]	Exempt	48,000

Note: Amount contributed by X after April, 2020 shall not be considered for the purpose of apportionment of Interest pertaining to the previous Year 2020-21.

Illustration 8: X, an individual engaged in the business of finance, advances Rs. 5 lakh to his HUF on interest at 12 per cent per annum, which is the prevailing market rate. The HUF invests the amount in its business and earn profit of Rs. 2 lakh from this money. Can the Assessing Officer add a sum of Rs. 1,40,000 (i.e., Rs. 2,00,000-Rs. 60,000) as income of X under section 64(2) ? Will the position remain the same, if X does not charge any interest *?*

Solutions: Since the prevalent market rate is charged the Assessing Officer's action is not tenable. If X did not charge any interest, then also the income cannot be subjected to tax in his hands as the business (asset) belongs to HUF and is not owned by him individually.

Illustration 9: X & Co., the sole proprietary concern of X, gets converted into partnership after his death on May 10, 2020 by his two sons and the business of X & Co. is continued to be carried in the same manner. There are business losses of Rs. 4.25 lakh till March 31, 2014. The net results of the business for the year ending March 31, 2021 is profits of Rs. 5 lakh. The partners want to set off the losses of Rs. 4.25 lakh from the profits of the firm. Can they do so?

Solution: It has been held by the Apex Court in *CIT v. Madhukant M. Mehta* [2001] , that where legal heirs of a deceased-proprietor enters into partnership and carries on the same business in the same premises under the same trade name, there is succession by inheritance as contemplated in section 78(2) and the assessee-firm is entitled to car-forward and set-off of the deceased's business loss against its income for the subsequent years. In view of the aforesaid case, in the present problem, partners are entitled to set off the losses of Rs. 4.25 lakh from business income of the firm.

Illustration 10: A company which is entitled to claim deduction under section 80-IB has received duty drawback under a scheme framed by the Central Government under the Customs Act, 1962. Can such duty drawback form part of profit of eligible undertaking for the purpose of deduction under section 80-IB?

Solution: In *Liberty **India*** v. CIT[2009] , the Supreme Court held that the duty drawback receipt/DEPB benefits do not form part of the net profits of eligible industrial undertaking for the purposes of section 80-I/80-IA/80-IB.

Duty drawback is an incentive. Essentially, it is an export incentive. The object behind the duty drawback is to neutralize the incidence of customs duty payment on the import content of export product. The profits derived by way of such incentives do not fall within the expression "profits derived from industrial undertaking" in section 80-IB.

Illustration 11: If assessee fails to make claim for any deduction in the return of income, he looses his opportunity for claiming such deduction at the assessment stage or subsequent stage. Do you agree with the proposition?

Solution: If the assessee fails to make a claim in his return of income for any deduction under sections 10A, 10AA, 10B, 10BA, 80HH to 80RRB, no deduction shall be allowed to him thereafter. This provision is given in section 80A(5). In respect of other deductions (not claimed in the return of income), the assessee can file revised return - Goetze (India) Ltd. v. CIT[2006] 157 . If, however, sufficient information is available in the return of income, revised return is not required and deduction can be claimed at the time of assessment - **CIT** v. **Ramco** International [2009].

LESSON ROUNDUP

Clubbing of Income and Set-off and carry forward of losses

– Sections 60 to 65 of the Income-tax Act provide that in computing the total income of an individual for purposes of assessment, there shall be included all the items of income specified in these sections.

– **Transfer of Income (section 60):** Where a person transfers to any other person income (whether revocable or not) from an asset without transferring that asset, the income shall be included in the total income of the transferor. "Transfer" includes any settlement, trust, covenant, agreement or arrangement.

– **Revocable transfer:** Where a person transfers any asset to any other person with a right to revoke the transfer, all income accruing to the transferee from the asset shall be included in the total income of the transferor.

– The income under revocable transfer of asset shall be included in the income of transferor even when only a part of income from transferred asset has been applied for the transferor.

– **Irrevocable Transfer:** In case of an irrevocable transfer of assets for a specified period, the income from such assets shall not be included in the income of transferor.

– **Income to spouse from a concern in which such individual has substantial interest [Section 64(1)(ii)]:** All such income as arises directly or indirectly, to the spouse of an individual by way of salary, commission, fees or any other remuneration, whether in cash or kind from a concern in which such individual has a substantial interest, shall be included in the income of the individual.

– **Income to spouse from the assets transferred [Section 64(1)(iv)]:** Where any individual transfers directly or indirectly any asset (other than a house property) to the spouse, the income from such asset shall be included in the income of the transferor.

– **Income To Son's Wife [Section 64(1)(vi)]:** Where any individual transfers, directly or indirectly, any asset to his/her son's wife without adequate consideration, after 1.6.1973, the income from such asset shall be included in the income of the transferor.

– **Transfer for Immediate or Deferred Benefit of Son's Wife [Section 64(1)(viii)]:** Any income arising, directly or indirectly, to any person or association of persons from assets transferred directly or indirectly after June 1, 1973, otherwise than for adequate consideration to the person or association of persons by such individual shall, to the extent to which the income from such assets is for the immediate or deferred benefit of his son's wife be included in computing the total income of such individual.

– **Income to spouse through a third person [Section 64(1)(vii)]:** Where a person transfers some assets directly or indirectly to a person or association of persons (trustee or body of trustees or juristic person) without adequate consideration for the immediate or deferred benefit of his or her spouse, all such income as arises directly or indirectly from assets transferred shall be included in the income of the transferor.

– **Clubbing of Income Of Minor Child [Section 64(1a)]:** All income which arises or accrues to the minor child (not being a minor child suffering from any disability of the nature specified in Section 80U) shall be clubbed in the income of his parent. However, any income which is derived by the minor from manual work or from any activity involving application of his skill, talent or specialised knowledge and experience will not be included in the income of his parent.

In case the income of an individual includes any income of his minor child in terms of this section [i.e. Section 64(1A)], such individual shall be entitled **to exemption of the amount of such income or**

Rs. 1,500 whichever is less.

- **Set Off - carry Forward of losses:** Sometimes the assessee incurs a loss from a source of income and unless such loss is set-off against any income, the net result of the assessee's activities during the particular accounting year cannot be ascertained and consequently the tax payable would also be incapable of determination. For this purpose, the Income-tax Act contains specific provisions (Sections 70 to 80) for the set-off and carry-forward of losses.

- **Set-Off of Losses from one source against Income from another source under the same Head of Income [Section 70]:** If the net result for any assessment year in respect of any source falling under any head of income is a loss, the assessee is entitled to set off the amount of such loss against his income from any other source under the same head. However, Loss from Speculation Business, Loss from the activity of owning and maintaining race horses, long-term capital loss can be set-off from any other source of income.

- Where any individual transfers directly or indirectly any asset (other than a house property) to the spouse, the income from such asset shall be included in the income of the transferor.

- **Carry-Forward and Set-Off of Losses** If it is not possible to set-off the losses during the same assessment year in which these occurred, so much of the loss as has not been so set-off out of the following losses, can be carried forward to the following assessment year and so on to be set-off against the income of those years provided the losses have been determined in pursuance of a return filed by the asessee and it is the same assessee who sustained the loss.

  However, losses suffered under the following heads are not allowed to be carried forward and set off:

  (1) Losses under the head 'salaries'.

  (2) Losses under the head 'Income from other sources'

  (excepting loss suffered from the activity of owning and maintaining race horses).

- **Submission of Return for Loss (Section 80):** An assessee is not entitled to carry-forward a loss unless he has filed a return of loss to the Department in time and in the prescribed form. It is obligatory on the part of the assessee to file such return; otherwise he will be deprived of the benefit of carry-forward of losses. In fact, only that amount of loss is allowed to be carried-forward which has been computed by the Assessing Officer and not by the assessee.

Deductions

- **Section 80C:** Deduction on life insurance premia, contribution to provident fund, etc - Available to individual/HUF for a maximum amount of Rs. 1,50,000.

- **Section 80CCE:** Limit on deductions under Sections 80C, 80CCC and 80CCD - Cannot exceed Rs. 1,50,000.

- **Section 80D:** Deduction in respect of medical insurance premia - Available to individual/HUF.

- **Section 80DD:** Deduction in respect of maintenance including medical treatment of a dependant who is a person with disability or severe disability.

- **Section 80DDB read with Rule 11DD:** Deduction in respect of medical treatment, etc.: Available to Resident individual/resident HUF.

- **Section 80E:** Deduction in respect of repayment of loan taken for higher education: Available to individual.

- **Section 80G:** Deduction in respect of donations to certain funds, charitable institutions, etc. Available to all assessees subject to maximum of 50% of qualifying amount, 100% as the case may be.

- **Section 80GG:** Deduction in respect of rent paid Available to individual
- **Section 80GGA:** Deduction in respect of certain donations for scientific research or rural development
- **Section 80GGB:** Deduction in respect of contributions given by companies to political parties
- **Section 80GGC:** Deduction in respect of contributions given by any person to political parties
- **Section 80-JJA:** Deduction in respect of profits and gains from the business of collecting and processing bio-degradable waste - Available to all assessees carrying on the business of collecting and processing bio-degradable waste.
- **Section 80-JJAA:** Deduction in respect of employment of new workmen - Available to Indian company of 30% of additional wages paid to new regular workmen.
- **Section 80P:** Deduction in respect of income of co-operative societies - Specified incomes subject to amount specified in sub section (2).
- **Section 80QQB:** Deduction in respect of royalty income, etc., of authors of certain books other than text books - Available to resident individual, for a maximum deduction of Rs. 3,00,000.
- **Section 80RRB:** Deduction in respect of royalty on patents - Available to Resident Individual, maximum of Rs. 3,00,000.
- **Section 80TTA:** Deduction in respect of interest on deposits in savings account - Available to Individual/ HUF upto Rs. 10,000.
- **Section 80TTB –** Available to Senior Citizens – Maximum amount – Rs. 50,000
- **Section 80U:** Deduction in case of a person with disability - Available to Resident individual subject to maximum of Rs. 125,000
- Provision related to rebate and relief – Section 87A/89

TEST YOURSELF

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

ELABORATIVE QUESTIONS

1. Discuss the tax treatment to transactions which result in (a) transfer of income without transfer of the assets yielding the income; and (b) gift of the assets by an individual to his/her spouse, minor children, major sons and married daughters.
2. Distinguish between revocable and irrevocable transfer of assets and state what is meant by "a revocable transfer" for purposes of income-tax. Discuss also the tax implications arising out of revocable and irrevocable transfer of assets.
3. Discuss the tax effects of creation of a trust by an individual for the benefit of (i) himself, (ii) his/her spouse, (iii) his/her minor children, (iv) his married daughter, (v) his daughter-in-law and sisters.
4. What do you mean by "Set-off and carry forward of losses"? which losses can be carried forward?
5. Discuss the provisions of the Income-tax Act relating to the set-off of losses.
6. Enumerate the various rebates and reliefs available to individuals under the Income-tax Act, 1961.
7. What are the different kinds of incomes which are included in the total income but on which no income-

tax is payable?

8. What conditions are to be satisfied in order to claim a deduction for donations made to certain funds or/ and charitable institutions? Illustrate.
9. Write a short note on the relief available under Section 89.
10. Explain in brief the deduction for the medical insurance premium paid by the assessee.
11. Write a short note on :
    a. Deduction under section 80RRB in respect of royalty from patents
    b. Deduction under section 80GGB and section 80GGC in respect of contribution to political parties.

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 8

Computation of Total Income and Tax Liability

LESSON OUTLINE

- Computation of taxable income and tax liability of companies
- Minimum Alternate Tax (MAT)
- Taxability of Dividend
- Buy Back of Share
- Carbon Credit [Section 115BG]
- Computation of Taxable Income and Tax Liability of Non Corporate Entities
- Alternate Minimum Tax (AMT) [Section 115JC]
- Taxation of Individual
- Taxation of HUF
- Taxation of Firm
- Taxation of AOP/BOI
- Taxation of Co-Operative Society
- Tax Exemptions to Political Parties (Section 13A)
- Case Law
- Tax Planning consideration for Firm V/s LLP V/s Company
- Practical Questions
- LESSON ROUNDUP
- TEST YOURSELF

LEARNING OBJECTIVES

Income tax being Direct Tax is a major source of revenue for the Central Government. The entire amount of income tax collected by the Central Government is classified under the head: (a) Corporation Tax (Tax on the income of the companies) and (b) Income Tax (Tax on income of the non-corporate assesses). We shall divide our discussion in this chapter in two parts i.e. (1) Computation of taxable income and tax liability of corporate entity and (2) Computation of taxable income and tax liability of non-corporate entities.

COMPUTATION OF TAXABLE INCOME AND TAX LIABILITY OF COMPANIES

CONSTITUTIONAL PROVISIONS

Under the Constitution of India, the legislative fields in **entries 85 and 86** of the **Union List** in the **Seventh Schedule** specify **Corporation tax** and **taxes on capital value of the assets**, exclusive of agricultural land of individuals and companies, respectively. A tax on capital value of assets is a composite tax on the totality of all the assets owned by the company.

Article 366(6) of the Constitution defines corporate tax as follows:

Corporate tax means any tax on income, so far as that tax is payable by companies and is a tax in case the following conditions are fulfilled:

a) that it is not chargeable in respect of agricultural income;

b) that no deduction in respect of tax paid by companies is by any enactments which may apply to the tax authorised to be made from dividends payable by the companies to individuals;

c) that no provision exists for taking the tax so paid into account for computing for the purposes of Indian income tax, the total income of individuals receiving such dividends, or in computing the Indian income tax payable by, or refundable to, such individuals.

DEFINATION OF THE TERM COMPANY UNDER SECTION 2(17) OF THE INCOME TAX ACT, 1961

As per section 2(17), company means:

(i) any Indian company, or

(ii) any body corporate incorporated by or under the laws of a country outside India, or

(iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 (11 of 1922) or was assessable or was assessed under this Act, as a company for any assessment year commencing on or before April 1, 1970; or

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

Provided that such institution, association or body shall be deemed to be a company only for such assessment year or assessment years (whether commencing before the 1st day of April 1971, or on or after that date) as may be specified in the declaration.

CBDT Order

In cases where the CBDT specifies any association or body to be a company, it is essential that the order of the Board is taken to be valid only in respect of the assessment year or years specifically mentioned in the Board's order. The Board's power is specifically made exercisable in respect of past assessment year. In other words, the declaration of the Board does not automatically mean that the association or body would continue to be treated as a company for all purposes and for all assessment years. Whilst declaring any institution, association or body as a company, the Board has also to justify itself that they have characteristics as would generally enable them to be recognized as companies in common parlance as sometimes, such a declaration may be sought for by institutions for avoiding taxes.

The power of the Board to declare any foreign association or body as a company is absolute and unqualified and the Board would normally declare such association or body to be a 'company' only after taking into consideration the benefit to the revenue (**Section 119 read together with Section 295 of the Income Tax Act, 1961).**

Liquidating Company

A Company in liquidation is also a "company" and the Income tax authorities are entitled to call upon the liquidator to make a return of the company's income. Likewise, penalty proceedings can also be initiated against a company in liquidation for a default committed prior to liquidation. Thus, the expression Company as defined in the Income Tax Act has a much wider connotation than what is normally understood by a 'Company' under the Companies Act.

Companies established under section 8 of the Companies Act, 2013

In order to be regarded as a taxable entity under the Income Tax Act, 1961, it is not essential that the company must always have a share capital and must have been formed with a profit motive. Even companies having no share capital and those, which are limited by guarantee, are assessable as companies for income-tax purposes even if such companies may have been formed without any profit motive and registered under Section 8 of the Companies Act, 2013 (e.g. Chambers of Commerce etc.). Under Section 28 (iii) of the Income tax Act, 1961, trade, professional or similar associations are liable to tax in respect of the income they derive from rendering of specific services to their members. Accordingly, in respect of specific services to their members, such entities, even if they are non-profit making, would become liable to tax under the Income tax Act as a company in respect of their income from business although they may not have been specifically formed to carry on any business with a view to make profit. A statutory corporation established under the Act of Parliament, Government companies and the State Government companies who carry on a trade or business would also be treated as a company for all purposes of income tax.

Discontinuance of Business

A company or for that matter, any assessee who discontinued their business are statutorily required to intimate to the Assessing Officer within 15 days (Section 176 of the Income Tax Act, 1961).

Assessment of Companies

For assessment to income tax, each company is assessed separately although the companies might be interrelated or inter-connected; for instance, holding and subsidiary companies must be assessed separately to Income tax in respect of the profits made by each of them since they have a separate and distinct legal existence. The company is liable to pay tax at a flat rate on its taxable income. In addition to such tax, domestic company is liable to pay Dividend Distribution tax under section 115-O on the amount distributed as profit to its shareholders. Such distribution of profits is not allowed as expenditure to the company (as it is an appropriation of profits of company and not a charge against it).

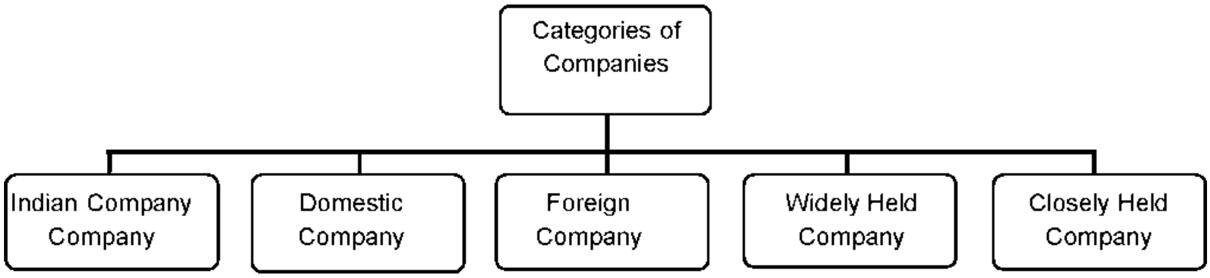
Similarly Company being an independent and separate legal entity distinct from its members, income of the company is computed and assessed separately in the hands of the company.

Dividend received by the shareholders from the company, on which company has paid tax under Section 115-O, is exempt in the hands of shareholders under Section 10(34) unless it is taxable under Section 115BBDA.

The Supreme Court in the case of Mrs. Bacha F. Guzdar v. CIT (1955) 27 ITR 1(SC) has held that dividend received from a company earning agricultural income is not an agricultural income in the hands of the shareholders and therefore does not qualify for exemption under Section 10(1) which grants exemption to agricultural income.

CLASSIFICATION OF COMPANIES UNDER INCOME TAX ACT, 1961

In continuation of our, earlier discussion on definition of company, we will now discuss broadly the different categories of companies:



Let us now discuss these in detail from taxation point of view.

Indian Company

Section 2(26) of the Income Tax Act, 1961 defines the expression '**Indian Company'** as a company formed and registered under the Companies Act, 2013 and includes:

(a) a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir, and the Union Territories specified in (e) below);

(b) any corporation established by or under a Central, State or Provincial Act;

(c) any institution, association or body which is declared by the Board to be a company under Section 2(17) of the Income Tax Act, 1961;

(d) in the case of State of Jammu & Kashmir, any company formed and registered under any law for the time being in force in that State; and

(e) in the case of any of the Union Territories of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory;

Provided that the registered or, as the case may be, principal office of the company, corporation, institution, association or body in all cases is in India.

From the above definition, it may be seen that statutory corporations as well as government companies are automatically treated as Indian companies for purposes of the Income Tax Act, 1961. The definition of an Indian company has been specifically given under the Income Tax Act, 1961 because of the fact that Indian companies are entitled to certain special tax benefits under this Act. It must be noted that all companies falling within the definition given in Section 2(17) of the Act are not necessarily Indian companies whereas all Indian companies are companies within the meaning of Section 2(17) of the Act.

Infrastructural capital company is defined under **Section 2(26A)**. It means a company which makes investments by way of acquiring shares or providing long-term finance to any enterprise or undertaking wholly engaged in the business referred to in Section 80-IA(4) or Section 80-IAB(1) or an undertaking developing and building a housing project referred to in Section 80-IB(10) or a project for constructing a hotel of not less than three-star category as classified by the Central Government or a project for constructing a hospital with at least one-hundred beds for patients.

Domestic Company

Section 2(22A) of the Income Tax Act, 1961, defines domestic company as an Indian company or any other company which, in respect of its income liable to tax under the Income Tax Act, has made the prescribed arrangements for the declaration and payment within India, of the dividends (including dividends on preference shares) payable out of such income.

From this definition, it is clear that all Indian companies are domestic companies while all domestic companies need not necessarily be Indian companies. In other words, a non-Indian company would be considered as a domestic company if it makes the prescribed arrangements for the declaration and payment of dividends in India on which tax is deductible under Section 194.

Under Rule 27 of Income tax rules, the prescribed arrangements are as follows:

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

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

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

Foreign Company

Section 2(23A) of the Income tax Act defines foreign company as a company, which, is not a domestic company. However, all non-Indian companies are not necessarily foreign companies. If a non-Indian company has made the prescribed arrangements for declaration and payments of dividends within India, such a non-Indian company must be treated as a "**domestic company**" and not as a "**foreign company**".

Company in which public are substantially interested (a widely-held company)

Section 2(18) of the Income Tax, Act defines the expression "**company in which the public are substantially interested**".

A company is said to be one in which public are substantially interested in the following cases, namely -

(i) **A company owned by Govt./ RBI**: If it is a company owned by the Government or the Reserve Bank of India or in which not less than 40 per cent of the shares, whether singly or taken together, are held by the Government or the Reserve Bank of India or a corporation owned by the Reserve Bank of India; or

(ii) **Section 8 company**: If it is a company which is registered under Section 8 of the Companies Act, 2013 ; or

(iii) **A company having no share capital declared by CBDT**: If it is a company, having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by an order of the Board (CBDT) to be a company in which the public are substantially interested. However, such a company shall be deemed to be one in which the public are substantially interested only for the assessment year(s) as may be specified in the declaration; or

(iv) **Nidhi/ Mutual Benefit Society**: If it is mutual benefit finance a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under Section 406 of the Companies Act, 2013 to be a Nidhi or Mutual Benefit Society; or

(v) **A company owned by co-operative Society**: If it is a company in which shares carrying not less than 50 per cent of the voting power have been allotted unconditionally to or acquired unconditionally by, and are throughout the relevant previous year beneficially held by, one or more cooperative societies; or

(vi) **Listed company**: If it is a company which is not a private company as defined in Companies Act, and equity shares of the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in the profits, i.e. preference shares) were, as on the last day of the relevant previous year, listed in a recognised stock exchange in India;

(vii) **Public company owned by Govt. and/ or public limited company**: If it is a company which is not a private company within the meaning of the Companies Act, and the shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 50 per cent (40 per cent in case of an industrial company) of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant accounting year beneficially held by (a) the Government, or (b) a corporation established by a Central or State or Provincial Act, or (c) any company in which the public are substantially interested or a wholly owned subsidiary company.

Note:

Industrial Company means an Indian company where business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power.

It may be noted that, a public company under the Companies Act, need not necessarily fall within the meaning of a company in which the public are substantially interested under the Income-tax Act, 1961 because a public company under the Companies Act, may be considered as one in which the public are not substantially interested under the Income-tax Act, 1961 after considering the nature and extent of shareholding.

Illustration: State with the reason whether in the following cases Companies are widely held or closely held:

(a) The shares of ABC Private Limited are held as follows:

i	A corporation owned by RBI	15%
ii	Central Govt.	18%
iii	R.B.I.	10%
iv	Mr. Raman	28%
v	Mr. Bhuvan	27%

(b) 85% equity shares of **Progressive Private Limited** were held by the public and its affairs during the relevant previous year were controlled by seven persons.

Solution: (a) Shares held by Govt., RBI and Corporation owned by RBI = 18%+10%+15% = 43%.

As shares held by CG along with RBI are more than 40%, therefore, ABC Pvt. Ltd. is a Govt. Participating company. Hence it is a company in which Public is substantially interested i.e. widely held.

(b) As none of the criteria mentioned in Section 2(18) is met in case of Progressive Pvt. Ltd. (such as Govt. Participating, Section 8 Company or Nidhi etc.) therefore, it is a closely held company.

Closely held company

A Company in which the public is not substantially interested is known as a **closely held company.**

The distinction between a closely held and widely held company is significant from the following viewpoints.

(i) Section 2(22)(e), which deems certain payments as dividend, is applicable only to the shareholders of a closely-held company; and

(ii) A closely held company is allowed to carry forward its business losses only if the conditions specified in Section 79 are satisfied.

TAX INCIDENCE UNDER INCOME TAX ACT, 1961

As you know, the incidence of Income tax depends upon the residential status of a company in India during the relevant previous year. A Company may be either resident or non-resident in India, i.e., company cannot be ordinary or not-ordinary resident.

According to Section 6(3) of the Act, a company is said to be resident in India (resident company) in any previous year, if:

(i) It is an Indian company; or

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

If any of the above two tests is satisfied the company would be a resident company in India during that previous year.

A foreign company is resident in India if its Place of Effective Management (POEM) during the previous year is in India. For this purpose, the 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 are made.

According to Section 5(1) of the Act, the total income of any previous year of a **resident company** would consist of:

(i) income received or deemed to be received in India during the previous year by or on behalf of such company;

(ii) income which accrues or arises or is deemed to accrue or arise to it in India during the previous year;

(iii) income which accrues or arises to it outside India during the previous year.

It is important to note that under clause (iii) only income accruing or arising outside India is included. Income deemed to accrue or arise outside India is not includible in the hands of residents. Hence, net dividends received from foreign companies are includible in income and not the gross dividends [CIT v. Shaw Wallace & Co. Ltd. (1981) 132 ITR 466].

In this context, the Calcutta High Court had followed the Supreme Court's decision in Commissioner of Income-tax v. Clive Insurance Co. Ltd. (1978, 113 ITR 636) holding that the assessee could be said to have paid Income Tax in U.K, by deduction or otherwise, in respect of the net dividend so as to be eligible for relief contemplated by Section 49D of the Indian Income Tax Act, 1922. Following the Supreme Court's decision, the Bombay High Court held in the case of Commissioner of Income tax v. Tata Chemicals Ltd. (1986, 162 ITR 556) that the assessee was entitled to double taxation relief under Section 91 of the Income Tax Act, 1961 in respect of dividends from the United Kingdom. Following its decision in the case of Shaw Wallace & Co. Ltd. (supra), the Calcutta High Court held in the case of the same assessee (1983, 143 ITR 207) that dividends from foreign companies are to be assessed not on the gross amount of the dividends but on the gross amount of the dividends less tax deducted there from in foreign countries. In other words, only the net foreign dividends are to be included in the total income of a resident assessee under Section 5(1)(c) of the Income Tax Act, 1961.

Under Section 5(2) of the Act, the total income of any previous year of **non-resident company** would consist of:

(i) Income received or deemed to be received in India in the previous year by or on behalf of such company;

(ii) Income which accrues or arises or is deemed to accrue or arise to it in India during the previous year.

The decision of the Supreme Court in the case of Standard Triumph Motor Co. Ltd. v. CIT (1993) 201 ITR 391 to the effect that when an Indian resident passes an entry crediting a non-resident with amount payable to him, that would tantamount to the latter receiving income in India, is having grave consequences. In this case, the royalty payable to non-resident in pound sterling was credited to the non-residents accounts in the books of the assessee. The Supreme Court held that the plea to accept royalty income in U.K. was immaterial because the amount was available for the use of the non-resident in India in any manner he liked. Hence, the income was received in India. In the wake of this decision, non-residents who have all along been held to be not liable to Indian Income-tax if the contract was signed outside India, executed outside India and paid for outside India could well fall into the Indian- tax net, should their clients/customers credit them for the amount due before making payments to them outside India. In other words, a non-resident's tax liability depends upon the accounting entry passed by his client customer.

RATES OF TAX FOR ASSESSMENT YEAR 2021-22

Domestic Company	***Assessment Year 2021-22***
- Where it has opted for Section 115BA [other than those opted under section 115BAA and section 115BAB] [This regime shall be available only for the manufacturing companies incorporated in India on or after 01-03-2016.	25%
- Where it opted for Section 115BAA [This benefit shall be available when total income of the company is computed without claiming specified deductions, incentives, exemptions and additional depreciation available under the Income-tax Act.]	22%
- Where it opted for Section 115BAB [This regime shall be available only for the manufacturing companies incorporated in India on or after 01-10-2019. Hence, old companies will not be able to take the benefit of this section.]	15%
- Where it has not opted for Section 115BAA and the Total Turnover or Gross receipts of the company in the last previous year does not exceeds 400 crore rupees	25%
- Any other domestic company	30%
Foreign Company	
On so much of the total income as consists of- royalties received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 31st day of March, 1961 but before the 1st day of April, 1976; or fees for rendering technical services received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 29th day of February, 1964 but before the 1st day of April, 1976,and where such agreement has, in either case, been approved by the Central Government	50%
On other incomes	40%

a) *Surcharge*:

(i) *For Domestic Company* : The amount of income-tax shall be increased by a surcharge at the rate of 7% of such tax, where total income exceeds one crore rupees but not exceeding ten crore rupees and at the rate of 12% of such tax, where total income exceeds ten crore rupees. However, the rate of surcharge in case of a company opting for taxability under Section 115BAA or Section 115BAB shall be 10% irrespective of amount of total income.

(i) *For Foreign Company* : Surcharge @ 2% where total income exceeds Rs. 1 crore and @ 5% where total income exceeds Rs. 10 crore.

(ii) *Health and Education Cess*: The amount of income-tax and the applicable surcharge, shall be further increased by health and education cess calculated at the rate of four percent of such income-tax and surcharge.

Marginal Relief: In case of a company having a total income exceeding Rs. 1 crore, marginal relief would be provided to ensure that the additional income-tax payable including surcharge, on the excess of income over Rs. 1 crore is limited to the amount by which the income is more than Rs. 1 crore.

In other words, marginal relief = {Tax on total income (plus surcharge) - Tax on total income of Rs. 1 crore} – {Total Income – Rs. 1 crore)}, if positive.

Similarly in case of a company having total income exceeding 10 Crore, the amount payable as income tax and surcharge shall not exceed the total amount payable as income tax and surcharge on total income of Rs 10 Crore by more than the amount of income that exceeds Rs 10 Crore.

In other words marginal relief = [Tax on total income (+surcharge) – Tax on total income of 10 crore(+surcharge)] – [Total Income – 10 crore], if positive.

Tax on Income of certain manufacturing Domestic Companies [Section 115BA]

Income-tax payable by domestic company, w.e.f. A/Y 17/18, shall, at its option, be computed @ 25%, if the following conditions are satisfied:

(a) Company has been set-up & registered on or after 1/3/2016;

(b) Company is only engaged in business of manufacture/production of any article/thing and research in relation to, or distribution of, such article or thing manufactured

(c) Total income of the company has been computed,—

(i) without any deduction

- u/s 10AA or
- u/s 32(1)(iia) or
- u/s 32AC or u/s 32AD or
- u/s 33AB or u/s 33ABA or
- u/s 35(1)(ii)(iia)(iii) or u/s 35(2AA)(2AB) or
- u/s 35AC or
- u/s 35AD or
- u/s 35CCC or
- u/s 35CCD or
- u/s 80C to 80U (profit based) other than u/s 80JJAA;

(ii) without set off of any loss c/f from any earlier A/Y if such loss is attributable to any of the deductions referred to in sub-clause (i); and

(iii) depreciation u/s 32, other than clause (iia) of sub-section (1) of the said section, is determined in the manner as may be prescribed.

The loss referred as above shall be deemed to have been already given full effect to and no further deduction for such loss shall be allowed for any subsequent year.

Nothing contained in this section shall apply unless option is exercised in the prescribed manner on or before due date u/s 139(1) for furnishing the first of returns of income which the person is required to furnish under the provisions of this Act:

Provided that once the option has been exercised for any p/y, it cannot be subsequently withdrawn for the same or any other p/y.

Provided further that where the person exercises option u/s 115BAA, the option under this section may be withdrawn.

Tax on income of certain Domestic Companies [Section 115BAA]

The income-tax payable of domestic company, w.e.f. A/Y 20/21, shall, at option of such person, be computed @22%, if the following conditions are satisfied, Provided that where the person fails to satisfy specified conditions in any p/y, the option shall become invalid in respect of that p/y and subsequent years and other provisions of the Act shall apply, as if the option had not been exercised for the p/y and subsequent years.

1. the total income of the company shall be computed:

   (i) without any deduction

   - u/s 10AA or
   - u/s 32(1)(iia) or
   - u/s 32AC or u/s 32AD or
   - u/s 33AB or u/s 33ABA or
   - u/s 35(1)(ii)(iia)(iii) or u/s 35(2AA)(2AB) or
   - u/s 35AC or
   - u/s 35AD or
   - u/s 35CCC or
   - u/s 35CCD or
   - u/s 80C to 80U (profit based) other than u/s 80JJAA;

   (ii) without set off of any loss c/f or depreciation from any earlier year, if such loss or depreciation is attributable to any of above deductions

   (iii) without set off of any loss or allowance for unabsorbed depreciation deemed u/s 72A, if such loss or depreciation is attributable to any of the deductions referred to in clause (i); and (iv)

   (iv) by claiming the depreciation, if any, u/s 32, except clause (iia) of sub-section (1) of the said section, determined in such manner as may be prescribed.

The loss and depreciation referred to in clause (ii) and clause (iii) of sub-section (2) shall be deemed to have been given full effect to and no further deduction for such loss or depreciation shall be allowed for any subsequent year:

In case of a person, having Unit in International Financial Services Centre, u/s 80LA, which has exercised option under sub-section (5), deduction under section 80LA shall be available to such Unit subject to fulfilment of the conditions contained in the said section.

Nothing contained in this section shall apply unless the option is exercised by the person in the prescribed manner on or before the due date specified u/s 139(1) for furnishing the returns of income for A/Y commencing 20/21 and such option once exercised shall apply to subsequent assessment years:

Provided that in case of a person, where the option exercised by it under section 115BAB has been rendered invalid due to violation of conditions contained u/s 115BAB(2), such person may exercise option under this section:

Provided further that once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.

Tax on Income of new manufacturing domestic companies [Section 115BAB]

Any domestic manufacturing company has an option to pay tax at 15%, subject to the following conditions:

1. any deduction under the provisions of section 10AA or clause (iia) of sub-section (1) of section 32 or section 32AD or section 33AB or section 33ABA or sub-clause (ii) or sub-clause (iia) or sub-clause (iii) of sub-section (1) or sub-section (2AA) or sub-section (2AB) of section 35 or section 35AD or section 35CCC or section 35CCD or under any provisions of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" other than the provisions of section 80JJAA;
2. 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 deductions referred to above;
3. set off of any loss or allowance for unabsorbed depreciation deemed so under section 72A, if such loss or depreciation is attributable to any of the deductions referred to above; and
4. by claiming the depreciation, if any, under any provision of section 32, except clause (iia) of sub-section (1) of the said section, determined in such manner as may be prescribed.

However, losses and depreciation would be deemed that full effect has already been given and no further deduction shall be allowed for any subsequent years.

Such Company:-

1. Is incorporated on or after 1 October 2019, and commences production on or before 31 March 2023.
2. Is not formed by splitting up or reconstruction of business already in existence (exception provided for undertaking formed as a result of reestablishment, reconstruction or revival of business referred to in section 33B of the Act).
3. Does not use any building previously used as a hotel or convention centre.
4. Is not engaged in any business other than the manufacture or production of an article or thing and research in relation to or distribution of article or thing manufactured or produced by it.

The option needs to be exercised before the due date as per section 139(1) for furnishing the return of income for any previous year starting from AY 2020-21 or subsequent assessment years. If once the option is exercised cannot be withdrawn for the same or subsequent assessment years.

Provisions similar to section 80IA(10) of the Act are made applicable for transactions between connected parties which has the effect of producing more than ordinary profit that might be expected to arise.

Domestic transfer pricing provisions under section 92BA of the Act is being made applicable to such transactions. The corresponding amendment has been made in section 92BA of the Act to consider such transactions as specified domestic transactions in order to bring it within the ambit of transfer pricing provisions.

MINIMUM ALTERNATE TAX (MAT)

Section 115J which was a special provision applicable to a company if its total income as computed under the Income tax Act was less than thirty per cent of its book profit was introduced with effect from 1.4.1988 but was discontinued with effect from 1.4.1991. It was revived as Section 115JA with effect from 1.4.1997 as a provision deeming total income equal to thirty per cent of book profit of companies referred to earlier. This provision was also discontinued with effect from 1.4.2001 but was substituted by Section 115JB effective from the same date. This provision follows concept of minimum alternate Tax.

Hence, the new provisions of Section 115JB were inserted which are simpler in application.

Section 115JB(1)-Applicability of MAT: if the income tax payable by a company on its total income as computed under the Income Tax Act in respect of any previous year relevant to the assessment year, is less than 15% of such book profit plus surcharge plus education cess then such book profit shall be treated as total income of the company and the tax payable for the relevant previous year shall be deemed to be 15% of such book profit. This non-absolute provision will override any other provision of the Income Tax Act.

Thus, where the Income-tax payable is less than 15% of Book Profit, such book profit will be deemed to be total Income and Income Tax will be payable @ 15% on such Book Profit. [**9% of book profits, in case of the assessee is a unit located in an International Financial Services Centre and derives its income solely in convertible foreign exchange][Section 115JB(7) w.e.f. AY 2017-18**]

Section 115JB(2): Maintenance of statement of Profit and loss account;-

Such company assessee has to prepare Profit & Loss A/c in accordance with the provisions of Schedule III of Companies Act 2013.

Sub-section (2) of this section requires the company in this case will prepare its profit and loss account for the relevant previous year in accordance with the provisions of Parts II of Schedule VI of the Companies Act, 1956 or statement of profit and loss as per schedule III of companies Act 2013. However, while preparing the annual accounts including profit and loss account -

(a) the accounting policies;

(b) the accounting standards followed for preparing such accounts including profit and loss accounts; and

(c) the method and rates adopted for calculating the depreciation,

shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account and laid before the company at its annual general meeting . But where the company has adopted or adopts the financial year, which is different from the previous year under the Income Tax Act, (a), (b) and (c) aforesaid shall correspond to the accounting policies, accounting standards and the method and rates for calculating the depreciation which have been adopted for preparing such accounts including profit and loss account for such financial year or part of such financial year falling within the relevant previous year.

As per section 115JB, every company is required to prepare its accounts as per Schedule VI of the Companies Act, 1956. However, as per the provisions of the Companies Act, 1956, certain companies, e.g. Insurance, Banking or Electricity Company, are allowed to prepare their profit and loss account in accordance with the provisions specified in their regulatory Acts.

In order to align the provisions of Income-tax Act with the Companies Act, 1956, with effect from assessment year 2013-14, section 115JB has been amended to provide that the companies which are not required to prepare their profit and loss account in accordance with the Schedule VI of the Companies Act, 1956*, profit and loss account prepared in accordance with the provisions of their regulatory Acts shall be taken as a basis for computing the book profit under section 115JB.

From the above it can be observed that the provisions of MAT are applicable to every company whether public or private and whether Indian or foreign. However MAT shall not apply to :

(i) any income arising to a company from life insurance business.

(ii) a person who has exercised the option referred to under sections 115BAA or 115BAB

(iii) any shipping income arising to a company liable to tonnage taxation.

(iv) a foreign company resident of a country with which India has an Double Taxation Avoidance Agreement (DTAA) and such company does not have a permanent establishment in India.

(v) the foreign company is a resident of a country with which India does not have an agreement (DTAA) and such company is not required to seek registration under any law for the time being in force relating to companies.

(vi) a foreign company, whose total income comprises of profits and gains arising from business referred to in section 44B, 44BB, 44BBA, or 44BBB and such income has been offered to tax at the rates specified in those sections.

COMPUTATION OF BOOK PROFIT FOR THE PURPOSE OF MAT AS PER AMENDED SECTION 115JB [w.e.f. AY 18-19]

Due to applicability of Ind AS Section 115JB has been amended to calculate MAT in case of Ind AS compliant companies. Following are steps for computation of book profit-

***Step 1**:* Find out the net profit [before other comprehensive income (OCI)] as per statement of profit and loss of the company.

Step 2: Make adjustments which are given in existing provisions under section 115JB(2) i.e. as per explanation 1 given u/s 115JB(2).

***Step 3**:* Make specific adjustments in the case of demerger as given by new sub-section 2B to section 115JB.

***Step 4**:* Make further adjustments pertaining to OCI items that will be permanently recorded in reserves (i.e. never to be reclassified to the statement of profit and loss).

Detailed discussion of steps to calculate book profit is as under:-

Step 1:- Find out Net profit (before other comprehensive income) as shown in profit and loss account (prepared in accordance with provisions of Schedule III of Companies Act, 2013).

Step 2:- Adjustments to be made to the Net Profit in Step 1 as given in existing provisions under Section 115JB(2):-

Following amounts shall be added; if debited to Profit and Loss account:-

(a) **the amount of Income tax paid or payable, and the provision therefor;**

The amount of income-tax shall include:

(i) any tax on distributed profits under Section 115O or on distributed income under section 115R; [Dividend distribution Tax not applicable w.e.f. 1/4/2020 by Finance Act, 2020]

(ii) any interest charged under this Act; and

(iii) Surcharge, Education Cess and SHEC on Income-tax, if any, as levied by the Central Acts from time to time.

The amount of income tax shall not include following taxes:

- STT, Banking cash transaction tax, gift tax, indirect taxes
- Interest, penalty, fine, surcharge, health and education cess on above taxes.

(b) the amounts carried to any reserves, by whatever name called other than reserve specified under Section 33AC, i.e., shipping reserve; or

(c) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities, (i.e. unascertained liabilities); or

(d) the amount by way of provision for losses of subsidiary companies; or

(e) the amount or amounts of dividends paid or proposed; or

(f) the amount or amounts of expenditure relatable to any incomes to which MAT is not applicable [e.g. Section 10 (other than the provisions contained in clause 38) or Section 11 or Section 12 apply.]

(fa) the amount or amounts of expenditure relatable to, income, being share of the assessee in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86; or

(fb) the amount or amounts of expenditure relatable to income accruing or arising to an assessee, being a foreign company, from, -

– the capital gains arising on transactions in securities; or

– the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII (i.e. Section 115A to 115BBE)

if the income-tax payable thereon in accordance with the normal provisions of this Act, other than the provisions governing MAT, is at a rate less than the rate specified in Section 115JB(1); or

(fc) -the amount representing notional loss on transfer of a capital asset, being share or a special purpose vehicle to a business trust in exchange of units allotted by the trust referred to in section 47(xvii)

Or

- the amount representing notional loss resulting from any change in carrying amount of said units

Or

-the amount of loss on transfer of units referred to in clause (xvii) of section 47 whether or not it appears in profit and loss account.

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

(g) the amount of depreciation.

(h) the amount of deferred tax and provisions therefore (inserted by Finance Act, 2008 with retrospective effect from 1.4.2001).

(i) the amount or amounts set aside as provision for diminution in the value of any asset (w.r.e.f. 1.4.2001) e.g. provision for bad and doubtful debts and provision for impairment losses.

(j) the amount standing in revaluation reserve relating to revalued asset on the retirement or disposal of such asset if such profit is not credited to profit and loss account.

(k) the amount of gain on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through profit or loss account, as the case may be.

Amounts to be deducted from Net profit mentioned in step 1:

(i) the amount withdrawn from any reserves or provisions if any such amount is credited to the profit and loss account;

Provided that, where this section is applicable to an assessee in any previous year, the amount withdrawn from reserves created or provisions made in a previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 shall not be reduced from the book profit unless the book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn) under this Explanation or Explanation below second proviso to Section 115JA, as the case may be; or

In other words, if amount is withdrawn from provisions/reserve not allowed as deduction earlier, it will not be added (taxed) again ; however in any other case the withdrawal will be taxed.

(ii) the amount of income to which any of the provisions of Section 10 (other than the provisions contained in clause 38) or Section 11 or Section 12 apply, if any such amount is credited to the profit and loss account; or

(iia) the amount of depreciation debited to the profit and loss account (excluding the depreciation on account of revaluation of assets); or

(iib) the amount withdrawn from revaluation reserve and credited to the profit and loss account, to the extent it does not exceed the amount of depreciation on account of revaluation of assets referred to in Clause (iia); or

(iic) the amount of income, being the share of the assessee in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86, if any, such amount is credited to the profit and loss account; or

(iid) the amount of income accruing or arising to assessee, being a foreign company, from, -

(A) the capital gains arising on transactions in securities; or

(B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII,(i.e. under section 115A to 115BBE)

if such income is credited to the profit and loss account and the income-tax payable thereon in accordance with the normal provisions of this Act, other than the provisions of MAT , is at a rate less than the rate specified in section 115JB(1); or

(iie) the amount representing, -

(A) notional gain on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust referred to in clause (xvii) of section 47; or

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

(C) gain on transfer of units referred to in clause (xvii) of section 47, if any, credited to the profit and loss account; or

(iif) the amount of loss on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through profit or loss account, as the case may be;

(iig) the amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF; or

(iii) the amount of loss brought forward or unabsorbed depreciation, whichever is less, as per books of account. For the purposes of this clause, the loss shall not include depreciation. Therefore, in a case where an assessee has shown profit in a year, but after adjustment of depreciation it results profit or loss, no adjustment in book profit is allowed; or

(iv) the amount of profits of sick industrial company for the assessment year commencing on and from the assessment year relevant to the previous year in which the said company has become a sick industrial company under Sub-section (1) of Section 17 of the Sick Industrial Companies (Special Provisions) Act, 1985 and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses. "Net Worth" shall have the meaning assigned to it in Clause (ga) of Sub-section (1) of Section 3 of the Sick Industrial Companies (Special Provisions) Act, 1985.

(v) The amount of deferred tax, if any such amount is credited to the profit and loss account.

Step 3 and step 4

A) No further adjustments to be made to net profits(i.e. net profits before other comprehensive income), other than those already specified under section 115JB, shall be made.

B) The OCI includes certain items that will permanently be recorded in reserves and hence never be reclassified to statement of profit and loss included in computation of book Profit. Following items shall be included in the book profits for the MAT purposes as explained under:

1. Changes in revaluation surplus of Property, Plant or Equipment (PPI) and Intangible assets (Ind AS 16 and 38)
   - Revaluation reserve credited or debited to OCI shall not be adjusted in the book profits in the year in which it is debited or credited. **First proviso to section 115JB (2A)**
   - It shall be included in the book profit in the year in which the Asset/Investment is retired, disposed, realised or otherwise transferred. **Second Proviso to section 115JB(2A)**
2. Gains and losses from Investments in equity instruments designated at fair value through OCI (Ind AS 109)
   - Gain or loss from such Investments debited/credited to OCI shall not be adjusted in book profits in the year in which it is credited/debited. **First proviso to section 115JB (2A)**
   - It shall be adjusted in book profits in the year in which investment is retired/disposed/realised . **Second proviso to section 115JB (2A)**
3. Re-measurements of defined benefit plans (Ind AS 19) - It shall be adjusted in book profits every year in which such re-measurement gain/loss arises.
4. Any other Item - It will be adjusted in book profits every year in which such profit/loss arises.

C) As per Appendix A of Ind AS 10 any distribution of non cash assets to shareholders in case of demerger shall be accounted at fair value and the difference between carrying value and fair value of such assets is adjusted in profit and loss. Reserves of such company are debited with fair value of assets to record distribution of "deemed dividend" to shareholders. Since such difference between fair value and carrying amount is included in retained earnings, therefore, such difference arising on demerger shall be excluded from book profits. However, where such assets are recorded in books of resulting company at any value different from the value at which such assets were recorded in books of demerged company before demerger, then such difference shall be ignored for the purpose of calculation of book profits of resulting company. [**Section 115JB(2C)**]

D) **MAT on first time adoption [Section 115JB(2C)]**

The adjustments arising on account of shifting from existing Indian GAAP to Ind AS are required to be recorded in OCI at the date of such transition to Ind AS. Several of these items shall never be reclassified to statement of profit and loss or included in computation of book profits. Following adjustments shall be made:

- Those adjustments which are recorded in OCI and which would be reclassified to profit or loss account subsequently shall be included in book profits in the year in which these are reclassified to profit or loss.
- Those adjustments recorded in OCI and which would never be reclassified to profit or loss shall be treated as under:
  i. Changes in revaluation surplus of Property, Plant or Equipment (PPI) and Intangible assets (Ind AS 16 and 38) - It shall be included in the book profit in the year in which the Asset/ Investment is retired, disposed, realised or otherwise transferred.
  ii. Gains and losses from Investments in equity instruments designated at fair value through OCI (Ind AS 109) - It shall be adjusted in book profits in the year in which investment is retired/disposed/ realised.
  iii. Re-measurements of defined benefit plans (Ind AS 19) - It shall be adjusted in book profits equally over a period of 5 years starting from the year of first time adoption of Ind AS.
  iv. Any other Item - It shall be adjusted in book profits equally over a period of 5 years starting from the year of first time adoption of Ind AS.
- All other adjustments recorded in reserves and surplus (excluding capital reserve and securities premiums) and which would otherwise never subsequently be reclassified to profit and loss account, shall be included in book profits, equally over a period of 5 years starting from the year of first time adoption of Ind AS.

Note 3 : If an entity shows fair value of PPE and Intangible asset in opening Ind AS Balance sheet as deemed cost as per Ind AS 101, then treatment shall be as under :

i. Existing provisions of section 115JB provide that in case of revaluation of assets, any impact on account of such revaluation shall be ignored for the purpose of computation of Book profits. Also the adjustments in retained earnings due to first time adoption of Ind AS shall be ignored for the purposes of computation of Book Profit.
ii. Depreciation shall be computed ignoring above said adjustment.
iii. Gain or loss on realisation/disposal/retirement of such assets shall be computed ignoring the above said adjustment to retained earnings.

E) *If any entity uses fair value as deemed cost in its opening Ind AS Balance Sheet in respect of investments in subsidiary, joint venture or associate as per Ind AS 101, then retained earnings adjustment shall be included in in the book profits at the time of realisation of such investment.*

F) *If any entity, at the time of transition to Ind AS, chooses that cumulative translation differences of all foreign operations are deemed to be zero and also gain or loss on a subsequent disposal of any foreign operations shall exclude translation differences that arose before the date of transition to Ind AS and shall include only the translation difference after the date of transition, then the cumulative translation* *differences transferred to the retained earnings on the date of transition shall be included in book profits at the time of disposal of foreign operation.*

G) All other adjustments to retained earnings at the time of transition (e.g. decommissioning liability, asset retirement obligations, foreign exchange capitalisation/de-capitalization, borrowing costs etc,) shall be included in book profits, equally over a period of 5 years starting from the year of first time adoption of Ind AS.

H) As section 115JB already provides for adjustment on account of deferred tax and its provision. Any deferred tax adjustment recorded in reserves and surplus on account of transition to Ind AS shall be ignored.

The following points should also be noted in this context:

1. **Losses and unabsorbed Depreciation allowed to be carried forward** [**Section 115JB(3)]**

   Provisions of MAT under Section 115JB(1) **shall not** affect the determination of the amounts unabsorbed depreciation under Section 32(2), business loss u/s 72(1), speculation loss u/s 73, capital loss u/s 74 and loss u/s 74A in relation to the relevant previous year to be carried forward to the subsequent year or years. In other words these are allowed to be carried forward in usual manner.

2. **Report from a Chartered Accountant to be submitted [Section 115JB(4)]**

   Every company to which this section applies, shall furnish a report in the prescribed form from a Chartered accountant as defined in the Explanation below Section 288(2), certifying that the book profit has been computed in accordance with the provisions of this section along with the return of income filed under Section 139(1) or along with the return of income furnished in response to a notice Section 142(1)(i).

3. **All other provisions to be applicable as usual [Section 115JB(5)]**

   Save as otherwise provided in this section, all other provisions of this Act shall apply to such companies, i.e. all the provisions such as Advance tax, Interest under Section 234A, 234B and 234C, penalty etc shall also apply to such companies.

4. **Applicability of Provisions to SEZ enterprises and SEZ developers**:-

   The provisions of this section are applicable to SEZ enterprises and SEZ Developers from AY 2012-13.

5. **Rate of MAT in case of a unit located in International Financial Service Centre:-**

   Notwithstanding anything contained in Section 115JB(1), where the assessee referred to therein, is a unit located in an International Financial Services Centre and derives its income solely in convertible foreign exchange, the rate of MAT shall be 9% instead of 15% of Book Profits.

6. **Applicability of provisions of MAT applicable to foreign companies:-**

   Since ‘company’ defined u/s 2(17) includes any body corporate incorporated under the laws outside India, so foreign companies are also liable to MAT in respect of their income in India.

   However, foreign companies shall not liable u/s 115JB without physical presence.

   The Authority for Advance Ruling (“AAR”) has delivered a ruling in the case of Timken India Ltd. In re (2005) 273 ITR 67 (AAR) where it holds that the provisions of section 115JB of the Income-tax Act, 1961 (“the Act”) levying Minimum Alternate Tax (“MAT”) on the book profit of a Company would not apply to a Foreign Company not having any physical presence in India. In this case, the AAR distinguished its earlier ruling of 1998 (234 ITR 828) wherein it had held that a foreign company would be subject to MAT provisions. The critical factor for distinguishing was on the basis that in the earlier ruling the applicant had a project office in India, which constituted a Permanent Establishment and was preparing its financial statements as required under Indian Companies Act, 1956. In order to comply with the requirement of MAT provisions regarding preparing Profit & Loss Account in accordance with the provisions of the Indian Companies Act, it is essential that the foreign company should have a place of business within India.

Similar view has been upheld by AAR in the recent ruling of *Praxair Pacific Ltd., In re [2010] 326 ITR 276 (AAR)*

Further, the provisions of section 115JB were amended vide Finance Act, 2015 to provide that in case of a foreign company any income chargeable at a rate lower than the rate specified in section 115JB shall be reduced from the book profits and the corresponding expenditure will be added back.

However, since this amendment was prospective w.e.f. assessment year 2016-17, the issue for assessment year prior to 2016-17 remained to be addressed.

With a view to provide certainty in taxation of foreign companies, an amendment has been made vide Finance Act, 2016 so as to provide that with effect from 01.04.2001, the provisions of section 115JB shall not be applicable to a foreign company if -

- the assessee is a resident of a country or a specified territory with which India has an agreement referred to in sub-section (1) of section 90 or the Central Government has adopted any agreement under sub-section (1) of section 90A and the assesse does not have a permanent establishment in India in accordance with the provisions of such Agreement; or
- the assessee is a resident of a country with which India does not have an agreement of the nature referred above and the assessee is not required to seek registration under any law for the time being in force relating to companies.

This amendment effective retrospectively from the 1st day of April, 2001 and accordingly apply in relation to assessment year 2001-02 and subsequent years.

7. Whether Assessing officer has the power to examine correctness of net profit shown in profit and loss Account [Apollo Tyres Ltd. v. CIT(2002) 255 ITR 273 (SC)]

The AO does not have the power to question correctness of P&L A/c prepared by assessee and certified by the statutory auditors of the company as having been prepared in accordance with the provisions of the Companies Act, 2013. The AO does not have the jurisdiction to go behind the net profits shown in the P&L A/c except to the extent provided in the Explanation 1 to Section 115JB.

In the following cases Assessing officer has power to rework or rewrite the profit and loss account:

- Where the profit and loss account submitted is not as per Companies Act, 2013.
- Where accounting policies or accounting standards or rate of depreciation adopted are different from those adopted for the profit and loss prepared for the AGM.

MAT CREDIT [SECTION 115JAA]

MAT Credit for taxes paid as per Section 115JB in earlier years (in which MAT liability was more than tax liability as per normal provisions of the Act) is available in the Assessment year in which Tax payable on the total income computed under the normal provisions of this Act is more than tax payable u/s 115JB for that Assessment year.

MAT Credit to be set off in an AY = Regular Income tax - Minimum alternate tax

MAT credit can be carried forward up **to 15th assessment year** (10th assessment year upto AY 2017-18) immediately succeeding the assessment year in which such credit becomes allowable.

The amount of MAT credit shall not be allowed to be carried forward to the 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 the Act.

TAXABILITY OF DIVIDEND

Taxability of Dividend upto AY 2020-21

Domestic company was liable to Pay Dividend Distribution (DDT) tax u/s 115-O on dividend declared or paid by it. Dividend included deemed dividend u/s 2(22).Therefore DDT was payable both on actual dividend as well as deemed dividend.

Actual and deemed dividend u/s 2(22)(a),(b),(c) & (d) was subject to DDT @ 15% plus surcharge @ 12% plus Health & education cess @ 4%. But deemed dividend u/s 2(22)(e) was liable to be DDT at higher rate of 30% plus surcharge @ 12% plus Health & Education cess @ 4%

Since Domestic company was liable to pay DDT, the dividend received by shareholder was exempt u/s 10(34) upto 10 lakhs on receipt of actual dividend and deemed dividend u/s u/s 2(22)(a),(b),(c) & (d). Dividend u/s 2(22)(e) was fully exempt in hands of the shareholder u/s 10(34).

Since Actual and Deemed dividend u/s u/s 2(22)(a),(b),(c) & (d) was chargeable to DDT at less rates as compared to 2(22)(e), they was also chargeable to additional tax @ 10% in hand of specified shareholder u/s 115BBDA in excess of Rs.10 lakhs.

Taxability of Dividend w.e.f. AY 2021-22

Finance Act 2020 has abolished Dividend Distribution Tax for dividend declared or paid w.e.f. 1/4/2020. Hence, implication is as follows:

Section 115-O is not applicable on Domestic company on dividend paid or declared w.e.f. 1/4/2020.Therefore domestic company not liable to pay Dividend Distribution Tax 'DDT' on dividend paid or declared w.e.f. 1/4/2020.

Since domestic company not liable to pay DDT, exemption u/s 10(34) shall also not be applicable in hands of shareholder for dividend received on or after 1/4/2020.Therefore now dividend received from domestic company will be taxable in hand of shareholders. Section 115BBDA will also be not be applicable w.e.f. 1/42020

Meaning of the term "Dividend" [Section 2(22)] :The term "dividend" is ordinarily used to refer to any distribution made by a company to its shareholders out of its profits in proportion to the number of shares held by the shareholder concerned in the company.

Apart from that dividend paid by a company to its shareholders, the definition of dividend includes deemed dividend as laid down under section 2(22) of the Act, which is inclusive but not exhaustive. Accordingly, the following payments or distribution made by a company to its shareholders are deemed as dividends to the extent of accumulated profits of the company whether capitalised or not (i.e. bonus shares issued is the capitalisation of profit). It may be noted that these payments may not be covered as dividend under Companies Act, 2013.:

(a) Any distribution if such distribution entails the release of all or any part of the assets of the company. Such accumulated profits are distributed in cash or in kind. For in kind distribution, the market value of assets shall be the deemed dividend in hands of shareholders.

(b) Any distribution of debentures, debenture-stock, or deposit certificates in any form, whether with or without interest to Equity or Preference shareholders. Any distribution of bonus shares to its preference shareholders. However, bonus shares allotted to equity shareholders does not amount to deemed dividend.

(c) Any distribution made on liquidation of a company

(d) any distribution on the reduction of capital of a company

Deemed dividend under clause (c) and clause (d) does not include :

i. Any distribution by to shareholders on liquidation or reduction of capital of the company in respect of full cash consideration, where the shareholder is not entitled to participate in the surplus asset in the event of liquidation.

ii. Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act.

iii. Any distribution of shares made in accordance with the scheme of demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

(e) Any payments in the form of loans or advances to the extent of accumulated profits (excluding capitalised profit) made by a closely-held company (i.e. a company in which public are not substantially interested) to:

i. its shareholder who is the beneficial owner of shares holding not less than 10% of voting power in such company.

ii. to any concern (HUF, Firm, AOP, BOI or Company) in which such shareholder is a member or a partner and which he has a substantial interest (20% of voting power or share of profit)

iii. any person on behalf of such shareholder for his/her individual benefit.

Deemed dividend under clause (e) does not includes:

- Any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off.
- Vide CBDT circular No. 19/2017, any trade advance in the nature of commercial transactions would not fall within the ambit of advance.

CIT v. Parle Plastics Ltd. 332 ITR 63 (Bom.)

If lending of money is a substantial part of the business of the lending company, the money given by it by way of advance or loan to the assessee could not be regarded as a dividend, as it had to be excluded from the definition of “dividend” by virtue of the specific exclusion in section 2(22).

Inter-corporate Dividend relief: As the taxability of dividend has been shifted from companies to shareholders w.e.f. 01.04.2020, the Government has introduced **a new section 80M** under the Act to remove the cascading effect where a domestic company receives a dividend from another domestic company. However, nothing has been prescribed where a domestic company receives dividend from a foreign company and further distribute the same to its shareholders. **[As amended by Finance Act, 2020]**

The taxability in such cases shall be as under:

Domestic co. receives dividend from another Domestic Compnay.: The provisions of **section 80M** removes the cascading effect by providing that inter-corporate dividend shall be reduced from total income of company receiving the dividend if same is further distributed to shareholders one month prior to the due date of filing of return.

Domestic co. receives dividend from a Foreign Company. : Dividend received by a domestic company from a foreign company, in which such domestic company has 26% or more equity shareholding, is taxable at a rate of 15% plus Surcharge and Health and Education Cess under **Section 115BBD.** Such tax shall be computed on a gross basis without allowing deduction for any expenditure.

Dividend received by a domestic company from a foreign company, in which equity shareholding of such domestic company is less than 26%, is taxable at normal tax rate. The domestic company can claim deduction for any expense incurred by it for the purposes of earning such dividend income.

BUY-BACK OF SHARES

(i) Levy of additional income-tax @ 20% on buyback of shares [Section 115QA]

The Finance (No. 2) Act, 2019 has extended the levy of additional income-tax on buy back to all companies including listed companies with effect from 5.7.2019. Thus, hereafter, In case of buyback of shares (whether listed or unlisted) by domestic companies, additional income-tax @20% (plus surcharge@12% and cess@4%) is leviable in the hands of the company.

Consequently, the income arising to the shareholders in respect of such buyback of shares by the domestic company would be exempt under section 10(34A), since the domestic company is liable to pay additional income-tax on the buyback of shares.

It means additional income tax is applicable to all companies, whether listed or unlisted, with effect from 5th July, 2019, However, the provision of this sub-section shall not apply to such buy of shares being the shares listed on recognized stock exchange in respect of which public announcement has been made before 5th July, 2019 in accordance with the provisions of SEBI (Buy Back Of Securities) Regulation 2018 made under the SEBI Act, 1992 as amended from time to time.

Note: Prior to 5.7.2019, additional income-tax was attracted only in case of buy-back of unlisted shares by domestic companies. Consequently, only holders of unlisted shares were entitled to exemption under section 10(34A).

Taxation provisions in respect of buyback effected on or after 5.7.2019

I	II	III	IV
Taxability in the hands of	Buyback of shares by domestic companies	Buyback of shares by a company, other than a domestic company	Buyback of specified securities by any company
Company	Subject to additional income-tax@23.296%.	Not subject to tax in the hands of the company.	Not subject to tax in the hands of the company.
Shareholder/ holder of specified securities	Income arising to shareholders exempt under section 10(34A)	Income arising to shareholder taxable as capital gains u/s 46A.	Income arising to holder of specified securities taxable as capital gains u/s 46A.

Such tax should be paid to the credit of the Central Government within 14 days from the date of payment of any consideration for such buyback to the shareholder

Meaning of buyback and distributed income:

1. **Buyback** : Purchase by a company of its own shares in accordance with the provisions of any law for the time being in force to companies [clause (i) of Explanation to section 115QA]

2. **Distributed income**: The consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares, determined in the manner as may be prescribed [clause (ii) of Explanation to section 115QA]

Section 115QB

The principal officer of the domestic company and the company will be liable to pay simple interest on such additional tax which has not been paid in time.

Such interest is leviable @ 1% for every month or part of the month on such amount of tax not paid / short paid, for the period beginning the date immediately after the last date on which such tax was payable and ending with the date when it was actually paid.

Section 115QC

The principal officer of the domestic company and the company would be deemed to be an assessees in default if such additional tax is not paid to the credit of the Central Government. In such a case hence, all provisions of collection and recovery of the tax would apply.

Exemption on Sale of stock of crude oil by Foreign Company

- The provisions of Section 10(48), 10(48A) and 10(48B) of the Income tax Act, 1961 exempts the following Incomes of a foreign company:
  1. Income received in India on account of Sale of crude oil as per the agreement approved by the Central Government – Section 10(48).
  2. Income accrue or arise in India on account of storage of crude oil in India and sale of crude oil therefrom in India as per the agreement approved by Central Government – Section 10 (48A).
  3. Income accrue or arise in India on account of Sale of leftover stock after the expiry of agreement approved by Central Government – Section 10(48B).

Finance Bill, 2018 has made the amendment that even in case of termination of agreement, exemption benefit under Section10(48B) will be available to such foreign company.

Liability of director of private company in liquidation: Director of a private company any time during the previous is jointly and severally liable for amount of tax which due from such company in respect of such previous year, if such tax could not be recovered from company. However, he shall not be liable if it can be proved that such non recovery was not any way attributed to any of his act which can be regarded as gross negligence, misfeasance or breach of duty on his part in relation to affairs of company.

CARBON CREDIT [SECTION 115BBG]

Where total income of the assessee includes any income from the transfer of carbon credit then such income shall be taxable at concessional rate of 10% (+SC+EC+SHEC) on the gross amount of such income. No expenditure or allowance in respect of such income shall be allowed.

STATEMENT SHOWING COMPUTATION OF TAXABLE INCOME AND TAX LIABILITY FOR COMPANY/AOP/BOI

COMPUTATION OF TOTAL INCOME	
Income from house property [A]	xxx
Income from PGBP [B]	xxx
Income from Capital gain [C]	xxx
Income from Other source [D]	xxx
Total [A+B+C+D]	xxx

Less: Adjustment towards set off and carry forward of losses	xxx
Gross Total Income (GTI)	xxx
Less: Deduction under Chapter VIA	xxx
Total income or Net income (Taxable income) [R/O Section 288A]	xxx
COMPUTATION OF TAX LIABILITY	
Tax on Total income or Net income (Taxable income)	xxx
Add: Surcharge	xxx
Tax and surcharge	xxx
Add: Health and Education Cess @ 4%	xxx
Less: Rebate under section 86/89/90/90A/91	
Total Tax payable	xxx
Less: Prepaid taxes	
• Self-assessment tax	xxx
• TDS/TCS	xxx
• Advance tax	xxx
Net Tax liability [R/O Section 288B]	xxx

COMPUTATION OF TAXABLE INCOME AND TAX LIABILITY OF NON CORPORATE ENTITIES

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

1. Determine the residential status of the person as per section 6 of the Act.
2. Calculate the income as per the provisions of respective heads of income. Section 14 classifies the income under five heads.
   (i) Income from salaries
   (ii) Income from House Property
   (iii) Profits and gains of business or Profession
   (iv) Capital Gains
   (v) Income from other sources
3. Consider all the deductions and allowances given under the respective heads before arriving at the net under each head.
4. Exclude the income exempt under section 10 of the Act.
5. Aggregate of incomes computed under the 5 heads of income after applying clubbing provisions and making adjustments of set off and carry forward of losses is known as Gross Total Income.
6. Deduct therefrom the deductions admissible under Sections 80C to 80U. The balance is called Total income.

7. The total income is rounded off to the nearest multiple of Rupees ten. (Section 288A)
8. Add agriculture income (if any) in the total income calculated in (6) above. Then calculate tax on the aggregate as if such aggregate income is the Total Income.
9. Calculate income tax on the net agricultural income as increased by Rs. 2,50,000/3,00,000/5,00,000 as the case may be, as if such increased net agricultural income were the total income.
10. The amount of income tax determined under (9) above will be deducted from the amount of income tax determined under (8) above.
11. Calculate income tax on capital gains under Section 112, and on other income at specified rates.
12. The balance of amount of income tax left as per (10) above plus the amount of income tax at (11) above will be the income tax in respect of the total income.
13. Deduct the following from the amount of tax calculated under (12) above.
    - Rebate under section 87A (if applicable).
    - Tax deducted and collected at source.
    - Advance tax paid.
    - Double taxation relief (Section 90 or 91).
14. The balance of amount left after deduction of items given in (13) above, shall be the net tax payable or net tax refundable for the assessee. Net tax payable/refundable shall be rounded off to the nearest multiple of Ten rupees (Section 288B).
15. Along with the amount of net tax payable, the assessee shall have to pay penalties or fines, if any, imposed on him under the Income-tax Act.

For calculation of income, amount received is classified under 5 heads of income; it is then to be adjusted with reference to the provisions of the Income Tax laws in the following manner:

Computation of Tax Liability	**Sections**	**Amount**
1. Income from Salary **Less** : Deductions u/s 16 ia. Standard Deduction of Rs. 50,000 or Gross Salary, whichever is lower. ii. Entertainment Allowance iii. Professional Tax Paid	15 to 17	XXX
2. Income from House property **Less** : Deduction U/s 24 Standard Deduction Interest on House Property Loan	22 to 27	XXX
3. Income from Profits and gains from business and profession **Turnover/Receipts/Fees/Sales** **Less** : Deductions u/s 30 to 37(1)	28 to 44	XXX

4. Income from Capital Gains **Full value of consideration** **Less** : Cost of acquisition/Cost of Improvement/Transfer expenses **Less** : Exemption u/s 54/54B/54EE etc	45 to 55A	XXX
5. Income from Other Sources **Income u/s 56** **Less : Deductions u/s 57**	56 to 59	XXX
Add : Clubbing of Income **Less** : Set Off & Carry Forward Provisions' under respective heads		
Gross Total Income [GTI]		**XXX**
Less : Deductions under Chapter VIA	80C to 80U	(XXX)
Total Income (Rounded off to nearest Rs.10 u/s 288A)		**XXX**
Tax on Total Income		XXX
Add : Surcharge on Total Tax (if applicable)		XXX
Less : Rebate u/s 87A		(XXX)
Add : 4% Health & Education Cess on [Total tax + Surcharge – Rebate]		XXX
Net Tax Liability		XXX
Less : (i). TDS (ii). Advance Tax (iii). Relief u/s 89		(XXX)
Balance tax payable on Self Assessment u/s 140A		XXX
Less : Self Assessment tax paid		XXX
Balance Tax		**NIL**

NEW TAXATION SYSTEM FOR INDIVIDUAL AND HUF [SECTION 115BAC]

Till FY 2019-20 (AY 2020-21) there was only one regime of Taxation for Individuals and HUFs and were required to apply the Slab rate specified in the Annual Finance Act on Total Income computed after allowing many deductions and exemptions.

Finance Act, 2020 has introduced a New Optional Tax System for Individuals and HUFs u/s 115BAC of the Income Tax Act, 1961 w.e.f. A/Y 21-22 to provide for concessional rate of Slab Rates to be applied on Total Income calculated without claiming specified deductions and exemptions.

Hence, from AY 2021-22 (or FY 2020-21), there are two operative tax system –

One is the Existing tax system where all the applicable deductions and exemptions are allowed and the tax rates are as per the Slab rates of tax specified in the Finance Act, 2020.

The second one is section 115BAC which is a Optional Tax System and under which many deductions and exemptions have been disallowed but lower slab tax rates are provided in the section 115BAC as under:

(1) Notwithstanding anything contained in this Act but subject to provisions of this Chapter, the income -tax payable in respect of the total income of a person, being an individual or a Hindu undivided family , for any

previous year relevant to the assessment year beginning on or after the 1st day of April, 2021, shall, at the option of such person, be computed at the rate of tax given in the following Table, if the conditions contained in sub -section (2) are satisfied, namely:—

TABLE

Sl. No.	Total Income	Rate of tax
(1)	(2)	(3)
1.	Up to Rs. 2,50,000	Nil
2.	From Rs. 2,50,001 to Rs. 5,00,000	5%
3.	From Rs. 5,00,001 to Rs. 7,50,000	10%
4.	From Rs. 7,50,001 to Rs. 10,00,000	5%
5.	From Rs. 10,00,001 to Rs. 12,50,000	20%
6.	From Rs. 12,50,001 to Rs. 15,00,000	25%
7.	Above Rs. 15,00,000	30%

Provided that where the person fails to satisfy the conditions contained in sub-section (*2*) in any previous year, the option shall become invalid in respect of the assessment year relevant to that previous year and other provisions of this Act shall apply, as if the option had not been exercised for the assessment year relevant to that previous year:

Provided further that where the option is exercised under clause (*i*) of sub-section (*5*), in the event of failure to satisfy the conditions contained in sub-section (*2*), it shall become invalid for subsequent assessment years also and other provisions of this Act shall apply for those years accordingly.

(2) For the purposes of sub-section (1), the total income of the individual or Hindu undivided family shall be computed,—

(i) without any exemption or deduction under the provisions of Section 10(5) or Section 10(13A) or prescribed u/s 10(14) (other than those as may be prescribed for this purpose) or u/s 10(17) or u/s 10 (32) or section 10AA or section 16 or Section 24(b) (in respect of the property referred in section 23(2)) or section 32(1)(iia) or section 32AD or section 33AB or section 33ABA or sub-clause (ii) or sub-clause (iia) or sub-clause (iii) of sub-section (1) or sub-section (2AA) of section 35 or section 35AD or section 35CCC or section 57(iia) or under any of the provisions of Chapter VI-A other than the provisions of section 80CCD(2) or section 80JJAA;

(ii) without set off of any loss,—

(a) carried forward or depreciation from any earlier assessment year, if such loss or depreciation is attributable to any of the deductions referred to in clause (i);

(b) under the head “Income from house property” with any other head of income;

(iii) by claiming the depreciation, if any, under any provision of section 32, except clause (iia) of sub-section (1) of the said section, determined in such manner as may be prescribed; and

(iv) without any exemption or deduction for allowances or perquisite, by whatever name called, provided under any other law for the time being in force.

(3) The loss and depreciation referred to in clause (ii) of sub-section (2) shall be deemed to have been given full effect to and no further deduction for such loss or depreciation shall be allowed for any subsequent year:

Provided that where there is a depreciation allowance in respect of a block of assets which has not been given full effect to prior to the assessment year beginning on the 1st day of April, 2021, corresponding adjustment shall be made to the written down value of such block of assets as on the 1st day of April, 2020 in the prescribed manner, if the option under sub-section (5) is exercised for a previous year relevant to the assessment year beginning on the 1st day of April, 2021.

(4) In case of a person, having a Unit in the International Financial Services Centre, as per section 80LA(1A), which has exercised option under sub-section (5), the conditions contained in sub-section (2) shall be modified to the extent that the deduction under section 80LA shall be available to such Unit subject to fulfilment of the conditions contained in the said section.

Explanation.– For the purposes of this sub-section, the term "Unit" shall have the meaning assigned to it in clause (zc) of section 2 of the Special Economic Zones Act, 2005.

(5) Nothing contained in this section shall apply unless option is exercised in the prescribed manner by the person,—

(i) having income from business or profession, on or before the due date u/s 139(1) for furnishing the returns of income for any previous year relevant to the assessment year commencing on or after the 1st day of April, 2021, and such option once exercised shall apply to subsequent assessment years;

(ii) having income other than the income referred to in clause (i), along with the return of income to be furnished u/s 139(1) for a previous year relevant to the assessment year:

Provided that the option under clause (*i*), once exercised for any previous year can be withdrawn only once for a previous year other than the year in which it was exercised and thereafter, the person shall never be eligible to exercise option under this section, except where such person ceases to have any income from business or profession in which case, option under clause (*ii*) shall be available.

Comparison of Existing Tax System with new Optional Tax System for Individual & HUF

	EXISTING SYSTEM OF TAX	NEW SYSTEM OF TAX U/S 115BAC
Exemption Limit for Incomes taxable at Slab Rates	Three exemption limit are applicable 1) 5,00,000 for super senior citizen (minimum 80 years & resident) 2) Rs 3,00,000 for senior citizen (minimum 60 years but less than 80 years & resident) 3) Rs.2,50,000 for other individual	Only one exemption limit of Rs.2,50,000 available irrespective of age/residential status

Slab Rates	3 different slab rates 0 – 2,50,000 : Nil > 2,50,000 upto 5,00,000 : 5% > 5,00,000 upto 10,00,000 : 20% > 10,00,000 : 30% ——— 0 – 3,00,000 : Nil >3,00,000 upto 5,00,000 : 5% >5,00,000 upto 10,00,000 : 20% > 10,00,000 : 30% ——— 0 – 5,00,000 : Nil > 5,00,000 upto 10,00,000 : 20% > 10,00,000 : 30%	One slab rate 0 to 2,50,000 Nil > 2,50,000 to 5,00,000 : 5% > 5,00,000 to 7,50,000 : 10% > 7,50,000 to10,00,000 : 15% > 10,00,00 to12,50,000 : 20% > 12,50,00 to 15,00,000 : 25% > 15,00,000 30%
Special rates of Taxes e.g. section 115BB,112,112A etc.	Available	Available
Rebate u/s 87A	Available	Available
Chapter VI- A Deductions	Available	Not available except 80CCD(2), 80JJAA
Surcharge	Applicable (10%/15%/25%/37%)	Applicable at same rates (10% / 15% / 25% / 37%)
Health & Education Cess	4%	4%
Deductions and Exemptions	Available	Many Deductions & Exemptions not available
Set off of C/F losses & Depreciation, from past p/y	Available	Not allowed if related to Deductions & exemptions not allowed u/s 115BAC
Set off of current year losses	Available	Allowed Except losses of House Property
Intimation	Not required as old tax system available by default	Assessee can opt for new tax system only if Intimation given in prescribed manner
Provisions of AMT u/s 115JC	Applicable	Not Applicable

Many exemptions & deductions are not allowed under the new tax system. The exemptions and deduction not available under the new system related to head of income are given under the respective chapters.

ALTERNATE MINIMUM TAX (AMT) [SECTION 115JC]

The provisions of section 115JC are applicable both to firm and LLP where the regular income tax payable for a previous year is less than the alternate minimum tax payable for such previous year then the adjusted total income shall deemed to be the total income of that person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus HEC @ 4%.

It is further provided that the provisions of AMT under Chapter XII-BA shall also apply to an **individual or a Hindu undivided family or an association of persons or a body of individuals (whether incorporated or not) or an artificial juridical person** if the adjusted total income of such person **exceeds twenty lakh rupees**.

The regular income tax payable shall be the income-tax payable for a previous year by a person other than a company on his total income in accordance with the provisions of the Act other than the provisions of Chapter XII-BA i. e section 115JC to 115JF.

Adjusted total income shall be the total income before giving effect to provisions of Chapter XII-BA as increased by the deductions claimed under any section (other than section 80P) included in Chapter VI-A under the heading "C - Deductions in respect of certain incomes" and deduction claimed under section 10AA. Further, total income shall be increased by the deduction claimed under section 35AD for purpose of computation of adjusted total income. The amount of depreciation allowable under section 32, as if no deduction u/s 35 AD in respect of such assets was allowed, shall however, be reduced in computing the adjusted total income.

The provisions can be summarized as:

1. If regular income tax payable is more than or equal to the alternate minimum tax (18.5% plus HEC @ 4% of adjusted total income), the regular income tax payable is the tax liability of the assessee.
2. If regular income tax payable is less than the alternate minimum tax (18.5% plus HEC @ 4% of adjusted total income), the adjusted total income is the deemed income of the assessee for that year and alternate minimum tax is the tax liability.

However, it is also provided that the credit for tax (tax credit) paid by a person on account of AMT under Chapter XII- BA shall be allowed to the extent of the excess of the AMT paid over the regular income-tax. This tax credit shall be allowed to be carried forward up to the **fifteen assessment year** (w.e.f. AY 18-19) immediately succeeding the assessment year for which such credit becomes allowable and set off against regular tax liability. In other words, it shall be allowed to be set off for an assessment year in which the regular income-tax exceeds the AMT, to the extent of the excess of the regular income-tax over the AMT.

The amount of AMT credit shall not be allowed to be carried forward to the subsequent year to the extent such credit relates to the difference between the amounts of foreign tax credit (FTC) allowed against AMT and FTC allowable against the tax computed under regular provisions of the Act.

No interest is allowed on such tax credit. Tax credit shall be allowed even if adjusted total income does not exceed 20 lakh in the year of set off.

As per Section 115JE all other provisions of act such as self assessment u/s 140A, advance tax, Interest u/s 234A, 234B, 234C , penalty etc. shall also apply to the person covered by AMT.

Every person to which this section applies shall obtain a report, *before the specified date referred to in section 44AB, in such form as may be prescribed, from an accountant referred to in the Explanation below sub-section (2) of section 288, 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*.**[Words in italics inserted by Finance Act, 2020]**

The provisions of AMT shall not apply to a person who has exercised the option referred to in section 115BAC or section 115BAD. **[Amendment by Finance Act, 2020]**

FORMAT SHOWING COMPUTATION TAXABLE INCOME AND TAX LIABILITY FOR INDIVIDUAL/HUF/FIRM

COMPUTATION OF TOTAL INCOME	
Income from Salary [A]	xxx
Income from House Property [B]	xxx
Income from PGBP [C]	xxx
Income from Capital Gain [D]	xxx
Income from Other Source [E]	xxx
Total [A+B+C+D+E]	xxx
Less: Adjustment towards set off and carry forward of losses	xxx
Gross Total Income (GTI)	xxx
Less: deduction under section 80C to 80U	xxx
Total income or Net income (Taxable income) [R/O Section 288A]	xxx
COMPUTATION OF TAX LIABILITY	
Tax on Total income or Net income (Taxable income)	xxx
Less: Rebate u/s 87A (In case of Resident Individual having Net income not exceeding Rs. 500000) (a) 100% of Tax on income (b) Rs. 12500 (a) or (b) whichever is lower.	xxx
Income Tax After Rebate under section 87A	xxx
Add: Surcharge	xxx
Tax and surcharge	xxx
Add: Health and Education Cess@4%	xxx
Less: Rebate under section 86/89/90/90A/91	
Total Tax payable	xxx
Less: Prepaid taxes • Self-assessment tax • TDS/TCS • Advance tax	 xxx xxx xxx
Net Tax liability [R/O Section 288B]	xxx

Rounding off Income [Section 288A]

Taxable income shall be rounded off to the nearest multiple of Rs. 10 and any part of rupee consisting of paisa shall be ignored and thereafter such amount is not multiple of 10, then last figure in that amount if five or more, the amount shall be increased to the next higher amount which is multiple of Rs10 and if last figure is <5, amount shall be reduced to next lower amount which is multiple of 10.

Rounding off Income [Section 288B]

Any sum payable by an assessee and the amount of refund due under provision of act shall be rounded off to nearest Rs. 10.

TAXATION OF AN INDIVIDUAL

Tax Act As per section 2(31) of Income tax act, the term "person" includes an Individual. However, the term 'Individual' is not defined anywhere in Income Tax Act, but it means a human being or a natural person. It also includes a minor or a person of unsound mind whether major or minor, married or unmarried. Individual shall be liable to tax if his income exceeds threshold exemption limit.

Steps for computation of taxable income have been explained in Introduction part above. However, steps for computation of taxable income and tax liability of an individual are briefly explained as under:-

1. Calculate the gross total income ignoring incomes exempted u/s 10, 10A or 10B or 10BA etc. of the Individual by adding Income under the five heads. Adjustment should be made regarding clubbing provisions u/s 60 to 65 and losses should be set off as per provisions of section 70 to 80.
2. Deductions should be allowed from gross total income under chapter VI-A for arriving at taxable income. An Individual is allowed deduction u/s 80C, 80CCC, 80CCD, 80CCG, 80D, 80DDB, 80E, 80EE, 80G, 80GG, 80GGA, 80GGC, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, 80JJA, 80-JJAA, 80QQB, 80RRB, 80TTA, 80TTB, 80U.
3. Certain incomes of Individual are taxable at flat rate of 30% under section 115BB such as winnings from lottery etc. No deduction is allowed under section 80C to 80U on such Income. Similarly care should be taken to calculate tax on capital gains u/s 112 or 111A etc.
4. There are special provisions related to taxation of non resident Indians u/s 115C to 115-I. Non resident Indians can take benefit of these provisions.
5. Provisions of AMT are applicable to an Individual who has claimed deduction under 10A or 80H to 80RRB(except section 80P) or 35AD and their adjusted total income exceeds Rs. 20 lakh.
6. Certain rebates and reliefs are specifically allowed to Individuals from their tax liability such as:
   - Rebate u/s 87A
   - Rebate u/s 86
   - Relief u/s 89 in respect of arrears or advance of salary income.

TAXATION OF HINDU UNDIVIDED FAMILIES

The term 'Hindu undivided family' has not been defined in the Income-tax Act but it is treated as a separate entity or person **under** section 2(31) of the Income-**tax Act**, 1961 for the purpose of assessment under the Act. Under Hindu Law, an HUF is a family which consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. Jain and Sikh families even though are not governed by the Hindu Law, but they are treated as HUF under the Act. An HUF cannot be created under a contract and is created automatically in a Hindu Family. Creation of a HUF is a God-gifted phenomenon since birth of a child to a married Hindu, automatically creates a new HUF. It is not at all necessary that every HUF must have joint property or family income. *[R. Subramania Iyer* v. *CIT* (1955) 28, ITR, 352]. However, to become an assessee under the Income-tax Act, there must be 'income-yielding' joint property of the family.

A HUF may consist of a number of smaller HUFs. A smaller HUF has a legal existence and may be assessable as a unit distinct from the apex joint family even when the bigger HUF is in place [CIT v. *Khanna* (1963) 49 ITR 232].

The Supreme Court's decision in the case of *Surjit Lal Chhabra* v. *CIT* (1975 101 ITR 776) has come to stay as one of the leading case laws. The ratio laid down by the Supreme Court had been applied by the Andhra Pradesh, Orissa and Madras High Courts, followed by Bombay, Patna, Madhya Pradesh and Delhi High Courts and relied upon by the Punjab High Court. In the latest case, the Delhi High Court held in *Commissioner of Income-tax* v. *S.P Chopra* (1991, 191 ITR 455) that the income from the half share of the property had to be treated as the individual income of the assessee under the personal law and not as income of the family. The character of the property had to be determined in accordance with the personal law of the assessee and not on the basis of how the property had been treated by the revenue in respect of earlier assessments.

A son conceived or in his mother's womb is equal in many respects to a son actually in existence, viz., inheritance, partition, survivorship etc. But this doctrine does not apply to the Income-tax Act. Hence, a son conceived is not treated a member of the H.U.F. for Income-tax purposes. [IS. *Srinivasan* v. *C.I.T.,* (1966) 60, ITR, p.36 (S.C.)].

Jain and Sikh undivided families are also treated as Hindu undivided families unless, under special circumstances, the assessee claims not to be treated as such. If such claim is made, the assessee shall have to prove that there is some such custom in his family on account of which it cannot be treated as a Hindu undivided family.

A Hindu does not cease to be a Hindu merely because he declared for the purpose of the Special Marriage Act, 1872, that he does not profess Hindu Religion. Such a Hindu does form an H.U.F. with his children from such marriage. [CIT v. *Partap Chand* (1959), 36 ITR, 262]. Similarly, a Muslim family governed by the Marumakkathayam law constitutes *'Tarwad'* or *'Thavazhi'* and falls within the definition of a H.U.F. *[V.K.P. Abdul Kadar Hajiv. Ag. ITO* (1967) 66, ITR, 173].

If a Hindu gets converted as a Christian, the family of such a person will not be a HUF. However a Hindu, along with his son (by a christian wife) who has been brought up as a Hindu will be a HUF. *[CWT* v. *R. Sridharan* (1976) 104, ITR, 436 (S.C.)].

A Hindu Joint Family consists of two types of members:

1. Coparceners: The lineal male descendants of a person up to the third generation of such person are known as coparceners. The coparceners acquire, on birth, ownership in the ancestral properties of such ascendant and have a right to claim partition of such property at any time. However, w.e.f. 9.9.2005 due to amendment of Hindu Succession Act, the daughter of a coparcener shall by birth become a coparcener in her own right in the same manner as the son. Hence, the daughter can also ask for partition.

2. Other members: Such members include wives of male members of the family and other male members. Widow or widows of deceased male member or members. [Gowli Buddanna *v.* C.I.T. *(1966) 60, ITR, p. 293 (S.C.)]*

However, an unmarried coparcener who receives share on the partition of joint family properties, cannot form a Hindu undivided family unless he marries. After his marriage, he can hold the property received from family as joint family property consisting of himself and his wife. [C. *Krishna Prasad*v. *C.I.T.* (1974) 97, p. 493 (S.C.)].

The joint property of the HUF is managed through Karta: Property of the family is ordinarily managed by the father or other senior member for the time being of the family. He is called Karta. However, the senior member may give up his right of management and a junior member may be appointed as Karta with the consent of all other members. *[Narendra Kumar J. Modi* v. *CIT* (1976) 105, ITR, 109 (S.C.)]. In the absence of a male member in the family or when all male members are minors, a woman member can be treated as manager of the family for income-tax purposes. *[Smt. Champa Kumari Singhi* v. *Addl. Member of the Board of Revenue* (1962) 46, ITR, p. 81].

School of Hindu Law: According to Hindu Law, HUFs are governed by two schools viz. Mitakshara and Dayabhaga. Mitakshara School applies to whole of India except the states of West Bengal and Assam.

Dayabhaga school applies to the States of West Bengal and Assam. The difference between the two schools is as under:

(i) *Foundation:* In the Mitakashara School, the foundation of a coparcenary is laid down when a child is born to the Mitakshara father. Under the Dayabhaga school the foundation of a coparcenary is laid on the death of the father leaving, as survivors, one or more sons.

(ii) *Right to partition:* A Mitakshara son, in whom the interest in family property is vested by birth, all along possesses a right to demand partition. A Dayabhaga son, on the other hand acquires no interest in the family property by birth and, consequently, has no right to demand partition of the HUF property from his father.

(iii) *Quantum of share:* Under Mitakshara Law, each coparcener takes as undefined share in the coparcenary property. The share of the members decreases by birth in the family and increases upon death of a coparcener. A Dayabhaga coparcener, on the other hand, always takes a defined share in the property left by his deceased father. Thus, the heirs of a deceased governed by the Dayabhaga school do not constitute a HUF automatically on the death of the deceased and cannot be assessed as a HUF unless they have by mutual consent agreed to form a joint family.

(iv) *Gift out of ancestral property:* A Mitakshara Karta may make a gift of movable property of the family, out of love and affection, within reasonable limits. He can also make a gift of immovable properties, within reasonable limits for pious purposes; i.e., for charitable and religious purposes or to a daughter in fulfilment of a nuptial promise etc. However, a gift to a stranger is void. On the contrary, a Dayabhaga father can alienate ancestral property, both movable as well as immovable, by sale, gift, will or otherwise in the same way as he can dispose of his separate property.

Position under Hindu Succession Act, 1956

This Act came into force on and from 17th June, 1956. It lays down a uniform and comprehensive system of inheritance and applies to persons governed by the Mitakshara as well as the Dayabhaga Schools, superseding and abrogating all previous law or customs or usage having the force of law.

Under this Act, the heirs of a male Hindu dying intestate on or after 17th June, 1956 are divided into three classes. Class I heirs get the right to the deceased's property simultaneously to the exclusion of all other Classes of heirs. Class II relations succeed only if there is no class I relation and, the heirs in the first entry of class II being preferred to heirs in the second entry, and so on, but heirs in any one entry taking in equal shares amongst themselves.

The students should note that Section 4 of the Hindu Succession Act, 1956 clearly lays down that "save as otherwise expressly provided in the Act, any text, rule or interpretation of Hindu Law or any custom or usage as part of that law in force immediately before the commencement of the Act shall cease to have effect with respect to any matter for which provision is made in the Act." And, Section 8 of the Hindu Succession Act, 1956, lays down the scheme of succession to the property of a Hindu dying intestate. The schedule classifies the heirs on which such property shall devolve.

The preferential heirs of class I are as under:

(1) Son (2) Daughter (3) Widow (4) Mother (5) Son/daughter/widow of a predeceased son (6) son/daughter of a predeceased daughter (7) Son/daughter/ widow of a predeceased son of a predeceased son.

A son's son is not mentioned as an heir under Class I of the schedule and, therefore, he cannot get any right in the property of his grandfather under the provision. The right of a son's son in his grandfather's property during the lifetime of his father which existed under the Hindu Law as in force before the Act, is not saved expressly by the Act and, therefore the earlier interpretation of Hindu Law giving a right by birth in such property 'ceased to have effect'.

Therefore, the property which devolves on a Hindu on the death of his father intestate after coming into force of the Hindu Succession Act, 1956, does not constitute H.U.F. property consisting of his own branch including his sons. *[Shri Vallabhdas Modani* v. *C.I.T.* (1982) 138, ITR, p. 673].

The Allahabad High Court's decision supra in the case of *Shri Vallabhdas Modani* v. *Commissioner of Income-tax* was followed by the Andhra Pradesh High Court (1983, 144 ITR 18) and later approved by the Supreme Court in the case of *Commissioner of Wealth-Tax* v. *Chander Sen* (1986, 161 ITR 370) holding that it is not possible to say that when a son inherits the property in the situation contemplated by the Hindu Succession Act, 1956, he takes as Karta of his own undivided family.

COMPUTATION OF INCOME OF THE H.U.F.

Income of the HUF is assessed as joint family income of HUF if there exists a coparcenership and joint property of the family till partition is claimed by any of its coparceners.

Joint Property of the family consists of:

(i) ancestral property which a man inherits from any of his three immediate male ancestors, namely, father, grandfather , great grandfather;

(ii) accretion thereto;

(iii) acquisition with joint funds; and

(iv) self-acquired property of any member thrown by him into the common stock to be treated as family property. In the case of Pushpa Devi v. C.I.T. the Supreme Court has held that a Hindu female, not being a coparcener, cannot blend her separate property with Joint family property. However, she can make a gift of her property or sell the property to the family. [(1977) 109, ITR p. 730].

The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assessee's. Incomes exempt under section 10 to 13A are exempt and deductions allowable under chapter VIA are to be provided. However, in this connection the following points are worth noting:

(i) The holder, who is the senior most male member of the family, of a impartible estate is liable to tax on income from that estate in his individual capacity though the estate belongs to HUF.

(ii) Conversion of self-acquired property into joint family property. Section 64(2) provides that where an individual being a member of Hindu undivided family transfers his separate property after 31st December, 1969 to the family for the common benefit of the family, otherwise than for adequate consideration, such property is known as converted property. The income derived from the converted property or any part thereof shall be included in the total income of the transferor individual and not in the income of the family.

(iii) If the funds of a Hindu Undivided family are invested in a company or a firm, fees or remuneration received by the member as a director, or a partner in the company or firm may be treated as income of the family in case the fees or remuneration is earned essentially as a result of investment of funds. But, if the fees or remuneration is earned essentially for services rendered by the member in his personal capacity, the income shall constitute the personal income of the member.

(iv) Where a member of a HUF is a partner in a firm on behalf of the family and on partition of the property of the family, the share in the firm is allotted to such a member, subsequent to such allotment when the firm settles its accounts the whole income for that year would be the income of the individual member and no part of the income would be added to the income of the family. [CIT v. *Ashok Bhai Chiman Bhai* (1965) 56, ITR, 42 (S.C.)].

(v) The personal earning, including income from self acquired property of a member of the HUF, even though he has sons, would not be included in the income of the family. Such income shall be assessed as income of that individual. *[Kalyanji Vithal Das* v. *CIT* (1937) 5 ITR 90 (PC)].

(vi) Any sum paid by an HUF to a member of the family out of its income is not deductible in computing the income of the family. However, such amount will not be included in the income of such individual whether the family had paid tax on its income or not [Section 10(2)].

(vii) If any remuneration is paid by the Hindu Undivided family to the karta or any other member for services rendered by him in conducting family's business, the remuneration is deductible if remuneration is (a) paid under a valid and bona fide agreement; (b) in the interest of, and expedient for, the business of family; and (c) genuine and not excessive. *Jugal Kishore Baldeo Sahai* v. *CIT* [1967] 63 ITR 238 (SC).

(viii) If salary is paid by the Hindu undivided family to its karta for looking after its interest in firms in which it is partner through said karta, such salary is allowable as deduction - *CIT* v. *Prakash Chand Agarwal* [1982] 11 Taxman 55 (MP).

(ix) Income from 'stridhan' is not includible in the income of the family. Property derived by a woman from her father or brother or husband or any other relative either before or after her marriage is known as 'stridhan'.

(x) Under the Dayabhaga School of law, as stated in a preceding page, no son has any right in the ancestral property during the lifetime of his father. If, therefore, the father does not have any brother as a coparcener, income arising from ancestral property is taxable as his individual income.

Partition of a Hindu undivided family [Section 171]

'Partition' signifies division of property. In the cases of property capable of physical division, share of each member is determined by making physical division thereof. It must be noted that a division of income without physical division of property does not amount to partition. Where, however, the property is not capable of physical division, partition implies such division as the property may admit.

Who is entitled to share on partition

Though only coparceners can demand partition, once the partition takes effect, the following persons are entitled to a share:

(a) all coparceners;

(b) a son in the womb of his mother at the time of partition;

(c) mother, who gets an equal share if the partition takes place among her sons after the death of her husband; and

(d) wife, who gets a share equal to that of a son at the time of a partition between father and sons. *Assessment after partition (Section 171)*

Section 171 applies to an HUF which is assessed as such. Therefore, if incase a family is not assessed as a hindu undivided family this section does not apply. A joint family, once assessed as a HUF, continues to be assessed as such till one or more coparceners claim partition. Such claim must be made by the coparceners before the assessment of the income of the HUF for the relevant assessment year is completed. On the receipt of such a claim, the Assessing Officer must make an inquiry after giving due notice to the members and record a finding whether there has been a partition and, if so, the date of the partition. The income of the family from the first day of the previous year to the date of partition is assessed as income of the HUF and from the next date of the partition to the date of close of the previous year, as the individual income of the recipient-members. If the recipient member forms another HUF along with his wife and son(s), the income of the property which was subject to partition is chargeable to tax in the hands of the new H.U.F.

A partition of the HUF can be both total and partial

Where the entire joint family property is divided among all coparceners and the family ceases to exist as an undivided family, the partition is total. A partial partition may be as regards: (a) the persons constituting the joint family, or (b) the properties belonging to the joint family, or (c) both. In case of partial partition, some coparceners continue as a joint family or some properties continue as a joint estate as against some coparceners or properties which separate from HUF. The device of partial partition has been used as a medium for reduction of proper tax liability. To curb such a practice, the Finance (No. 2) Act, 1980 inserted Sub-section 9 in Section 171 which lays down that partial partitions of HUFs assessed as such (Union of India vs MV Valliappan 1999 AIR SCW 2689), effected after 31st December 1978 will not be recognised for tax purposes.

The provisions made by Sub-section (9) in Section 171 are as follows:

(i) In a case where a partial partition of a HUF has taken place after 31.12.1978, no claim of such partition will be enquired into and the Assessing Officer will not record a finding as to whether there has been a partition of the family property. Further, any finding regarding partial partition recorded under Section 171(3) will be null and void and of no legal effect.

(ii) Such family will continue to be assessed as if no such partial partition has taken place, i.e., the property or source of income will be deemed to continue to belong to the Hindu undivided family and no member will be deemed to have separated from the family.

(iii) Each member or group of members of such family will be jointly and severally liable for any tax, interest, penalty, fine or other sum payable under the Act by the family, whether before or after such partition. The several liability of any member or group of members of such family will be computed according to the portion of the joint family property allotted to him on such partial partition. This amendment has come into force with effect from April 1, 1980 and has, accordingly, been applicable with effect from assessment year 1980-81 and onwards.

TAXATION OF FIRMS

Under Section 2(23) of the Income-tax Act, the terms “firm”, “partner”, and “partnership” have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

The expression “partner” also includes a minor who has been admitted to the benefits of partnership and a partner of a Limited Liability Partnership Act 2008. However a minor cannot validly enter into any partnership as a ‘full partner’ with other persons but he can be admitted to the benefits of partnership only.

A joint Hindu family as such cannot be a partner in a firm. However, through its Karta it may enter into a valid partnership with a third person or with a member of the undivided family in his individual capacity. In such a case, the Karta occupies a dual position. On the partnership he functions in his individual capacity; on the relations to other members of the Hindu undivided family, in his representative capacity.

An incorporated company being a legal person may form a partnership with an individual or with another company. In considering the maximum number of partners comprising a firm, the company will be considered as one person only.

A partnership firm as such is not entitled to enter into a partnership with another firm, H.U.F., individual, or a company. However, its partners in their individual capacity can enter into another partnership.

Scheme of taxation of a firm and its partners **Assessment as a Firm [Section 184]**

As per the scheme, a partnership firm in the first assessment year shall be assessed as a firm if the following conditions are satisfied:

1. The partnership is evidenced by an instrument i.e. partnership deed which is to be in writing containing necessary clauses.

2. The individual shares of the partners as specified in that instrument (including how the loss will be borne by major partners in case of a minor admitted for benefits only).
3. A copy of the partnership deed certified by all the partners or their duly authorized agents, in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.

Where the return is made after the dissolution of the firm, the copy of the partnership deed should be certified in writing by all persons (excluding minors) who were partners of the firm immediately before its dissolution and by the legal representative of any deceased partner.

When a firm is assessed as such for any assessment year, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or in the shares of partners as evidenced by the partnership deed on the basis of which assessment as a firm was first sought.

Where any such change has taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for the assessment year relevant to such previous year. In doing so all the provisions of Section 184 will apply to the firm. Further, any change in remuneration or interest to partners is to be notified in the same manner to comply with section 40(b).

Circumstances where the firm will be assessed as a firm but shall not be eligible for deduction on account of interest, salary, bonus, etc.

Where the firm -

(a) fails to make the return required under Section 139(1) and has not made a return or revised return under Section 139(4) or 139(5), or

(b) fails to comply with all the terms of a notice issued under Section 142(1) or fails to comply with a direction issued under Section 142(2A), or

(c) having made a return, fails to comply with all the terms of a notice issued underSection143(2),

(d) does not comply with three conditions mentioned above u/s 184.

then the firm shall not be eligible for any deduction on account of interest to a partner and remuneration to a working partner although the same is mentioned in the partnership deed.

Computation of income and tax thereon of firm

The income of the firm shall be computed as per the normal provisions of the Act under various heads of income excluding incomes exempt from tax and deductions under section 80 as applicable.

Rate of Tax

In the case of a firm which is assessable as such (i.e. as a firm), tax is chargeable on its total income at the rate of 30%.

Surcharge @12% shall be applicable where the total income exceeds Rs. 1 crore. Health and Education cess shall be added as 4% of tax plus surcharge. However, firm and LLP is subject to alternate minimum tax under section 115JC (as discussed in introduction part above).

Partnership is not a separate entity distinct from the partners, but for tax purposes a partnership is taxed as a separate entity and therefore total income will be computed under various heads of income. A partnership firm is also entitled for deductions under section 30 to 38 for expenditures incurred. However, for payment of remuneration to partners and interest on capital are allowed subject to conditions laid down under section 40(b).

Section 40(b), contain the following conditions which need to be complied with while making payment of remuneration and interest on borrowed capital to the partners:

(i) Payment of salary, bonus, commission or remuneration by whatever name called to a non-working partner shall not be allowed as deduction. Such payments are allowed only to working partners if it is authorised by the partnership deed and are in accordance with partnership deed. Also, such payments should pertain to the period after the partnership deed.

(ii) Interest payable to a partner, authorised by the partnership deed for period after the partnership deed shall be allowable as deduction subject to a maximum of 12% p.a. If the partnership deed provides for interest at less than 12% p.a, the deduction of interest shall be allowed to the extent provided by the partnership deed.

(iii) the payment of remuneration to working partner, although authorised by partnership deed however it is subject to maximum of the following limits.

Finance Act, 2009 provides for uniform limits for both professional firms and nonprofessional firms:	
I. On the first Rs. 3,00,000 of the book-profit or in case of a loss	Rs. 1,50,000 or 90% of the book-profit, whichever is more.
II. On the balance of the book-profit	60% of the book profits.

Meaning of Book Profit [Explanation 3 to section 40(b)]

Book-profit" means the net profit, as shown in the profit and loss account and make the additions and deductions as per section 28 to 44DB explained under the head income from Business and Profession increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit. Interest paid/payable to partners in excess of 12% shall also be disallowed as per section 40(b).

Change in Constitution of a Firm [Section 187]

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

For the purposes of this section there is a change in the constitution of a firm if:

(a) one or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change (this clause, however, shall not apply to a case where the firm is dissolved on the death of any of its partners) or

(b) where all the partners continue with a change in their respective shares or in the shares of some of them. Losses of Registered Firms [Section 75]

Where the assessee is a firm, any loss in relation to the assessment year commencing on or before the 1st day of April, 1992, which could not be set off against any other income of the firm and which had been apportioned to a partner of the firm but could not be set off by such partner prior to the assessment year commencing on the 1st day of April, 1993, then, such loss shall be allowed to be set off against the income of the firm subject to the condition that the partner continues in the said firm and to be carried forward for set off under sections 70, 71, 72, 73, 74 and 74A.

Carry forward and set off of losses in case of change in constitution of firm or on succession [Section 78(1)]

Where a change has occurred in the constitution of a firm on account of death or retirement, the firm is not entitled to carry forward and set off so much of the loss as is proportionate to the share of a deceased or retired partner in the firm in respect of the previous year.

Method of computation of amount not to be allowed to be set off and carried forward

Step 1: In the year of change first ascertain the share of outgoing partner in the profit or loss of the firm.

Step 2: Compute share of loss of the outgoing partner for each of the preceding years from which the loss is carried forward.

Step 3: Amount not allowed to be set off and carried forward:

(i) Sum of [Amounts computed in Steps (1) and (2) where there is loss in the year of change].

(ii) Difference of [Amounts computed in Steps (1) and (2) in case of profit in the year of change].

Carry forward of unabsorbed depreciation

Unabsorbed depreciation and unabsorbed capital expenditure on scientific research can be carried forward by the reconstituted firm (without deducting share of the outgoing partner) as these are not covered under section 78.

Assessment of Partners

As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm will not be included in computing his total income. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.

Further, the explanation to Sub-clause (2A) provides that the share of a partner in the total income of the firm assessed as a firm shall be an amount which bears to the total income of the firm the same proportion as the amount of his share in the profits of the firm (in accordance with the partnership deed) bears to such profits.

In terms of a formula, the amount exempt would be:

Partners share in the profit of the firm =as shown in the partnership deed Total Profits of the Firm x Total income of the firm

Any interest, salary, bonus, commission or remuneration by whatever name called which is due to or received by a partner of a firm from the firm will be chargeable to tax in the hands of the partner (to the extent allowed as deduction to the firm) under the head “profits and gains of business or profession”. However, if such salary, interest, bonus, commission or remuneration (or any part thereof) has not been allowed as deduction as per Section 40(b) in the hands of the firm, the amount not allowed as deduction shall not be charged to tax in the hands of partners.

Further, deductions under Sections 32 to 37 can be claimed by a partner from any income where any expenditure was incurred to earn such income.

Succession of one firm by another firm [Section 188]

When all the partners in the predecessor firm are replaced by new partners in the successor firm, it is known as succession of one firm by another firm. If a firm is dissolved and some of the partners take over the firm’s business or carry on a similar business with or without new partners, it would be a case of succession by a new firm (62 I.T.R. 75).

In *CIT*v. *K.H. Chambers* (1965) 55 ITR 674, the Supreme Court laid down the following requisites of succession:

(i) There is a change of ownership.

(ii) The whole business is transferred.

(iii) Substantially the identity and the continuity of the business are preserved.

Where the partnership deed does not provide specifically for continuance of the firm on the death of a partner, there would be no change in constitution of the firm but it would be a case of succession. *[Addl. CIT* v. *Thyagasundara Mudaliar* (1981) 127 ITR 520].

Where a firm is succeeded by another firm, separate assessments are made on the predecessor and successor firms respectively in accordance with the provisions of Section 170. Section 170 provides that the predecessor shall be assessed in respect of the income of the previous year in which the succession took place up to the date of succession and the successor shall be assessed in respect of the income of the previous year after the date of succession. If the predecessor cannot be found, or the tax assessed on the predecessor cannot be recovered from him for the previous year (in which the succession took place) and the previous year immediately preceding such previous year, the unrealised tax payable by the predecessor shall be recovered from the successor.

However, the successor firm is entitled to recover from the predecessor firm any tax paid by it on behalf of the former. If any tax is due against any partner of the predecessor firm, it cannot be recovered from the successor firm.

Joint and several liability of partners for tax payable by firm [Section 188A]

Section 188A provides that every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of Income-tax Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

Firm Dissolved or Business Discontinued [Section 189]

Where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the assessment of the total income of the firm shall be made as if no such discontinuance or dissolution had taken place and all the provisions of the Act, including the provisions relating to penalty or any other sum (interest, fine) chargeable under the Act, shall apply. Consequently, every person who was a partner of the firm at the time of discontinuance of business or dissolution of the firm and legal representative of the deceased partner shall be jointly and severally liable to the amount of tax penalty and any other sum. Where the dissolution or discontinuance of business takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the partners or legal representative of a deceased partner from the stage at which the proceedings stood at the time of such dissolution or discontinuance.

Thus, every partner of the firm and the legal representative of the deceased partner is liable to pay the tax which is already due or may have become due after the dissolution, irrespective of his interest in the firm.
However, if there was any irrecoverable amount at the time of dissolution or discontinuance of business and later on it was recovered by the partners, the partners shall personally pay the tax on their share so recovered.

Taxation of Association of Persons /Body of Individuals

'Association of persons' has not been defined in the Income-tax Act. However in the case of *CIT* v. *Indira Balkrishna* [(1960) 39 ITR 546] the Supreme Court has defined it as:

"Association of persons" means an association in which two or more persons join in for a common purpose or common action to produce income, profits or gains.

An association of persons may consist of non-individuals (Companies, firms joint families) *[Ipoth* v. *CIT* (1968) 67 ITR 106 (S.C.)]. A minor can join an AOP if his lawful guardian gives his consent. *[Murugesan & Bros.* v. *CIT* (1973) 88 ITR 432 (SC)].

Applying the ratio laid down by the Supreme Court in the case of G *Murugesan and Bros.* v. *Commissioner of Income-tax* (1973, 88 ITR 432), the Kerala High Court held in the case of *Commissioner of Income-tax* v. *Goel C. Dalal and Perin C. Dalal* (1990, 184 ITR 248) that in order to acquire the status of an association of persons, the persons must join in a common purpose or action and the object of the association must be to produce income. It is not enough that the persons receive the income jointly.

For the formation of an AOP, the association need not necessarily be on the basis of a contract, consent and understanding may be presumed *[Shanmugham & Co.* v. *CIT*(1971) 81 ITR 310 (S.C.)].

Applying the ratio laid down by the Supreme Court in the case of *N.V. Shanmugham & Co.* v. *Commissioner of Income-tax* (1971, 81 ITR 310) the Calcutta High Court held in the case of *Gopal Chand Sen* v. *Income-tax Officer and others* (1977, 109 ITR 820) that an assessment of business income has to be done in the hands of receivers and in such an assessment, the receivers are never assessed as independent earners of income. The income in the hands of the receiver is assessable in the like manner and to the same extent as it would have been assessed on the real owners.

However, co-owners, co-heirs or co-legatees do not constitute an AOP in respect of the income of the joint or common asset by reason only of their jural relationship. But if they write themselves with the objective of earning income they constitute an AOP for assessment purposes. *[Estate of MohamedRowther*v. *CIT* (1963, 49 ITR 39)]. Section 26 of the Income-tax Act provides that where property consisting of building or buildings and lands appurtenant thereto is owned by two or more persons in definite and ascertainable shares, such persons shall not, in respect of such property be assessed as an AOP, but on their respective share of income therefrom.

In order to constitute an association of persons, there must be joining together in a common purpose or in a common action, the object of which is to produce income, profits and gains. Though a body of individuals is not identical with an association of persons, they have some similarities. An association of persons may consist of non-individuals also but a body of individuals has to consist only of human beings. The word 'body' would require an association for some common purpose or for a common cause or there must be unity under some common tie or occupation. A mere collection of individuals without a common tie or common aid cannot be taken to be a body of individuals failing under Section 2(31) of the Income-tax Act, 1961. [See *CIT*v. *Deghamwala Estates* (1980, 121 ITR 684)].

Tax Liability of Association of Persons /Body of Individuals

With effect from assessment year 1989-90, the following provisions are applicable to assessees other than companies, co-operative societies and societies registered under the Societies Registration Act, 1860 or any law corresponding to that Act in force in any part of India.

(1) Interest paid by the AOP to a member will not be allowed as deduction from the income of the AOP [(Section 40(ba)]. In cases where interest is paid by the AOP to any member, who has also paid interest to the AOP, the amount of interest, that will be disallowed, is the amount of interest paid by the AOP to the member less the amount of interest paid to the AOP by the member [(Explanation 1 to section 40(ba)].

(2) In cases where an individual is a member of an AOP in a representative capacity, any interest paid by the AOP to such individual or by such individual to the AOP, otherwise than in a representative capacity will not be subject to disallowance under explanation 2(i) to Section 40(ba).

(3) In the cases of interest paid by AOP to such individual or by such individual to the AOP in a representative

capacity any interest paid by the AOP to the person represented by such person or vice versa, will not be allowed under Section 40(ba) [Explanation 2(ii) to Section 40(ba)].

(4) Explanation 3 to Section 40(ba) further provides that where an individual is a member of the AOP otherwise than as member in a representative capacity, any interest paid by the AOP to such individual will not be disallowed if the interest is received by him on behalf of any other person.

(5) Any salary, bonus, commission or remuneration (by whatever name called) paid by the AOP to a member will not be allowed as a deduction.

Section 167B makes the following provisions as regards the incidence of charge of tax on the association of persons.

A. Where shares of members are determinate

In this case, tax is chargeable on the income of the association of persons at the same rate as applicable to an individual. However, where the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate of 30%, i.e. the highest slab applicable to an individual.

More so, where the total income of any member of the AOP, irrespective of whether or not it exceeds the maximum amount not chargeable to tax in the case of an individual, is chargeable to tax at a rate higher than the maximum marginal rate (e.g. foreign company), tax will be charged on the total income of the AOP at such higher rate for that portion of the income of AOP which relates to the share of such member and the balance of income at a maximum marginal rate of tax.

Note: 1. Some incomes are taxable at special rates.

2. Provisions of alternate minimum tax under section 115JC to 115JF shall apply.

B. Where the shares of the members are indeterminate

In this case, tax will be charged on the total income of the AOP at the maximum marginal rate, that is, the rate of tax as well as surcharge, if any, applicable to the highest slab of income in the case of an individual as specified in the Finance Act of the relevant year. However, if income of any member of AOP is chargeable to tax at a rate higher than maximum marginal rate, then the rate of tax for the entire income of AOP shall be such higher rate.

The individual shares of the members in the whole or any part of the income of the AOP will be deemed to be indeterminate or unknown if such shares are indeterminate or unknown on the date of formation of the AOP, or at any time thereafter.

Method of Computing Share of a Member of Association of Persons / Body of Individuals [Section 67A]

Section 67A seeks to provide for the method of computing a member's share in the income of an association of persons or a body of individuals, wherein the shares of the members are determinate, in the same manner as provided for in Sub-sections (1) to (3) of Section 67 for computing a partner's share in a firm.

This section lays down the following methods of computing the member's share:

(a) Any interest, salary, bonus, commission or remuneration, by whatever name called, paid to any member in respect of the previous year shall be deducted from the total income of the association or body and the balance ascertained and apportioned among the members in the proportion in which they are entitled to share the income of the association or body.

(b) Where the amount apportioned to a member under (a) hereinabove is a profit, any interest, salary, bonus, commission or remuneration paid to the member by the AOP in respect of the previous year shall be added to that amount - the result shall constitute the member's share in the income of the association or body.

(c) Where the amount apportioned to a member under (a) is a loss, any interest, salary, bonus, commission or remuneration aforesaid paid to the member by the association or body in respect of the previous year shall be adjusted against that amount, the result shall be adjusted against that amount, and the result shall be treated as the member's share in the income of the association or body.

Notes:

1. The share of each member of AOP/BOI shall be apportioned under the various heads of income as is determined while computing the income of the AOP/BOI.
2. Deductions under section 80 to the extent allowed to AOP/BOI shall not be allowed to the members.

Taxation of share of income of a member of AOP/BOI

Section 86 relates to shares of members of an association of persons or a body of individuals in the income of the association or body. This section provides that if the assessee is a member of an association of persons or a body of individuals (other than a company or a Co-operative society or a Society registered under the Societies Registration Act, 1860, or any law corresponding to that Act in force in any part of India), his share in the income of the association or body, computed in the manner provided in Section 67A shall not be liable to tax.

Further

The taxability of share of income of a member of AOP/BOI depends on the rate at which income of such AOP/BOI is taxable:

1. Where AOP/BOI is chargeable to tax on its total income at the maximum marginal rate or any higher rate, the share of the member shall not be included in his total income.
2. Where AOP/BOI is chargeable to tax on its total income at the rate applicable to individuals (normal rate) and tax is paid, share of income of a member shall be chargeable to tax as part of his total income and rebate under section 86 shall be claimed.
3. Where AOP/BOI is chargeable to tax on its total income at the rate applicable to individuals (normal rate) and no tax is chargeable, share of income of a member shall be chargeable to tax as part of his total income and no rebate under section 86 shall be claimed.

Assessment in case of Dissolution of an Association of Persons [Section 177]

Where any business or profession carried on by an AOP has been discontinued or an AOP is dissolved, the Assessing Officer shall make an assessment of the total income of the AOP as if no such discontinuance or dissolution had taken place, and all provisions of this Act, including the provisions relating to the levy of penalty or any other sum chargeable under any provisions of the Income-tax Act shall apply.

Every person who was at the time of such discontinuance or dissolution a member of the AOP and the legal representative of any such person who is deceased, shall jointly and severally be liable for the amount of tax, penalty or other sum payable.

Where such discontinuance or dissolution takes place after any proceeding in respect of an assessment year have commenced, the proceedings may be continued against the members from the stage at which the proceedings stood at the time of such discontinuance or dissolution.

TAXATION OF CO-OPERATIVE SOCIETIES

Meaning [Section 2(10)]

'Co-operative Society' means a co-operative society registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any state for the registration of co-operative societies. The Income of the co-operative society is computed in the same manner as provided for other assesses. A co-operative society is entitled to the deductions from its gross total income u/s 80G, 80GGA, 80GGC, 80IA, 80-IB, 80JJA and 80P.

A regional rural bank (to which provisions of the Regional Rural Bank Act, 1976, apply) is deemed to be a cooperative society [Circular No. 319 dated 11.1.1982].

Computation of Income of Co-operative Societies

The income of a co-operative society is computed in the same manner as provided for other assessee's under the Act.

The provisions under various heads of income, clubbing of incomes, set off and brought forward losses, deductions under section 80 shall apply.

Further, the subsidy given by the government to a co-operative society for meeting managerial expenses and admission fee collected by the society is treated as revenue receipt and liable to tax. *[Ludhiana Central Co-operative Consumers' Stores Ltd.* v. *C.I.T* (1980) 122, I.T.R. 942]. There is, however difference of opinion with regard to tax treatment of 'subsidy' received from the Government. Distinguishing the ratio laid down by the Punjab & Haryana High Court in the case of *Ludhiana Central Cooperative Consumers' Stores Ltd.* v. *Commissioner of Income-tax* (1980, 122 ITR 942), the Punjab & Haryana High Court held in the case of *Commissioner of Income-tax* v. *Jindal Brothers Rice Mills* (1989, 179 ITR 470) that depreciation is allowable on the cost of the machinery or plant reduced by the amount of the subsidy as actual cost stands reduced by the percentage allowed by the subsidy. Though this case was followed by it in the case of *Commissioner of Income-tax* v. *Janak Steel Tubes (Pvt.) Ltd.* (1989, 179 ITR 536) (the capital subsidy should be deducted from the value of plant and machinery) but had been dissented from by the Bombay, Madras and Rajasthan High Courts in the following cases:

(i) *Srinivas Industries* v. *Commissioner of Income-tax* (1991, 188 ITR 22): The Madras High Court held that the subsidy really partook the character of cash grant expendable for any purpose-consequently, the amount of subsidy granted could not be deducted from the capital cost of the machinery.

(ii) In *Commissioner of Income-tax* v. *Elys Plastics Pvt. Ltd.* (1991, 188 ITR 11) the Bombay High Court held that the subsidies were not deductible in computing the cost of plant and machinery for purposes of allowing depreciation.

(iii) In *Commissioner of Income-tax* v. *Ambica Electrolytic Capacitors (P) Ltd. and others* (1991, 191 ITR 494) the Rajasthan High Court held that the subsidy or investment subsidy given by the Government cannot be deducted from the actual cost for purposes of investment or depreciation allowance.

Rates of Income-tax

The rates of income-tax applicable to a co-operative society for the assessment year 2021-22 are as follows:

1.	Where the total income does not exceed Rs. 10,000	10% of total income
2.	Where the total income exceeds Rs. 10,000 but total income does not exceeds Rs. 20,000.	Rs. 1,000 plus 20% of the amount by which income exceeds Rs. 10,000

3.	Where the total income exceeds Rs. 20,000	Rs. 3,000 plus 30% of the amount by which income exceeds Rs. 20,000

Health and Education cess @ 4%.

Surcharge @12% shall be applicable where the total income exceeds Rs. 1 crore

Note: 1. Some incomes are taxable at special rates.

2. Provisions of alternate minimum tax under section 115JC to 115JF shall apply.

Deduction in respect of income of co-operative societies [Section 80P]

Section 80P provides for certain deductions from the gross total income of a Co-operative Society. These deductions are:

(a) In the case of Co-operative Society engaged in:

(i) the business of Banking or providing credit facilities to its members, or

(ii) a cottage industry, or

(iii) the marketing of the agricultural produce grown by its members, or

(iv) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for purpose of supplying them to its members, or

(v) the processing, without the aid of power, of the agricultural produce of its members, or

(vi) the collective disposal of the labour of its members, or

(vii) fishing or allied activities, i.e., catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to its members,

the whole of the amount of profits and gains of business attributable to any one or more of such activities shall be deducted from the gross total income provided that in the case of a co-operative society falling under Subclause (vi) or (vii), the rules and bye-laws of the society restrict the voting rights to the following classes of its members:

(i) the individuals who contribute their labour or carry on the fishing or allied activities;

(ii) the co-operative credit societies which provide financial assistance to the society;

(iii) the State Government.

(b) In the case of primary co-operative society engaged in supplying milk, oilseeds, fruits, vegetables raised or grown by its members to

(i) a federal co-operative society engaged in supplying the above mentioned products; or

(ii) a Government or a local authority; or

(iii) a Government Company or a Corporation established by or under a Central, State or a Provincial Act (being a company or corporation engaged in supplying the above mentioned products to the public).

the whole of the amount of profits and gains of such business shall be deducted from the gross total income.

In the case of a co-operative society engaged in activities other than those specified in clauses (a) or (b) either independently of, or in addition to, profits and gains attributable to the activities mentioned at clauses (a) and (b) deduction from the gross total income will be allowed to the extent of' 50,000 w.e.f. assessment year 1999-2000.

(c) Where such co-operative society is a Consumers' Co-operative Society, the deduction shall be ' 1,00,000 w.e.f. assessment year 1999-2000.

(d) In the case of every co-operative society, the whole of the income by way of interest or dividends derived from its investments with any other co-operative society shall be deducted from the gross total income.

(e) In the case of every co-operative society, the whole of the income derived by the society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities shall be deducted from its gross total income.

(f) In the case of every co-operative society, not being a housing society or an urban consumers' society, or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power, where the gross total income does not exceed ' 20,000 the amount of any income by way of interest on securities or any income from house property shall be deducted from the gross total income.

Urban Consumers' Co-operative Society

An urban consumers' co-operative society means a society for the benefit of consumers, within the limits of a municipal corporation, municipality, notified areas committee, town area or, cantonment [Explanation to Section 80P(2)].

The provisions of this Section shall not apply in relation to any cooperative bank other than a primary agricultural credit society or a primary cooperative agricultural and rural development bank.

Other points

- Amount received for letting of godowns, incidental services of taking delivery of stock at rail-head and transporting it to godowns were also rendered and amount received was described as 'commission' was wholly exemption I.T. *v.* South Arcot District Co-operative Marketing Society Ltd. *(1989) 43 Taxman 328/176 ITR 117 (SC).*
- Income from ginning and pressing of cotton is exempt. *Broach Distt. Co-operative Cotton Sales, Ginning & Pressing Society Ltd.* v. *CIT* (1989) 177 ITR 418/44 Taxman 439 (SC).
- Where assessee, an apex co-operative society, derived (i) interest on cash security furnished by it for carrying on sugar agency business, and (ii) interest on temporary loans given by it for financing sugar business, while former interest was not exempt, latter was exempt under Section 14(3)(iii) of the 1922 Act, *CIT* v. *U.P. Cooperative Federation Ltd.* (1989) 176 ITR 435/43 Taxman 20 (SC).
- Amount of subsidy received by assessee from National Co-operative Development Corpn. towards loss incurred on account of price fluctuation qualifies for deduction under Section 81 (1)(c) - *CIT* v. *Punjab State Co-operative Supply & Marketing Federation Ltd.* (1989) 46 Taxman 156 (Punj. & Har.).
- Proportionate expenditure relating to such business activities of assessee co-operative society as are contemplated by Section 80P(2) is not to be disallowed. *Baghapurana Co-operative Marketing Society Ltd.* v. *CIT* (1989) 178 ITR, 653/44 Taxman 92 (Punj. & Har.).
- In the cases of agricultural produce, the agricultural produce marketed by assessee co-operative society need not have been produced by assessee's members - *CIT* v. *Punjab State Co-operative Supply & Marketing Federation Ltd.* (1989) 46 Taxman 156 (Punj. & Har.).

- The expression 'the marketing of the agricultural produce of its members means that agricultural produce should be owned by its members, whether supplied by them (that is, the members) or purchased from the market or acquired from any other producer. *C.I.T.* v. *Haryana State Co-operative Supply & Marketing Federation Ltd.* (1989) 79 CTR (Punj. & Har.) 94.
- Short-term call deposits are investment within the meaning of Section 80P(2)(d) *CIT* v. *Haryana Co-operative Sugar Mills Ltd.* (1989) 46 Taxman 28 (Punj. & Har.).

Assessment of Co-operative Societies

The following are the provisions which are specifically applicable to the assessment of Co-operative Societies -

I. *Co-operative Housing Society.* Under Section 27(iii), a member of co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or association, as the case may be, shall be deemed to be owner of that building or part thereof.

Clause (iiia) further provides that a person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act, 1882 shall be deemed to be the owner of that building or part thereof; and

As per Clause (iiib), a person who acquires any rights (excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof, by virtue of any such transaction as is referred to in Clause (f) of Section 269UA, shall be deemed to be the owner of that building or part thereof.

Clause (f) of Section 269UA, it may be noted, defines "transfer" for the purposes of Chapter XX-C of the Income-tax Act, dealing with purchase by Central Government of immovable properties in certain cases of transfer.

II. *Profits and Gains of Co-operative Society from insurance business* [Section 44]. The profits and gains of any business of insurance carried on by a Co-operative Society shall be computed in accordance with the rules contained in the First Schedule.

In this connection, the First Schedule and Rule 6E of the Income-tax Rules, 1962 provides as under:

The profits of non-life insurance business, e.g., Fire insurance business, marine insurance business, general insurance business etc. shall be the profits disclosed by the annual accounts required to be prepared under the Insurance Act, 1938 subject to the following adjustments:

(i) If such profits are arrived at after deducting any expenditure or allowance which is not admissible under Sections 30 to 43B of the Income-tax Act, such expenditure or allowance shall be added back to the profits.

(ii) The reserve for unexpired risks shall be allowed as a deduction to the following extent:

   (a) where the insurance business relates to fire insurance or miscellaneous insurance - 50% of the net premium income of such business of the previous year;

   (b) where the insurance business relates to marine insurance, 100% of the net premium income of such business of the previous year.

'Net premium income' means the amount of premium received, as reduced by the amount of re-insurance premiums paid during the relevant previous year.

Tax on Income of certain Resident Co-Operative Societies [Section 115BAD]

Till FY 2019-20 (AY 2020-21) there was only one regime of Taxation for Cooperative society and were required to apply the Slab rate(upto 10,000, next 10,000 & balance over 20,000) specified in the Annual Finance Act on

Total Income computed after allowing many deductions and exemptions. + surcharge @ 12% if

Total Income > 1 crore + 4% HEC

Finance Act, 2020 has introduced a New Optional Tax System for Cooperative society u/s 115BAD of the Income Tax Act, 1961 wef A/Y 21-22 to provide for flat rate of Tax of 22% + 10% flat surcharge + 4%HEC to be applied on Total Income calculated without claiming specified deductions and exemptions.

Hence, from AY 2021-22 (or FY 2020-21), there are two operative tax system –

One is the Existing tax system where all the applicable deductions and exemptions are allowed and the tax rates are as per the Slab rates of tax specified in the Finance Act, 2020.

The second one is section 115BAD which is a Optional Tax System and under which many deductions and exemptions have been disallowed but flat tax rate of 22% is provided in the section 115BAD itself.

Following section 115BAD shall be inserted by the Finance Act, 2020, w.e.f. 1-4-2021 :

(1) Notwithstanding anything contained in this Act but subject to the provisions of this Chapter, the income-tax payable in respect of the total income of a person, being a co-operative society resident in India, for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2021, shall, at the option of such person, be computed at the rate of 22%, if the conditions contained in sub-section (2) are satisfied:

Provided that where the person fails to satisfy the conditions contained in sub-section (2) in computing its income in any previous year, the option shall become invalid in respect of the assessment year relevant to that previous year and subsequent assessment years and other provisions of the Act shall apply, as if the option had not been exercised for the assessment year relevant to that previous year and subsequent assessment years.

(2) For the purposes of sub-section (1), the total income of the co-operative society shall be computed,—

(i) without any deduction u/s 10AA or u/s 32(1)(iia) or u/s 32AD or u/s 33AB or u/s 33ABA or subclause (ii) or sub-clause (iia) or sub-clause (iii) of sub-section (1) or sub-section (2AA) of section 35 or u/s 35AD or u/s 35CCC or under any of the provisions of Chapter VI-A other than sec 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 deductions referred to in clause (i); and

(iii) by claiming the depreciation, if any, u/s 32, other than u/s 32(1)(iia), determined in such manner as may be prescribed.

(3) The loss and depreciation referred to in clause (ii) of sub-section (2) shall be deemed to have been given full effect to and no further deduction for such loss or depreciation shall be allowed for any subsequent year:

Provided that where there is a depreciation allowance in respect of a block of asset which has not been given full effect to prior to the assessment year beginning on the 1st day of April, 2021, corresponding adjustment shall be made to the written down value of such block of assets as on the 1st day of April, 2020 in such manner as may be prescribed, if the option under sub-section (5) is exercised for a previous year relevant to the assessment year beginning on the 1st day of April, 2021.

(4) In case of a person, having a Unit in the International Financial Services Centre, as referred to in sub-section (1A) of section 80LA, which has exercised option under sub-section (5), the conditions contained in sub-section (2) shall be modified to the extent that the deduction under the said section shall be available to such Unit subject to fulfilment of the conditions contained in that section.

Explanation. – For the purposes of this sub-section, the term “Unit” shall have the meaning assigned to it in clause (zc) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005).

(5) Nothing contained in this section shall apply unless option is exercised by the person in such manner as may be prescribed on or before the due date specified under sub-section (1) of section 139 for furnishing the return of income for any previous year relevant to the assessment year commencing on or after the 1st day of April, 2021 and such option once exercised shall apply to subsequent assessment years:

Provided that once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.

TAX EXEMPTIONS TO POLITICAL PARTIES [SECTION 13A]

‘Political party’ means an association or body of individual citizens of India registered with the Election Commission of India as a political party and includes a political party deemed to be registered with that Election Commission of India.

Political parties are liable to pay tax on their income and they are assessed as ‘An association of persons’. However, the income derived by these parties as income by way of voluntary contributions, Income from House Property; and Income from Other Sources or Capital Gains are exempt from subject to the following conditions:

(i) the party keeps and maintains such books of account and other documents as would enable the Assessing Officer to properly deduce the income;

(ii) in respect of each such voluntary contribution in excess of’ 20,000, the party keeps and maintains a record of the contributions and names and addresses of the persons who have made such contribution; and

(iii) the accounts of the party are audited by a Chartered Accountant or other qualified accountant.

(iv) No donation of Rs. 2000 or more can be received by a Political Party otherwise than by an account payee cheque/draft/ECS through a bank account or through electoral bonds. (w.e.f. AY 2018-19)

Return of income under section 139(4B) should be filed by the Political Party on or before due date of filing of return u/s 139(1), otherwise exemption under section 13A will not be given. (w.e.f. AY 2018-19)

The Chief Executive Officer of the political party is required to file a return of income if the total income (computed under this Act without giving effect to the provisions of Section 13A) exceeds the maximum amount which is not chargeable to income-tax. In this connection, the provisions of Section 139(1) shall apply.

ELECTORAL TRUST

‘Electoral Trust’ means a trust so approved by the Board in accordance with the scheme made in this regard by the Central Government

Voluntary contributions received by an Electoral Trust (Section 13B)

Any voluntary contributions received by an electoral trust shall not be included in the total income of the previous year of such electoral trust, if -

(a) such electoral trust distributes to any political party, registered under section 29A of the Representation of the People Act, 1951, during the said previous year, ninety-five per cent of the aggregate donations received by it during the said previous year along with the surplus, if any brought forward from any earlier previous year; and

(b) such electoral trust functions in accordance with the rules made by the Central Government.

TAX EXEMPTIONS FOR CHARITABLE TRUSTS AND INSTITUTIONS

Trust: Section 3 of the Indian Trusts Act defines a trust to mean "an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him for the benefit of another and the owner".

Institution: An organisation with a constitution composed of a President, Vice-President, Secretary, Committee Members and ordinary members, is known as an Institution. The activities of the institution and its office-holders are regulated by rules and bye-laws of the institution. A university or a Chamber of Commerce is an Institution.

Charitable purpose: The term 'charitable purpose' has been defined in this Act in a wider sense than what is commonly understood. According to Section 2(15) of the Act, it includes relief of the poor, education, 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 advancement of any other object of general public utility not involving the carrying on of any activity for profit.

In order to qualify for tax exemptions the charity must be of a public character, and the trust or institution should not be created or established for the benefit of any particular religious community or caste, if the trust or institution is established for the benefit of the member of a club or employees of a factory, it would not be a public charitable trust. Vide Circular No. 395 dated Sept. 24, 1984 promotion of sports and games is considered to be a charitable purpose within the meaning of Section 2(15). Accordingly an association or institution, engaged in the promotion of sports or games can claim exemption under Section 11, even if it is not approved under Section 10(23).

Provided 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 -

(i) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and

(ii) the aggregate receipts from such activity or activities during the previous year, do not exceed twenty per cent of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year;

Income not to be included in the Total Income

According to Section 11(1), the following items of income are not to be included in the total income of the previous year of the assessee who is in receipt of the same:

(i) ***Income derived from property held under trust wholly for charitable or religious purposes:*** Income derived from property held under trust wholly for charitable or religious purposes shall be exempt to the extent to which such income is applied for such purposes in India and where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of 15% of the income from such property.

(ii) Income derived from property held under trust in part only for charitable or religious purposes: Income derived from property held under trust in part only for charitable or religious purposes shall be exempt. This exemption would, however, be available only for trusts created before 1.4.1962. Further, where any such income is finally set apart for application to such purposes in India, shall be exempt to the extent to which the income so set apart is not in excess of 15% of the income from such property.

(iii) ***Income from property held under trust created on or after 1.4.1952:*** for a charitable purpose which tends to promote international welfare in which India is interested shall be exempt to the extent to which such income is applied for such charitable purposes outside India.

(iv) **Income from property held under trust created before 1.4.1952** for charitable or religious purposes shall be exempt to the extent to which such income is applied for such purposes outside India. This exemption is, however, subject to the condition that the Central Board of Direct Taxes has, by a general or special order, issued a direction in either of the above two cases that the income in question would not be included in the total income of the person in receipt of such income.

(v) ***Income in the form of voluntary contributions*** made with a specific direction that they shall form part of the corpus of the trust or institution shall be fully e*xempt.*

Explanation

In respect of items (i) and (ii) above:

(1) In computing the 15% of the income which may be accumulated or set apart, any such voluntary contributions as are referred to in Section 12 (dealt with later in this Chapter) shall be deemed to be part of the income.

(2) If, in the previous year, the income applied to charitable or religious purposes in India falls short of 85% of the income derived during that year from property held under trust, by any amount on account of (i) not receiving the income during that year, or (ii) for any other reason, then:

(a) In case referred to in (i), so much of the income applied to such purpose in India during the previous year in which the income is received or during the previous year immediately following as does not exceed the said amount shall be deemed to be income applied to such purposes during the previous year in which the income was derived; and the income so deemed to have been applied shall not be taken into account in calculating the amount of income applied to such purposes during the previous year in which the income is received or during the previous year immediately following, as the case may be.

(b) In case referred to in (ii), so much of the income applied to such purposes in India during the previous year immediately following the previous year in which the income was derived as does not exceed the said amount shall be deemed to be income applied to such purposes during the previous year in which the income was derived; and the income so deemed to have been applied shall not be taken into account in calculating the amount of income applied to such purposes during the previous year immediately following the previous year in which the income was derived.

Any amount credited or paid, out of income referred to in clause (a) or clause (b) read with Explanation 1, to any other trust or institution registered under section 12AA, being contribution with a specific direction that they shall form part of the corpus of the trust or institution, shall not be treated as application of income for charitable or religious purposes. (w.e.f. AY 2018-19)

Where any income as discussed in (a) and (b) above is not applied to charitable or religious purposes in India within the prescribed time, then such income shall be deemed to be the income of the person in receipt thereof:

(a) In case of not receiving the income: Such income shall be deemed to be the income of the previous year immediately following the previous year in which the income was received.

(b) In any other case: Such income shall be deemed to be the income of the previous year immediately following the previous year in which the income was derived [Clause (1B)].

(3) For the purpose of computation of amount applied in clause a) and b) of explanation 2 above the

provisions of section 40(a)(ia) and 40A(3) and 40A(3A) shall apply in the same manner as they apply as in case of computation of PGBP income. (**w.e.f. AY 2021-22)**

Capital Gains [Section 11(1A)]

Asset held wholly for religious purposes or charitable purposes

Sometimes a capital asset held under trust wholly for charitable or religious purposes is transferred resulting in a capital gain. The net consideration received on such transfer may be utilised wholly or in part in acquiring another capital asset to be so held wholly for religious or charitable purposes. In such cases the capital gains arising from the transfer shall be deemed to have been applied for charitable or religious purposes to the extent stated herein below:

(i) Where the whole of the net consideration is utilised for acquiring the new capital assets, so much of the capital gains.

(ii) Where only a part of the net consideration is utilised for acquiring the new capital asset, so much of the capital gain as is equal to the amount by which the amount so utilised exceeds the cost of the transferred asset.

Example 1: A charitable trust had a capital asset the cost of which was Rs.80,000 and it sold the same for Rs. 1,00,000. The whole of the consideration, i.e., Rs. 1,00,000 will be exempt from capital gains tax if a new capital asset is bought for Rs. 1,00,000.

Example 2: If a trust had a capital asset costing Rs.1,00,000 and sold the same for Rs. 1,50,000 and then bought a capital asset for Rs. 1,30,000, then the working will be as follows:

Particulars	Rs.
Sale proceeds of old asset	1,50,000
Cost of the old asset	(1,00,000)
Capital gain	50,000
Cost of the new asset	1,30,000
Cost of the old asset	(1,00,000)
Capital gain utilised is	30,000
Capital gain taxable is	20,000

Assets held partly for religious or charitable purposes

It is quite possible that a capital asset is held by a trust partly for religious or charitable purposes. Where such a capital asset is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset, the appropriate fraction of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified here under:

(i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain;

(ii) in any other case, so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset

“Explanation” to Section 11(1A) provides:

‘Appropriate fraction’ means the fraction which represents the extent to which the income derived from the capital asset transferred was immediately before such transfer applicable to charitable or religious purposes.

'Cost of the transferred asset' means the aggregate of the cost of acquisition (as ascertained for the purposes of Section in any other case, so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset on 48 and 49 of the capital asset which is the subject of the transfer and the cost of any improvement thereto within the meaning assigned to that expression in sub-clause (b) of clause (1) of Section 55.

'Net consideration' means the full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

Illustration

A trust has a capital asset costing Rs. 2,00,000 and 1/2 of its income is utilised for charitable purpose. It is sold for Rs. 3,50,000. If the trust buys another capital asset for Rs. 3,50,000 then appropriate fraction of the capital gain deemed to have been applied for charitable purpose. Supposing that the trust buys another asset for Rs. 2,90,000:

Particulars	Rs.
Sale proceeds of Capital asset	3,50,000
Cost of the asset sold	(2,00,000)
Capital gain on transfer of capital asset	1,50,000
Appropriate fraction i.e. 1/2	75,000
Another asset purchased	2,90,000
Appropriate fraction utilised (1/2 of Rs. 2,90,000)=	1,45,000
Appropriate fraction of the original capital asset 1/2 of Rs. 2,00,000	(1,00,000)
Capital gain utilised	45,000
Capital gain not utilised	30,000

Accumulations of Income [Section 11(2)]

While dealing with Section 11 it has been stated that accumulation of income from trust property held for charitable purpose is permissible up to 15 per cent without attracting any liability to tax. Where the balance 85 per cent of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year, such income so accumulated or set apart shall not be included in the total income if the following conditions are fulfilled:

(a) such person furnishes a statement in the prescribed form 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 to be accumulated or set apart, which shall in no case exceed five years;

(b) the money so accumulated or set apart is invested or deposited in the forms or modes specified in subsection (5);

(c) the statement referred to in clause (a) is furnished on or before the due date specified under sub-section (1) of section 139 for furnishing the return of income for the previous year:

Provided that in computing the period of five years referred to in clause (a), 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.

Explanation : Any amount credited or paid, out of income referred to in clause (a) or clause (b) of Sub-section (1), read with the explanation to that sub-section, which is not applied, but is accumulated or set apart, to any trust or institution registered under Section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10, shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

It is important to note that to claim exemption subject to Section 11(2) it is enough to invest in Government securities etc., only that part of the unspent balance which falls over and above 15% of the total income derived from the property held under trust [C.I.T. v. H.H. Marthanda Varma Elayaraja of Travancore Trust and others (1981) 129 I.T.R. 191 (Ker.)].

Section 11(3) provides that:

(i) if the income accumulated for the specific purpose under Section 11(2) is applied to purposes other than charitable or religious, or ceases to be accumulated or set apart for application thereto, it will be chargeable to tax as income of that year. Further, such accumulated income will become liable to be taxed if,

(ii) it ceases to remain invested in any security or deposited in the manner provided under Section 11(5), or

(iii) it is not utilised for the purpose for which it is so accumulated or set apart during the specified period, or in the year immediately following the expiry thereof;

(iv) is credited or paid to any trust or institution registered under Section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10.

it shall be deemed to be the income of the previous year in which it ceases to remain so invested or deposited or is not so utilised, as the case may be.

Section 11(3A) provides that where due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in accordance with the provisions of Section 11(2) cannot be applied for the purpose for which it was accumulated or set apart, the Assessing Officer may, on an application made to him in this behalf allow such person to apply such income for such other charitable or religious purpose in India, as is specified by the person in the application subject further to the condition that it is in conformity with the objects of the trust.

Provided that the Assessing Officer shall not allow application of such income by way of payment or credit made for the purposes referred to in clause (d) of Sub-section (3) of section 11.

For the purposes of Section 11, 'property held under trust' includes a business undertaking so held and where a claim is made that the income of any such undertaking shall not be included in the total income of the persons in receipt thereof, the Assessing Officer shall have power to determine the income of such undertaking in accordance with the provisions of the Income-tax Act relating to assessment and where any income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious.

Provided that the Assessing Officer shall not allow application of such income by way of payment or credit made for the purposes referred to in clause (d) of Sub-section (3) of Section 11:

Provided further that in case the trust or institution, which has invested or deposited its income in accordance with the provisions of clause (b) of Sub-section (2), is dissolved, the Assessing Officer may allow application of such income for the purposes referred to in clause (d) of Sub-section (3) in the year in which such trust or institution was dissolved.

Sub-section (4A) as substituted by Finance Act, 1991 with effect from 1.4.1992 states that Sub-sections (1) or or (3) or (3A) of Section 11 shall not apply in relation to any business income of a trust or institution unless the business is incidental to the attainment of the objectives of the trust or institution and separate books of accounts are maintained by such trust or institution in respect of such business.

Forms and Modes of Investment [Section 11(5)]

The forms and modes for investing funds of charitable and religions trusts and institutions are given hereunder:

(i) investment in saving certificates as defined in clause (c) of Section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government. Investments in Indira Vikas Patra and Kisan Vikas Patra also qualify for the purpose of this Section;

(ii) deposit in any account with the Post Office Savings Bank;

(iii) deposit in any account with a scheduled bank or a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank);

Explanation: In this clause, "scheduled bank" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under Section 3 of the Banking Companies (Acquisition and Transfer of Undertaking Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

(iv) investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);

(v) investment in any security for money created and issued by the Central Government or a State Government;

(vi) investment in debentures issued by, or on behalf of, any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central Government or by a State Government;

(vii) investment or deposit in any public sector company;

Provided that where an investment or deposit in any public sector company has been made and such public sector company ceases to be a public sector company:

(A) such investment made in the shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public sector company ceases to be a public sector company;

Investment in debt instruments issued by and infrastructure Finance Company registered with RBI.

(B) such other investment or deposit shall be deemed to be an investment or deposit made under this clause for the period up to the date on which such investment or deposit becomes repayable by such company;

(viii) deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and which is eligible for deduction under clause

(viii) of Sub-section (1) of Section 36;

(ix) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance or construction or purchase of houses in India for residential purposes and which is approved by the Central Government for the purposes of clause (viii) of Sub-section (1) of Section 36;

(ixa) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

Explanation: For the purpose of this clause:

(a) "long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years;

(b) "public company" shall have the meaning assigned to it in Section 3 of the Companies Act, 1956 (1 of 1956);

(c) "urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyovers or urban transport.

(x) investment in immovable property.

Explanation: "Immovable property" does not include any machinery or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;

(xi) deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 [(18 of 1964)];

(xii) any other form or mode of investment or deposit as may be prescribed including investments in units of Mutual Fund and Transfer of Deposits to Public Account of India.

According to section 11(6), where any income is required to be applied or accumulated or set apart for application, then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income under this section in the same or any other previous year.

According to section 11(7), where a trust or an institution has been granted registration under clause (b) of subsection (1) of section 12AA or has obtained registration at any time under section 12A and the said registration is in force for any previous year, then, nothing contained in section 10 [other than clause (1) and clause *(23C)* thereof] shall operate to exclude any income derived from the property held under trust from the total income of the person in receipt thereof for that previous year.

Income of trusts or institutions from contributions [Section 12]

(1) The income of a trust by way of voluntary contributions would also be treated for all purposes as income deemed to have been derived by the trust from property held by it under trust except, however, in case where the voluntary contribution is received with a specific direction that it shall form part of the corpus of the trust. As a result, voluntary contribution received by a trust should also be applied for charitable purposes before the end of the accounting year or within 3 months following so that income-tax exemption could be availed of. However, voluntary contributions could be accumulated for future obligation for charitable purposes in the same manner as specified earlier.

(2) The value of any services, being medical or educational services, made available by any charitable or religious trust running a hospital or medical institution or an educational institution, to any person referred to in Clause (a) or Clause (b) or Clause (c) or Clause (cc) or Clause (d) of Sub-section (3) of Section 13, shall be

deemed to be income of such trust or institution derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be chargeable to income-tax notwithstanding the provisions of Sub-section (1) of Section 11.

Explanation: For the purposes of this sub-section, the expression "value" shall be the value of any benefit or facility granted or provided free of cost or at concessional rate to any person referred to in Clause (a) or Clause or Clause (c) or Clause (cc) or Clause (d) of Sub-section (3) of Section 13.

(3) Notwithstanding anything contained in Section 11, any amount of donation received by the trust or institution in terms of Clause (d) of Sub-section (2) of Section 80G which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilised in terms of Sub-section 5(C) of Section 80G in respect of which accounts of income and expenditure have not been rendered to the authority prescribed under clause (v) of sub-section (5C) of that section, in the manner specified in that clause, and not transferred to the Prime Minister's National Relief Fund on or before the 31st day of March, 2004 shall be deemed to be the income of the previous year and shall accordingly be charged to tax.

Conditions as to Registration of Trusts, etc. [Section 12A]

The provisions of Sections 11 and 12 shall not apply in relation to any trust or institution unless the following conditions are fulfilled:

(1)(aa) the person in receipt of the income has made an application for registration of the trust or institution on or after the 1st day of June, 2007 in the prescribed form and manner to the Principal Commissioner or Commissioner and such trust or institution is registered under section 12AA;

(ab) the person in receipt of the income has made an application for registration of the trust or institution, and subsequently, it has adopted or undertaken modifications of the objects which do not conform to the conditions of registration, in the prescribed form and manner, within a period of thirty days from the date of said adoption or modification, to the Principal Commissioner or Commissioner and such trust or institution is registered under section 12AA; (w.e.f. AY 2018-19)

(ac) notwithstanding anything contained in clauses (a) to (ab), the person in receipt of the income has made an application in the prescribed form and manner to the Principal Commissioner or Commissioner, for registration of the trust or institution,—

(i) where the trust or institution is registered under section 12A [as it stood immediately before its amendment by the Finance (No. 2) Act, 1996 (33 of 1996)] or under section 12AA, [as it stood immediately before its amendment by the Finance Act, 2020] within three months from the date on which this clause has come into force;

(ii) where the trust or institution is registered under section 12AB and the period of the said registration is due to expire, at least six months prior to expiry of the said period;

(iii) where the trust or institution has been provisionally registered under section 12AB, at least six months prior to expiry of period of the provisional registration or within six months of commencement of its activities, whichever is earlier;

(iv) where registration of the trust or institution has become inoperative due to the first proviso to sub-section (7) of section 11, at least six months prior to the commencement of the assessment year from which the said registration is sought to be made operative;

(v) where 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;

(vi) in any other case, at least one month prior to the commencement of the previous year relevant to the assessment year from which the said registration is sought,

and such trust or institution is registered under section 12AB; **[Clause ac inserted by Finance Act, 2020]**

(b) where the total income of the trust or institution as computed under this Act without giving effect to the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to income-tax in any previous year, the accounts of the trust or institution for that year have been audited by an accountant as defined in the Explanation to sub-section (2) of section 288 and the person in receipt of the income furnishes along with the return of income for the relevant assessment year 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.

(ba) the person in receipt of the income has furnished the return of income for the previous year in accordance with the provisions of sub-section (4A) of section 139, within the time allowed under that section. (w.e.f. AY 2018-19)

(2) Where an application has been made on or after the 1st day of June, 2007, the provisions of sections 11 and 12 shall apply in relation to the income of such trust or institution from the assessment year immediately following the financial year in which such application is made:

[Provided that the provisions of sections 11 and 12 shall apply to a trust or institution, where the application is made under—

(a) sub-clause (i) of clause (ac) of sub-section (1), from the assessment year from which such trust or institution was earlier granted registration;

(b) sub-clause (iii) of clause (ac) of sub-section (1), from the first of the assessment years for which it was provisionally registered **[Inserted by Finance Act, 2020]**

Provided that where registration has been granted to the trust or institution under section 12AA or section 12AB, then, the provisions of sections 11 and 12 shall apply in respect of any income derived from property held under trust of any assessment year preceding the aforesaid assessment year, for which assessment proceedings are pending before the Assessing Officer as on the date of such registration and the objects and activities of such trust or institution remain the same for such preceding assessment year:

Provided further that no action under section 147 shall be taken by the Assessing Officer in case of such trust or institution for any assessment year preceding the aforesaid assessment year only for non-registration of such trust or institution for the said assessment year

Rule 17A of the Income-tax Rules, 1962 provides that an application for registration of a trust shall be made in duplicate in Form No. 10A and shall be accompanied by the following documents:

(i) where the trust is created or the institution is established under an instrument, the instrument in original together with a copy thereof and where it is created otherwise than under an instrument, the document evidencing the creation of the trust or the establishment of the institution together with one copy thereof. The Principal Commissioner or Commissioner may accept a certified copy instead of the original where the original cannot be conveniently produced.

(ii) where the trust is in existence during any year or years prior to the financial year in which the application for registration is made, two copies each of the accounts of the trust for the three years (immediately) preceding the years in which the application for which the accounts have been made-up.

Procedure for Registration [Section 12AA]

Nothing contained in this section shall apply on or after the 1st day of June, 2020. [Inserted by Finance Act, 2020]

In terms of Section 12AA, on receipt of application for registration, the Principal Commissioner or Commissioner shall call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such inquiries as he may deem necessary in this behalf. Sub-section 12AA. He has to either grant or decline registration within six months from the end of the month in which the application was received.

Where the Principal Commissioner or Commissioner is satisfied that the activities of the trust or institution are not genuine or are not carried out in accordance with the objects of the trust or institution then the commissioner may pass an order in writing for the cancellation of registration granted under section 12AA or under section 12A after giving an opportunity of being heard.

Further, where a trust or an institution has been granted registration or has obtained registration at any time under section 12A and subsequently it is noticed that the activities of the trust or the institution are being carried out in a manner that the provisions of sections 11 and 12 do not apply to exclude either whole or any part of the income of such trust or institution due to operation of sub-section (1) of section 13, then, the Principal Commissioner or the Commissioner may by an order in writing cancel the registration of such trust or institution.

However the registration shall not be cancelled under this sub-section, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the said manner.

Procedure for Fresh Registration [Section 12AB]

(1) The Principal Commissioner or Commissioner, on receipt of an application made under clause (ac) of sub-section (1) of section 12A, shall,—

(a) where the application is made under sub-clause (i) of the said clause, pass an order in writing registering the trust or institution for a period of five years;

(b) where the application is made under sub-clause (ii) or sub-clause (iii) or sub-clause (iv) or sub-clause (v) of the said clause,—

(i) call for such documents or information from the trust or institution or make such inquiries as he thinks necessary in order to satisfy himself about—

(A) the genuineness of activities of the trust or institution; and

(B) the compliance of such requirements of any other law for the time being in force by the trust or institution as are material for the purpose of achieving its objects; and

(ii) after satisfying himself about the objects of the trust or institution and the genuineness of its activities under item (A), and compliance of the requirements under item (B), of sub-clause (i),—

(A) pass an order in writing registering the trust or institution for a period of five years;

(B) if he is not so satisfied, pass an order in writing rejecting such application and also cancelling its registration after affording a reasonable opportunity of being heard;

(c) where the application is made under sub-clause (vi) of the said clause, pass an order in writing provisionally registering the trust or institution for a period of three years from the assessment year from which the registration is sought,

and send a copy of such order to the trust or institution.

(2) All applications, pending before the Principal Commissioner or Commissioner on which no order has been

passed under clause (b) of sub-section (1) of section 12AA before the date on which this section has come into force, shall be deemed to be an application made under sub-clause (vi) of clause (ac) of sub-section (1) of section 12A on that date.

(3) The order under clause (a), sub-clause (ii) of clause (b) and clause (c), of sub-section (1) shall be passed, in such form and manner as may be prescribed, before expiry of the period of three months, six months and one month, respectively, calculated from the end of the month in which the application was received.

(4) Where registration of a trust or an institution has been granted under clause (a) or clause (b) of sub-section (1) and subsequently, the Principal Commissioner or Commissioner is satisfied that the activities of such trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, as the case may be, he shall pass an order in writing cancelling the registration of such trust or institution after affording a reasonable opportunity of being heard.

(5) Without prejudice to the provisions of sub-section (4), where registration of a trust or an institution has been granted under clause (a) or clause (b) of sub-section (1) and subsequently, it is noticed that—

(a) the activities of the trust or the institution are being carried out in a manner that the provisions of sections 11 and 12 do not apply to exclude either whole or any part of the income of such trust or institution due to operation of sub-section (1) of section 13; or

(b) the trust or institution has not complied with the requirement of any other law, as referred to in item (B) of sub-clause (i) of clause (b) of sub-section (1), 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,

then, the Principal Commissioner or the Commissioner may, by an order in writing, after affording a reasonable opportunity of being heard, cancel the registration of such trust or institution.

[Inserted by Finance Act, 2020]

Levy of tax where the charitable institution ceases to exist or converts into a non-charitable organization

Sections 11 and 12 of the Act provide for exemption to trusts or institutions in respect of income derived from property held under trust and voluntary contributions, subject to various conditions contained in the said sections. The primary condition for grant of exemption is that the income derived from property held under trust should be applied for the 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 various conditions provided in the section. 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 provides for registration of the trust or institution which entitles them to be able to get the benefit of sections 11 and 12. 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 in respect of whole or part of income would not be available to a trust or institution.

A society or a company or a trust or an institution carrying on charitable activity may voluntarily wind up its activities and dissolve or may also merge with any other charitable or non-charitable institution, or it may convert into a non-charitable organization. In such a situation, the existing law does not provide any clarity as to how the assets of such a charitable institution shall be dealt with.

In order to ensure that the intended purpose of exemption availed by trust or institution is achieved, a new chapter has been introduced that provide for levy of additional income-tax in case of conversion into, or merger with, any non-charitable form or on transfer of assets of a charitable organization on its dissolution to a non-charitable institution. The elements of the regime are under:

i. The accretion in income (accreted income) of the trust or institution shall be taxable on conversion of trust or institution into a form not eligible for registration u/s 12AA or on merger into an entity not having similar objects and registered under section 12AA or on non-distribution of assets on dissolution to any charitable institution registered u/s 12AA or approved under section 10(23C) within a period twelve months from dissolution.

ii. Accreted income shall be amount of aggregate of total assets as reduced by the liability as on the specified date. The method of valuation is proposed to be prescribed in rules. The asset and the liability of the charitable organisation which have been transferred to another charitable organisation within specified time will be excluded while calculating accreted income.

iii. The taxation of accreted income shall be at the maximum marginal rate.

iv. This levy shall be in addition to any income chargeable to tax in the hands of the entity.

v. This tax shall be final tax for which no credit can be taken by the trust or institution or any other person, and like any other additional tax, it shall be leviable even if the trust or institution does not have any other income chargeable to tax in the relevant previous year.

vi. In case of failure of payment of tax within the prescribed time, a simple interest @ 1% per month or part of it shall be applicable for the period of non-payment.

vii. For the purpose of recovery of tax and interest, the principal officer or the trustee and the trust or the institution shall be deemed to be assessee in default and all provisions related to the recovery of taxes shall apply. Further, the recipient of assets of the trust, which is not a charitable organisation, shall also be liable to be held as assessee in default in case of non-payment of tax and interest. However, the recipient's liability shall be limited to the extent of the assets received.

These amendments effective from 1st June, 2016.

Tax Planning Consideration for Firm V/s LLP V/s Company

Following points to be kept in mind while tax planning with reference to different form of organization.

- Tax Rate applicability
- MAT/AMT
- Dividend Distribution Tax
- Tax treatment in the hands of shareholder or partners
- Interest on capital to partners (Deducted up to 12% subject to conditions of section 184)
- Remuneration to partners
- Applicability of section 78 and 79 in case of change in constitution.
- Loan to partner or shareholders with reference to Section 2(22) (e)
- Applicability of presumptive taxation scheme under section 44AD

TAX PLANNING WITH REFERENCE TO NEW BUSINESS

LOCATION OF BUSINESS	NATURE OF BUSINESS
Tax incentives available ● SEZ (Section10AA) ● EOU (Section10B) ● Section 80IA ● Section 80IAB ● Section 80IB ● Section 80IC ● Section 80ID ● Section 80IE **[Section 80IA to 80IE as per chart provided]**	**Tax incentives available** ● SEZ (Section10AA) ● Investment Allowances (Section 32AD) ● Tea development Account (Section 33AB) ● Telecommunication services (Section 35ABB) ● Expense on specified business (Section 35AD) ● Section 35CCC ● Section 35CCD ● Section 44BB ● Section 44AD ● Section 44AE ● Section 80IA ● Section 80IAB ● Section 80IAC ● Section 80IB ● Section 80IBA ● Section 80IC ● Section 80JJAA ● Tonnage Tax scheme (Section 115V to 115VZC)

CASE LAWS

1. Allow ability of remuneration when partnership deed not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration.

OR

In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?

CIT Vs. Anil Hardware Store (2010) 323 ITR 0368 (HP)

Relevant section: 40(b)(v)

FACTS OF THE CASE

The partnership deed of the assessee firm provided that in case the book profits of the firm are up to Rs. 75,000, then the partners would be entitled to remuneration up to Rs. 50,000 or 90 per cent of the book profits, whichever is more. In respect of the next Rs. 75,000, it is 60 per cent and for the balance book profits, it is 40 per cent. Thereafter, it is further clarified that the book profits shall be computed as defined in section 40(b) of the Income-tax Act, 1961, or any other provision of law as may be applicable for the assessment of the partnership firm. It has also been clarified that in case there is any loss in a particular year, the partners shall not be entitled to any remuneration. Clause 7 of the partnership deed laid down that the remuneration payable to the partners should be credited to the respective accounts at the time of closing the accounting year and clause 5 stated that the partners shall be entitled to equal remuneration.

HIGH COURT'S DECISION

The High Court held that the manner of fixing the remuneration of the partners has been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other venture and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down, the assessee- firm is entitled to deduct the remuneration paid to the partners under section 40(b)(v) of the Income-tax Act.

Note:

(1) Payment of remuneration to working partners is allowed as deduction if it is authorised by the partnership deed and is subject to the overall ceiling limits specified in section 40(b)(v). The limits for partners' remuneration under section 40(b)(v) has revised upwards and the differential limits for partners' remuneration paid by professional firms and non-professional firms have been removed. On the first Rs. 3 lakh of book profit or in case of loss, the limit would be the higher of Rs. 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

(2) The CBDT had, vide Circular No. 739 dated 25-3-1996, clarified that no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

In this case, since the partnership deed lays down the manner of quantifying such remuneration, the same would be allowed as deduction subject to the limits specified in section 40(b)(v).

2. **Interest for default in payment of advance tax liable on to companies liable to MAT**

Join CIT v Rolta India ltd. (2011) 330 ITR 470 (SC)

FACTS OF THE CASE

The assessee filed NIL return of income for the relevant AY 1997-98. The TO assessed the income of the assessee under Minimum Alternative Tax ("MAT") provisions, levied MAT on the book profit and also levied interest under section 234B of the Act for default in payment of advance tax on the tax payable under a MAT.

SUPREME COURT'S OBSERVATION AND DECISION

The Supreme Court observed and held that,

- Sections 234B and 234C do not make any reference to section 115J / 115JA of the Act; however, levy of interest under section 234B is on 'assessed tax' so as to include tax determined on application of sections 115J / 115JA in the regular assessment
- Sections 115J / 115JA are special provisions. The sub-section (4) of section 115JA and sub-section (5) of section 115JB specifies that all other provisions of the Act shall apply to a company liable to MAT
- Para 2 of the Board circular no. 13/2001 dated 9 November, 2001 [2001] 252 ITR 50 (St.) clarified that section 115JB is a self-contained code and that all companies were liable to payment of advance tax under section 115JB of the Act, and consequently, the provisions of sections 234B and 234C of the act relating to default in payment of advance tax were also applicable
- Accordingly, interest under sections 234B and 234C of the Act would become payable on failure to pay advance tax if the company is liable to pay MAT.

3. Whether Long term capital gain exempted by virtue of Section 54E/54EC be included in book profits for the purpose of calculation of MAT under section 115J/115JB ?

N. J. JOSE & CO. (p) LTD. V ACIT [2010] 321 ITR 0132 (KER)

FACTS OF THE CASE

This is an appeal filed by the assessee under Section 260A of the IT Act, challenging the order of the Tribunal disposing of the appeal filed against the assessment for the year 1989-90. The substantial questions of law arising from the order under challenge are the following:

1. Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the capital gains is part of the book profits under Section 115J of IT Act, 1961?.
2. Whether there were materials for the Tribunal to hold that even though Section 115J is a deeming provision the long-term capital gain which itself is deemed income and which is saved by the operation of Section 54E is liable to be included in the book profit under Section 115J of the Act?

During the previous year relevant for the asst. yr. 1989-90, among other items, the appellant has substantial income of Rs. 26,03,245 being long-term capital gains. The assessee claimed relief under Section 54E of the Act on the income from long-term capital gains by depositing amounts in specified assets in terms of the said provision. However, after computation of income including income from capital gains and after granting exemption under Section 54E, the AO found that the total income so computed is less than 30 per cent of book profit and therefore the AO proceeded to make assessment on book profit authorised under Section 115J of the Act. In the computation of book profit under Section 115J of the Act, the assessee claimed exclusion of capital gains because of exemption available on it by virtue of Section 54E of the Act. The AO rejected the claim and reckoned the book profit including long-term capital gains for the purpose of assessment under Section 115J of the Act. Even though the assessee was successful in first appeal, the Tribunal on second appeal filed by the Department, reversed the order of the first appellate authority and held that long-term capital gains form part of book profit. It is against this order of the Tribunal, the assessee filed this appeal raising the above questions.

HIGH COURT'S OBSERVATIONS AND DECISION

Assessee contended that capital gains under Section 45 of the Act is a profit arising on transfer of capital assets and though chargeable to income-tax, the benefit of deduction/exemption available on investments made in specified assets in terms of Section 54E of the Act, cannot be denied to the assessee even if assessment is made under Section 115J of the Act. According to him, there is nothing in Chapter XII-B providing for disallowance of eligible exemption under Section 54E of the Act on capital gains in the course of assessment based on book profit.

Revenue, on the other hand contended that no deduction can be allowed in the computation of book profit except to the extent permissible under Section 115J(1A) of the Act. We are unable to accept the contention of the assessee, because assessment under Chapter XII-B on book profit is a self contained code. The scheme there under is to adopt the P & L a/c of the assessee prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956(now statement of profit and loss prepared in accordance with part –II of Schedule –III of Companies Act,2013) and to treat the net profit shown therein as book profit The permissible adjustments in the form of additions and deductions are provided under Explanation to Section 115J(1A) of the Act. No more deductions, rebates or allowances other than what is stated in the said Explanation are available for the computation of book profit. In fact, it is very clear from the non obstante clause in Section 115J(1) that the assessment under Section 115J overrides other provisions of the Act. In fact, the AO gets jurisdiction to make assessment under Section 115J of the Act only when the total income computed under the provisions of the Act is below 30 per cent of the book profit of the assessee as contemplated under the said section. While deductions, rebates and allowances are available in the computation of income for normal assessment, additions, deductions and adjustments except to the extent covered by the Explanation to Section 115J(1A) are not available in the computation of book profit. In other words, once the AO finds that total income as computed under the provisions of the Act is less than 30 per cent of the book profit he has to give up normal assessment and proceed to make assessment. The AO has to opt for the assessment under Section 115J which does not provide for any deduction in terms of Section 54E of the Act. The assessee has no case that the long-term capital gain is not profit includible in the P & L a/c prepared in terms of Schedule VI of the Companies Act. Since there is no provision in Chapter XII-B for deduction of capital gains in the computation of book profit, the assessee is not entitled to the deduction claimed. The Bombay High Court in the decision in CIT v. Veekaylal Investment Co. (P) Ltd. : [2001]249ITR597(Bom) also took the view that capital gains is part of profit which cannot be excluded in the computation of book profit. Even though the assessee contended that the case decided by the Bombay High Court did not Involve claim of exemption on capital gains under Section 54E of the Act, we do not think this distinction makes any difference, because so long as long-term capital gains is part of profit included in the P & L a/c prepared under Chapter VI of the Companies Act, it cannot be excluded unless so provided under Explanation to Section 115J(1A) of the Act. In the absence of any provision for exclusion of capital gains in the computation of book profit under the above provision, assessee is not entitled to the exclusion claimed. In other words, Section 54E has no application in the computation of book profit under Section 115J.

Therefore order of the tribunal is upheld and appeal of assessee is rejected.

4. Where the credit facility is extended to members of the society by virtue of sale of goods to them by consumers' co-operative society, the exemption is not available. When the society sells goods on credit to its members, such transaction cannot be construed as a credit society to which the benefit of Section 80P(2)(a)(i) can be extended.

*[**Rodier Mill Employees' Co-operative Stores Ltd.*** **v.** ***CIT*** **(1982) 135 ITR 355].**

Following the ratio laid down by the Madras High Court in the case of *Rodier Mill Employees' Co-operative Stores Ltd.* v. *Commissioner of Income-tax* (1982, 135 ITR 355), the Kerala High Court held in the case of *Kerala Co-operative Consumers Federation Ltd.* v. *Commissioner of Income-tax* (1988, 170 ITR 455) that the words 'providing credit facilities', occurring in Section 80P(2)(a)(i) of the Income-tax Act, 1961 should be construed as similar to, or akin to the 'carrying on the business of banking', preceding the words "or providing credit facilities" in the same sub-section. The words 'providing credit facilities to its members' means providing credit by way of loans and not selling goods on credit.

5. Where society purchases auto-rickshaws and sells them to members on hire-purchase, it is not providing credit facility to members and not entitled to exemption.

*[**C.I.T.*** **v.** ***Madras Auto Rickshaw Drivers' Co-operative Society*** **(1983) 143 ITR 981**].

In this case it was held that the tax relief under Section 80P(2)(a)(i) of the Income- tax Act, is a grant not to a category of income but to a category of assessees namely, a co-operative society answering the description of a society engaged in carrying on the business of providing credit facilities to its members. If the society in question does not answer to this description, it is not entitled to the relief.

(1) In ***Bihar State Co-operative Bank Ltd.*** **v.** ***C.I.T.*** **[(1960) 39 I.T.R. 114] the Supreme Court** has held that if a co-operative society carrying on banking business invests its circulating capital in such a manner that it is readily available, the interest on such investment shall constitute income from banking business and therefore shall be exempt in the hands of the co-operative society.

(2) Interest received on Government Securities held by co-operative society as its stock-in-trade qualifies for deduction from gross total income. But the deduction is inapplicable to interest received from Government Securities held as investments. [**CIT v.** ***Bombay State Co-operative Bank Ltd.*** **(1968) 70 ITR 86 (S.C.)].**

The Madhya Pradesh High Court held in the case of ***M.P. State Co-operative Bank Ltd.*** **v.** ***Addl. Commissioner***

of Income-tax **(1979, 119 ITR 327)** that income from investment of reserve capital in securities was not a part of the income from banking business and did not qualify for exemption. Similarly, the interest income from investment of provident fund income did not form part of the income from the banking business and did not qualify for exemption under Section 80(i)(a) (now Section 80P). Distinguishing the ratio laid down in this case, the Madhya Pradesh High Court held in the case of *Commissioner of Income-tax* v. *Bhopal Co-operative Central Bank Ltd.* (1987, 164 ITR 713) that the security deposits made are in accordance with the Banking Regulation Act, 1949 and interest income received on deposits formed part of income from business of banking and exempt under Section 80P(2)(i) of the Income-tax Act, 1961.

The Allahabad High Court held in the case of ***Addl. Commissioner of Income-tax*** **v.** ***U.P. Co-operative Cane Union*** **(1978, 114 ITR 70)** that selling goods on credit was only a mode of carrying on business. It did not become a business of providing credit facility. Following this case, the Allahabad High Court held in the case of

Commissioner of Income-tax **v.** ***U.P. Co-operative Cane Union Federation Ltd.*** **(1980, 122 ITR 913)** that the expression 'providing credit facilities' in Section 80P(2)(a)(i) would comprehend the business of lending money on interest. It would also comprehend the business of lending services on profit for guaranteeing payments because guaranteeing payment is as much a part of banking business for affording credit facility as advancing loans.

However, where a co-operative society holds securities as per requirements of Banking Regulation Act and directions of the RBI, the deduction is available on such interest income. Similarly, subsidy from Government for opening new branches and giving loans to poorer sections at lower rate of interest, is income attributable to banking business [CIT v. *Madurai District Central Co-operative Bank Ltd.* (1984) 148 ITR 196].

6. The Income earned by a co-operative society carrying on the business of banking and providing credit facilities to its members from commission and brokerage by dealing in bills of exchange, subsidy from Government, admission fee from members, incidental charges and financial penalties is attributable to the business of banking of providing credit facilities to its members and hence deductible under Section 80P(2)(a)(i).

[**CIT v.** ***Dhar Central Co-operative Bank*** **(1984) 149 ITR 438 (MP)]**

Following its decision in the case of *Commissioner of Income-tax* v. *Dhar Central Co-operative Bank* (1984, 149 ITR 438), the Madhya Pradesh High Court held in the case of *Commissioner of Income-tax* v. *Bhopal Cooperative Central Bank Ltd.* (1988, 172 ITR 423) that a co-operative society carrying on the business of banking is entitled to exemption in respect of interest on securities, commission, subsidy, donation and locker rent. Again, the said decision was followed by it in the case of *Madhya Pradesh Rajya Sahakari Bank* v. *Commissioner of Income-tax* (1988, 174 ITR 150) holding that the income from commission, exchange and other miscellaneous income was attributable to the business of banking and that the assessee was entitled to exemption under Section 81 (now 80P) of the Income-tax Act, 1961 in respect thereof.

7. A society which buys and sells products of other societies or individuals is not entitled to exemption. Where a society manufactures and sells its own products or the products of its members, such society is entitled to exemption. Hence, the Central Cottage Industries Emporium, New Delhi, is not entitled to exemption under Section 80P.

*[**Addl. C.I.T.*** **v.** ***Indian Co-operative Union Ltd.*** **(1982) 134 ITR 108 (Delhi)].**

If the godown or warehouse is let for a purpose other than storage, processing of facilitating the marketing of commodities, the income derived therefrom by a co-operative society would not be deductible under Section 80P *C.I.T.* v. *Ahmedabad Maskati Cloth Dealers Co-operative Warehouses Society Ltd.* [(1986) 162 ITR 142 (Guj.)] it was also held in this case that shops in which wholesale or retail business in cloth is carried on cannot come within the meaning of 'godowns' or 'warehouses'.

The Gujarat High Court's decision in the case of *Commissioner of Income-tax* v. *Ahmedabad Maskati Cloth Dealers Co-operative Warehouses Society Ltd.* (1986, 162 ITR 142) had since been approved by the Supreme

Court in the case of South Arcot District Co-operative Marketing Society Ltd. (infra). The Gujarat High Court had, inter alia, held that the words facilitating the marketing of commodities' would not lend colour to the words 'godowns or warehouses' so as to enlarge their meaning.

8. Whether the provisions of section 115JB of the Act relating to payment of MAT are applicable to only such foreign companies that have a physical business presence in India?

Timken Co., In re. [2010] ITR 193(AAR-New Delhi)

The applicant is a company registered under the laws of Panama. India has not entered into a Double Taxation Avoidance Convention with Panama. The applicant holds shares in two public limited companies, both governed by the Companies Act, 1956 and proposed to transfer shares. However, section 10(38) of the Income-tax Act exempts any income arising from the transfer of a long-term capital asset, being an equity share in a company, when such transaction is chargeable to securities transaction tax. According to it, however, the proviso to section 10(38) of the Act states that such long-term capital gain earned by a company shall be taken into account in computing the book profit and income-tax payable thereon under section 115JB of the Act. Since the proviso to section 10(38) would be attracted, it is desirous of seeking a ruling whether, the computation of tax based on the prescription contained in section 115JB of the Act would be applicable. The applicant had no physical presence in India. Hence, it was held that Section 115JB is not designed to be applicable of applicant, a foreign company having no presence or PE in India.

9. Constitutional Validity of Section 115-O and whether tea companies are liable for the tax on only 40% of the dividend income?

UOI vs. Tata Tea Co. Ltd [2017] 85 (Supreme Court)

Act was challenged before the High Court. The main plank of attack of learned counsel for the writ petitioners is, lack of legislative competence in the Parliament to enact Section 115O so as to impose additional income tax. The income out of which dividend is declared, distributed or paid is an agricultural income to the extent of 60%, tax on which can only be imposed by State legislature. The Parliament has transgressed its legislative power in enacting Section 115O. It has been observed that Part XI of the Constitution of India Chapter I contain provisions relating to distribution of legislative powers. Article 246 provides for subject matter of laws made by the Parliament and by the Legislatures of States. Hence, it has been held that Section 115-O is constitutionally valid.

10. Whether exemption be granted to Political party under section 13A if they unable to main accounts and fails to get it audited?

If political party fails to maintain its accounts for any reason whatsoever or satisfy preconditions sets out in proviso to section 13A, then exemption can't be granted to it from payment of tax. **CIT v Janata Party [2016]**

In addition to that where political party failed to submit accounts within stipulated time and mandated as per section 13A, it would not be entitled to tax exemption under section 13A. **CIT v Indian National Congress/All India Congress Committee[2016] (Delhi)**

11. LTCGC on concessional rate of tax under section 115E. (Assessment of Individual)

Shashi Parvatha Reddy v. Dy. CIT [2017] (Hyd)

Facts of Case: Where bonus shares were issued to assessee (who is NRI) on basis of original shares issued by overseas investors, the same would be treated as foreign exchange assets and cost of acquisition would be 'Nil. AO has viewed that long-term capital gain (LTCG) was taxed @ 10%, instead of 20%. AO observed that the assessee had been allotted bonus shares against the original shares bought by him and that some other shares were given to him by overseas investors without any payment from him.

High court observation and Decision: It has been observed that Bonus shares issued on original shares by investing convertible foreign exchange were also foreign exchange asset under section 115E. Therefore, the bonus shares acquire the nature of the original shares, though the cost of acquisition shall be "nil" under section 55(2)(aa). It was further observed that assessee had received the asset without any cost, it had to be treated as a gift and the cost of acquisition of the previous owner had to be treated as a cost of acquisition to the assessee. Hence it has been held that hares sold by the assessee have been treated as long-term capital assets and being the assets acquired by way of foreign exchange fall within the definition of foreign exchange asset under section 115E(b). Hence, the assessee was eligible for a concessional rate of 10% under section 115E.

12. Can widow be Karta of Joint Family?

CIT v Seth Govindram Sugar Mills [1965]57 ITR 510(SC)

Generally right to become manage of Joint Family based on fundamental fact that the person on whom the right devolves is a coparcener of joint family and Coparcener ship is essential qualification for manager of Joint Hindu Family. And as widow is not admittedly a coparcener and she has no legal qualification to become manager of Joint Hindu Family.

As per Hindu Succession (Amendment) Act, 2005, daughters are also given coparcener status in family and she can become karta of HUF. **[Sujat Sharma V Manu Gupta [2016] (Delhi)].** However, widow is eligible for share in assets of family event of partition can't become karta of HUF. She can act as manager of HUF if all coparceners are minors.

13. Whether firm constituted by partners including partner in dual capacity, entitle to get deduction of salary and interest paid to partners?

CIT V Budhalal Amolakhdas[1981] (Guj.)

There is no any provision which restrict individual to become partner in firm in dual capacity provided there is one or more other individuals to join valid and legal partnership. And they entitled to get deduction of salary and interest paid to partners if stipulated conditions are satisfied.

PRACTICAL QUESTIONS

Illustration 1:

Gross total Income of Mr. X, a tax consultant based at Mumbai, is Rs. 18,00,000 (income from profession Rs. 17,00,000 and interest on bank deposit Rs. 1,00,000). He pays Rs. 3,00,000 as house rent. He deposits Rs. 50,000 in public provident fund. Compute his taxable income for the assessment year 2021-22 assuming assessee has not oped for Section 115BAC of the Income Tax Act, 1961.

Solution

Computation of taxable Income of Mr. X for the A.Y 2021-22

Particulars		Amount (Rs.)
Professional Income		17,00,000
Interest on Bank Deposit		1,00,000
Gross Total Income		18,00,000
Less: Deductions under Chapter VI-A		
u/s 80C (PPF)	(50,000)	
u/s 80 GG (Note-1)	(60,000)	(1,10,000)

Net Income		16,90,000

Note 1 : Deduction u/s 80GG is least of the following:

a) Rs. 60,000

b) Rs. 4,37,500 [25% of total income (Rs. 18,00,000- 50,000)]

c) Rs. 1,25,000 [Excess of rent paid over 10% of Adjusted total income (Rs. 3,00,000- 1,75,000)]

Illustration 2:

From the following profit and loss account of Vinay for the year ended 31st March, 2021, compute his total income and tax liability for the assessment year: 2021-22:

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
Interest on capital	12,000	Gross profit	5,10,000
Insurance	2,000	Brokerage	30,000
Bad debts	30,000	Bad debts recovered (earlier allowed as deduction)	15,000
Depreciation	34,000	Sundry receipts	18,000
Advance tax	25,000	Interest on debentures	
General expenses	12,000	(gross) [TDS Rs. 4,120]	40,000
Advertisement	5,000		
Salary (including salary to Vinay Rs.20,000)	85,000		
Interest on loan	8,000		
Net profit	4,00,000		
Total	6,13,000	Total	6,13,000

Additional information:

(i) The amount of depreciation allowable as per income-tax rules is Rs. 42,000.

(ii) General expenses include Rs.5,000 given as Health insurance Premium.

(iii) Vinay pays Rs. 5,200 as premium on his own life insurance policy of Rs. 50, 000 issued in 2016-17.

(iv) Loan was obtained for payment of income-tax.

(v) Assessee has not oped for Section 115BAC of the Income Tax Act, 1961.

Solutions:

Particulars	**Amount (Rs.)**	**Amount (Rs.)**
(I) Income from business		

Net profit for the year		4,00,000
Add: Expenses not allowed under Income tax Act but debited to P & L A/C		
Interest on capital (Note 2)	12,000	
Depreciation as per books of a/c	34,000	
Advance tax	25,000	
General Expenses	5,000	
Salary to Vinay	20,000	
Interest on loan (Note 2)	8,000	1,04,000
Less : Income not allowed but Credited to P& L a/c or deductible expenses		
Interest on debentures	(40,000)	
Depreciation as per Income tax Act	(42,000)	(82,000)
Profits and Gains of Business & Profession		4,22,000
(II) Income from other sources (interest on debenture)		40,000
Gross total income (I + II)		4,62,000
Less: Deduction U/S 80C – 80U		
(i) Premium on life insurance policy (u/s 80C)(Note 1)		(5,000)
(ii) Health insurance Premium (u/s 80 D)		(5,000)
Total Taxable Income		4,52,000

Tax on total Income [4,52,000-2,50,000]*5% =	10,100
Less:- Rebate u/s 87A	10,100
Tax liability	Nil
Tax already paid:- TDS	4,120
Tax refundable	4120

Note

1. Under section 80C deduction of life insurance premium cannot exceed 10% of the sum assured.
2. Under Section 36(1)(iii) Interest paid on borrowed capital is allowed as a deduction. Interest on own capital is not deductible. Similarly, interest on money borrowed to pay income tax in not allowed as a deduction.

Illustration 3:

X (63 years) has the following income during the previous year 2020-21

Salary Income :	Rs.6,80,000
Interest on savings bank account with Allahabad Bank :	Rs.16,000
Interest of fixed deposit with Canara Bank	40,000

Other particulars given by X are as under -

1. Insurance premium paid to Max Life Insurance (premium paid: Rs. 25,000 under a policy taken on life of X's son. The policy was taken on July 20, 2011 and the sum assured is Rs. 1,80,000).
2. Insurance premium paid to LIC (premium paid: Rs. 22,000 under a policy taken on X's life on April 20, 2012 and the sum assured is Rs. 2,00,000).
3. Health insurance premium paid to National Insurance Co. (premium paid by cheque : Rs. 38,000 on the health insurance of X).
4. Expenditure on preventive health check-up (expenditure incurred in cash: Rs. 8,000 paid to a hospital for X).

Compute total income of X for assessment year 2021-22 on the basis of above particulars assuming assessee has not oped for Section 115BAC of the Income Tax Act, 1961.

Solution:

Computation of income of X-

Particulars	**Rs.**
Salary income	6,80,000
Income from other sources (savings bank interest)	56,000
Gross total income	7,36,000
Less : Deductions –	
Under section 80C	
[(Rs. 25,000 or 20% of Rs. 1,80,000, whichever is less)	
+ (Rs. 22,000 or 10% of Rs. 2,00,000, whichever is less),	
subject to a maximum of Rs. 1,50,000]	(45,000)
Under section 80D	
(Rs. 38,000 + Rs. 5,000, subject to a maximum of Rs. 50,000)	(43,000)
Under section 80TTB (savings bank interest+ FD)	
(maximum: Rs.50,000)	(50,000)
Net income	5,98,000

Illustration 4:

X, 66 years, has a proprietary business. He furnishes the particulars of his income for the year ending March 31, 2020:

1. Net profit of Rs. 4,35,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the profit and loss account:

a. personal travelling expenses of Rs. 12,750; and

b. purchase of furniture items for shop on June 13, 2020 of Rs. 25,000 but charged in shop expenses.

2. He owns a two storey house. It was constructed with financial assistance of HDFC. The ground floor of the house is used by him for his self use and the first floor is on rent from April 1, 2020 for Rs. 8,500 per month. The municipal tax paid for the whole house is of Rs. 2,500 and interest paid on housing loan taken for the construction is Rs. 52,000. Both the floors of the house are identical

3. He had deposited insurance premium on his own life of Rs. 12,500, on the life of his wife of Rs. 13,500 and on the lives of his son and daughter of Rs. 28,000. Further, he has made investment of Rs. 50,000 in the bonds issued by infrastructure company and paid Rs. 82,500 by credit card for med claim insurance of himself and the family(children and spouse).

Compute taxable income and the amount of tax payable by X for the assessment year 2021-22 assuming assessee has not oped for Section 115BAC of the Income Tax Act, 1961.

Solution:

Particulars	GF	FF
Computation of income from house property	**Rs.**	**Rs.**
Gross annual value	NIL	1,02,000
Less: Municipal tax	NIL	(1,250)
Net annual value		1,00,750
Deduction under section 24		
Standard deduction	NIL	(30,225)
Interest on borrowed capital	(26,000)	(26,000)
Income from House Property	(26,000)	44,525
Computation of Business Income -		
Net profit as per profit and loss account		4,35,500
Adjustments		
Add: Personal travelling expenses		12,750
Add: Cost of furniture included in shop expenses		25,000
Less: Depreciation on furniture		(2,500)
Business income		4,70,750
Computation of income and tax liability -		
Income from house property (Rs. 44,525 – Rs. 26,000)		18,525
Business income		4,70,750
Gross total income		4,89,275
Less: Deductions		

Under section 80C (Rs. 12,500 + Rs. 13,500 + Rs. 28,000 + Rs. 50,000, subject to a maximum of Rs. 1,50,000)		1,04,000
Under section 80D(Rs. 50,000 for self and Rs. 25,000 for family)		75,000
Net income (rounded off)		**3,10,280**
Tax on net income		
Income-tax		3,014
Rebate u/s 87A		3014
Tax after rebate		Nil
Tax liability		Nil

Assumptions - The following assumptions have been made to calculate net income and tax liability —

1. X is resident in India.
2. Insurance premium is not more than 20% of sum assured in the case of insurance policies given in the problem,
3. Mediclaim insurance premium payable on the life of X (who is a senior citizen) is not less than Rs. 50,000.

Illustration 5:

Ram Manhar & Sons HUF, running Raghuveer Departmental Stores consists of Karta, his wife, two sons and daughter. Both the sons who are having professional/technical qualifications as a Chartered Accountant and as an Automobile Engineer started in partnership, a garage for the repairing of motor cars, with a clear understanding that the technical side of the business be looked after by the Engineer while the general administration and finance part be taken care by the Chartered Accountant. They had taken an interest-free loan of Rs. 5,00,000 from the HUF for starting the venture. The business of garage resulted in a net profit of Rs. 15,00,000 for the year ended 31.03.2021. The Assessing Officer proposes to assess the income from the business of motor garage in the hands of HUF. Examine the validity of the proposition of the Assessing Officer in the light of a decided case law.

Solution:

The facts of the case are similar to that of the case of CIT v. Charan Dass Khanna & Sons (1980) 123 ITR 194, where the Delhi High Court observed that if the investment made by the HUF in the business started by the coparceners plays a minor role and it is primarily the personal efforts, specialized skill and enterprise of the individual coparceners which resulted in setting up of a new business and earning of goods profits, then it may not essentially be said that the income belongs to the HUF.

The Supreme Court has also supported this view in the case of K.S. Subbiah Pillai v. CIT (1999) 237 ITR 11 and held that where the remuneration and commission earned by the Karta were on account of the personal qualifications and exertions and not on account of the investment of the family funds, such income cannot be treated as income of the HUF.

Thus, in the given case, profits were earned primarily because of the specialized skills acquired by both the partners in their respective fields and used in the business of motor garage. The initial capital taken from the HUF as interest free loan, of course, has its role but it is nevertheless a minor one. Therefore, the income from the business set up by the brothers is assessable in their individual hands and not as the income of the family.

Further, the proposition of the Assessing Officer to tax the profits of the business of motor garage earned by the two sons in the hands of the HUF is not valid.

Illustration 6:

X & Family is a HUF in which Mrs. X has impressed upon a house property owned by her for the common hatch patch of the family. Examine whether the personal property of Mrs. X so blended by her be treated a property of HUF.

Solution:

Mrs. X is not a coparcener of HUF and she cannot blend her separate property as property of the HUF— Pushpa Devi v. CIT [1977] 109 ITR 730 (SC). The income from property would continue to get taxed in her hands only.

Illustration 7:

ABC LLP, a limited liability partnership 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 Chennai. The particulars relating to previous year 2020-21 furnished by the assessee are as follows -

Total turnover: SEZ unit Rs. 120 lakh and the other unit Rs. 100 lakh

Export turnover: SEZ unit Rs. 100 lakh and the other unit Rs. 60 lakh

Profit: SEZ unit Rs. 50 lakh and the other unit Rs. 40 lakh.

The assessee has no other income during the year. Compute tax payable by ABC LLP for the assessment year 2021-22. Will the amount of tax payable change, if ABC LLP is an overseas entity?

Solution:

Computation of deduction under section 10AA-	**Rs.**
Profit of SEZ unit (a)	50,00,000
Export Turnover of SEZ unit (b)	1,00,00,000
Total Turnover of SEZ unit (c)	1,20,00,000
Amount Deductible u/s 10AA [i.e. (a)X(b)/(c)]	41,66,667
Computation of Normal Tax Liability:	
Income before deduction u/s 10AA (Rs.50 lakh+ Rs. 40 lakh)	90,00,000
Less: Deduction u/s 10AA	41,66,667
Net Income (rounded off)	48,33,330
Tax on total income @ 30% (+ HEC @4%)	15,07,999
Computation of AMT:	
Adjusted total Income (Rs. 48,33,333 + 41,66,667)	90,00,000
Alternate Minimum Tax @ 18.5% (+ HEC @4%)	17,31,600
Tax payable – Normal Tax or AMT whichever is higher	**17,31,600**

Provisions of AMT shall be applicable even if ABC LLP is an overseas entity. Therefore tax liability will remain same i.e. Rs. 17,31,600

Illustration 8

XY Associates is an association of persons (AOP) consisting of two members, Xand Y (6:4). Income of the AOP for the previous year 2020-21 is Rs. 6 lakh. Compute the tax liability of the AOP and the members in the following two situations:

1. Income of X and Y from other sources is Rs. 1,00,000 and Rs. 3,10,000, respectively.
2. Income of X and Y from other sources is Rs. 1,00,000 and Rs. 1,20,000, respectively.

Solution:

Situation 1 - Since one of the members of the AOP has total income exceeding the basic exemption limit, the income of AOP will be taxed at maximum marginal rate, i.e., @ 31.2%. Tax liability of AOP will be Rs.1,87,200. Tax liability of the members shall be calculated as follows –

Particulars	**X**	**Y**
	Rs.	**Rs.**
Share of profit from AOP (not chargeable to tax, as AOP is Taxable as maximum marginal rates)	NIL	NIL
Income from other sources	1,00,000	3,10,000
Net income	1,00,000	3,10,000
Tax liability	NIL	3,000
Less:- rebate u/s 87A	NIL	3,000
Tax liability	NIL	Nil
Add Health and Education Cess @ 4%	NIL	Nil
Tax + HEC	NIL	Nil

Situation 2 - Since none of the members has income exceeding the exemption limit, AOP would be taxed at the rates applicable to an individual. The tax liability on Rs. 6,00,000 will be Rs. 33,800 (Tax 32500 + HEC @4% - 1300). Tax liability of members will be calculated as follows:

Particulars	**X** **Rs.**	**Y** **Rs.**
Share of profit from AOP	3,60,000	2,40,000
Income from other sources	1,00,000	1,20,000
Net income	4,60,000	3,60,000
Tax liability (tax + HEC) (a)	10,920	5,720
Less: Rebate u/s 87A	10,920	5,720
Tax payable	Nil	Nil

Illustration 9:

M, N and O are partners sharing profits and losses in the ratio of 2:1:1 respectively. Their summarised Profit and Loss A/c for the year ending 31st March, 2021 is appended below:

Particulars	Rs.	Particulars	Rs.
Office salaries	5,680	Gross Profit	60,570
Telephone and Telegram	2,000	Rent received	6,000
Interest on loan from M	2,000	Interest on securities	4,000
Local taxes (let out property)	1,000		
Salary to N	3,000		
Commission to partners			
M	4,000		
N	5,000		
O	6,000		
Collection charges of interest on securities	50		
Bad debts reserve	1,000		
Net Profit to partners:			
M	20,420		
N	10,210		
O	10,210		
Total	**70,570**	**Total**	**70,570**

Compute total income of the firm for the assessment year 2021-22 and tax liability thereon. Interest paid to M has been calculated at the rate of 20% p.a. simple.

Solution:

Computation of Book-Profit

Particulars	Amount (Rs.)	Amount (Rs.)
Net Income as per P & L A/c		40,840
Add: Inadmissible items -		
Local taxes (on let out property)	1,000	
Salary to N (Partner)	3,000	
Commission to partners	15,000	
Collection charges	50	
Bad debts reserve	1,000	20,050
Less: Other Incomes –		

Rent received	(6,000)	
Interest on securities	(4,000)	(10,000)
Book Profit		50,890

Maximum remuneration payable to partners

Here Rs. 1,50,000 will be allowed as maximum remuneration. But as the partners have drawn only Rs. 18,000 by way of salary and commission, the entire amount will be allowed as deduction.

Computation of total income of the firm for the Assessment Year 2021-22

Particulars	Amount (Rs.)	Amount (Rs.)
Book Profit:	50890	
Less: Salary and commission to partners	(18,000)	
Taxable Business Profit (A)		**32,890**
Income from house property Rent received	6,000	
Less: Municipal taxes	(1,000)	
Net adjusted annual value (NAAV)	5,000	
Less: Repairs (30% of NAAV) u/s 24	(1,500)	
Income from House Property (B)		**3,500**
Income from other sources:		
Interest on Securities	4,000	
Less: Collection charges	(50)	
Income from Other Sources (C)		**3,950**
GROSS TOTAL INCOME (A) + (B) + (C)		**40,340**

The firm will have to pay tax on Rs. 40,340 @ 30%, which comes to Rs. 12,102 plus health and education cess @ 4% on 12,102 making the total liability as Rs. 12,586.

Illustration 10:

Compute tax liability of the firm X & Co. for the assessment year 2020-21 considering the provisions of Section 115JC. The business income of the firm is Rs. 21,00,500 before deduction under section 32 and before deduction under section 35AD Rs. 11,00,000, because of which depreciation of Rs. 40,000 cannot be claimed. Deduction under section 80IB Rs. 1,00,000. Donation paid to a political party Rs. 85,000.

Solution:

Particulars	Rs.	Rs.
GTI - Business Income (Rs. 21,00,500 less 11,00,000)		10,00,500
Less Deductions		

Under section 80IB	1,00,000	
Under section 80GGC	85,000	(18,5000)
Net Income		**8,15,500**
Tax on Rs. 8,15,500 @ 30%	2,44,650	
Add: HEC @ 4%	9,786	
Tax liability		**2,54,436**
Tax liability (Rounded off)		**2,54,440**
Adjusted total income and alternate minimum tax for the purpose of section 115JC		
Net Income		8,15,500
Add: Under section 80IB		1,00,000
Add: under section 35AD (Rs. 11,00,000 less 40,000)		10,60,000
Adjusted total income		19,75,500
AMT on Rs. 19,75,500 @ 18.5%		3,65,468
Add: HEC @ 4%		14,619
AMT liability		**3,80,087**
		3,80,090 (round off)

Tax payable is Rs. 3,80,090 being higher of tax liability Rs. 2,54,440 and AMT Rs. 3,80,090.

Illustration 11:

Income & Expenditure A/c of Lawyers & Co. for the year ending March 31, 2021

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
To Expenses	1,50,000	By Professional Receipts	3,80,000
To Depreciation	20,000	By Other fees	90,000
To Remuneration to partners	1,50,000		
Interest on Capital to partners @ 20 per cent	20,000		
To Net Profit	1,30,000		
Total	**4,70,000**	**Total**	**4,70,000**

Other Information:

1. Expenses include Rs. 18,000 and Rs. 12,000 paid in cash as brokerage to a single party on a single day.
2. Depreciation calculated as per section 32 is Rs. 40,000

Compute the total income of the firm.

Solution:

Computation of Total Income of Lawyers & Co. for A. Y. 2021-22

Particulars	Amount Rs.	Amount Rs.
Net profit as per profit and loss account		1,30,000
Add : Expenses not allowable		
Section 40A(3)- Cash payments to a broker exceeding Rs. 20,000 (Note 1)	30,000	
Section 40(b)-Excess interest on capital to partners 20%-12% i.e. (20000*8/20) (Note 2)	8,000	38,000
Add : Remuneration to partners debited to profit and loss account		1,50,000
Less : Depreciation u/s 32		
(Rs. 40,000-Rs. 20,000 debited in profit and loss account)		(20,000)
Book profit (Note 3)		2,98,000
Maximum permissible remuneration(lower of the two :		
(i.e. 90 per cent of Rs. 2,98,000)	2,68,200	
Actual	1,50,000	(1,50,000)
Business Income of the Firm		1,48,000
Tax Liability (30% of 1,48,000)		44,400
Add : Health and Education Cess @ 4%		1,776
Total Tax Liability		**46,176**

Notes :

1. As per section 40A(3) of the Act, if the aggregate payment made (otherwise than by an account payee cheque/draft) to the same person during a day exceeds Rs. 20,000/- the entire amount of such payment is disallowed.
2. As per section 40 (b) of the Act, if the interest payable to the partners exceeds simple interest of 12% per annum, the excess amount is not deductible.
3. The remuneration paid to the working partners cannot exceed the permissible limits specified under section 40 (b) of the Act.

Illustration 12:

Mr. X, carrying on the business of operating a warehousing facility for storage of sugar, has a total income of Rs. 80 lakh. In computing the total income, he had claimed deduction under section 35AD to the tune of Rs. 70 lakh on investment in building (on 1.4.2020) for operating the warehousing facility for storage of sugar. Compute his tax liability for A.Y. 2021-22. Show the calculations of Alternate minimum Tax also.

Solution:

Computation of Tax payable by Mr. X for AY 2021-22

Computation of Normal Tax

Particulars	**Amount (Rs. in lakh)**
Tax liability under the normal provisions of the Income-tax Act, 1961	24.00
Add: Health and Education Cess @4%	0.96
Total Tax Liability	24.96

Computation of Alternate Minimum Tax

Particulars	**Amount (Rs. in lakh)**
Total Income	80.00
Add : Deduction under section 35AD	70.00
Less : Depreciation under section 32	(7.00)
Adjusted Total Income	143.00
AMT @18.5%	26.46
Surcharge @ 15% (since adjusted total income> Rs. 100 lakh)	3.97
Tax	30.43
Add: Health and Education Cess @ 4%	1.22
Total tax Liability	31.65

Since the regular income tax payable is less than the AMT payable, the adjusted total income of Rs. 143 lakhs shall be deemed to be the total income of Mr. X and tax is payable @18.5% thereof plus surcharge @ 15% and HEC @4%. Therefore, tax liability is 31.65 lakhs.

However, Mr. X would be eligible for credit in 15 subsequent years to the extent of difference between the AMT and Normal Tax i.e. Rs. 6.69 lakhs.

Illustration 13:

Mr. A, Mr. B and a foreign company X Ltd. are members of a AOP sharing profits and losses in the ratio of 2:2:1. The total income of the AOP is Rs. 2,50,000 including long term capital gains Rs. 40, 000. Calculate tax liability of the AOP for AY 2021-22.

Solution:

Foreign company X Ltd. is taxable at a rate higher than maximum marginal rate (i.e. 40%) and remaining income is taxable at maximum marginal tax rate (i.e. 30%)

Particulars	**Rs.**
Tax on LTCG 40,000 at 20%	8,000
Tax on share of X Ltd. (2,10,000 *40%*1/5)	16,800

Balance (2,10,000 *30%*4/5)	50,400
Total Tax	75,200
Add Health and Education Cess (4%)	3,008
Tax liability	78,208
Tax liability (round off)	78,210 (round off)

Illustration 14:

Delhi Co-operative Society derived the following incomes during the previous year (1.4.2020 to 31.3.2021 - Assessment Year 2021-22).

(1)	Marketing of agricultural produce of its members	10,000
(2)	Interest from members on delayed payment of the price of goods purchased	1,000
(3)	Processing (without aid of power) of agricultural produce of its members	8,000
(4)	Supplying milk to the Government (raised by its members)	15,000
(5)	Agency business	25,000
(6)	Dividends from other Co-operative Societies	15,000
(7)	Income from letting of godowns	20,000
(8)	Income from House Property	30,000

Compute the total income of the Delhi Co-operative Society assuming assessee has not oped for Section 115BAC of the Income Tax Act, 1961.

Solution:

Computation of total income of Delhi Co-operative Society

Particulars	**Rs.**	**Rs.**
(1) Income from House Property	30,000	
Letting of godowns	20,000	50,000
(2) Income from Business:		
Marketing of agricultural product	10,000	
Processing of goods	8,000	
Supplying milk	15,000	
Agency business	25,000	58,000
(3) Income from other sources:		
Interest from members	1,000	
Dividends	15,000	16,000

Gross Income		1,24,000
Deductions under Section 80P:		
(1) Letting of godowns	(20,000)	
(2) Marketing of agricultural produce	(10,000)	
(3) Processing of goods	(8,000)	
(4) Supplying milk	(15,000)	
(5) Agency business	(25,000)	
(6) Dividends	(15,000)	(93,000)
Total income		31,000

Notes:

(1) Interest from members Rs. 1,000 is not deductible as it is not from the credit facilities provided to the member and for this purpose society cannot be said to be a credit society *[Rodier Mill Employees' Cooperative Stores Ltd.* v. *CIT* (1982) 135 ITR 355].

(2) The gross total income of the society exceeds Rs. 20,000 hence deduction regarding income from house property is not available.

Illustration 15:

Compute the net income and tax liability of X Ltd. For the assessment year 2021-22 assuming that X Ltd. has a deemed long-term capital gain of Rs.60,000 under proviso (i) to section 54D(2) which is not credited in profit and loss account.

Particulars	**Amount (Rs.)**	**Amount (Rs.)**
Sale proceeds of goods (domestic sale)	22,23,900	
Sale proceeds of goods (export sale)	5,76,100	
Amount withdrawn from General Reserve (created by debiting the P&L a\c)	2,00,000	
Amount withdrawn from revaluation reserve	1,50,000	
Total		31,50,000
Less:		
Business Expenses	(2,10,000)	
Depreciation (normal)	(6,16,000)	
Depreciation (extra depreciation because of revaluation)	(2,70,000)	
Salary & wages	(2,85,820)	
Income-tax	(3,50,000)	

Outstanding customs duty (not paid as yet)	(17,500)	
Proposed Dividend	(60,000)	
Consultation fees paid to a tax expert	(1,39,000)	
Other expenses	(21,000)	(19,69,320)
Net profit		11,80,680

The company wants to claim/ set off the following:-

1. Deduction under section 80-IB (30% of Rs. 11,80,680)
2. Depreciation under section 32 (Rs. 5,36,000)
3. Bought forward the loss of 2015-16 being Rs. 14,80,000 for tax purposes and Rs. 40,00,000 for accounting purpose
4. Unabsorbed depreciation being Rs. 70,000 for accounting purpose.

Solution:

Computation of the net income and tax liability of X Ltd. for the assessment year 2021-22

Tax Liability under normal provisions of Income Tax Act

Particulars	**Amount (Rs.)**	**Amount (Rs.)**
Net profit as per P&L A/c		11,80,680
Add:		
Excess depreciation	3,50,000	
[i.e., Rs. 6,16,000+Rs. 2,70,000 – Rs. 5,36,000]		
Income Tax	3,50,000	
Customs Duty which is not paid	17,500	
Proposed dividend	60,000	7,77,500
Less:		
Amount withdrawn from General reserve	(2,00,000)	
Amount withdrawn from Revaluation reserve	(1,50,000)	
Unabsorbed loss	(14,80,000)	(18,30,000)
Business Income		1,28,180
Long term capital gain		60,000
Deductions under section 80-IB (30% of 1,28,180)		(38,454)
Net Income		1,49,726
Tax Liability(rounded off)		38,920

Computation of Book Profits and Tax Liability as per MAT provisions under section 115 JB

Particulars	**Amount (Rs.)**	**Amount (Rs.)**
Net Profit		11,80,680
Add:		
Depreciation (Rs. 6,16,000+Rs.2,70,000)	8,86,000	
Income Tax	3,50,000	
Proposed dividend	60,000	12,96,000
Less:		
Amount withdrawn from general reserve	(2,00,000)	
Unabsorbed depreciation	(70,000)	
Normal depreciation	(6,16,000)	
Amount withdrawn from revaluation reserve to the extent it does not exceed extra depreciation because of revaluation	(1,50,000)	(10,36,000)
Book Profit		14,40,680
Tax Liability @ 19.24% (18.5% plus HEC @ 4%)(rounded off)		2,77,190

X Ltd. will pay Rs. 2,77,190 as tax for the A.Y 2021-22 as per section 115JB. Tax credit however is available in respect of excess tax (Rs. 2,38,270) under section 115JBB).

Illustration 16

Anubav Pvt. Ltd. is a Company incorporated on 1.4.2010, and the only capital issued is in the form of equity shares. The shares are held throughout by X, Y and Z, equally. The company has made losses/profits in the past as under and these have been accepted by the tax department on assessment :

Assessment Year	**Business Loss**	**Unabsorbed Depreciation**	**Total**
	Rs.	**Rs.**	**Rs.**
2017-18	--	15,00,000	15,00,000
2018-19	--	12,00,000	12,00,000
2019-20	6,75,000	11,25,000	18,00,000
Total	6,75,000	38,25,000	45,00,000

During the previous year ended 31.3.20 X transferred his shares to P and during previous year ended 31.3.21 Y transferred his shares to Q. During the year ended 31.3.2020 the company made a profit of Rs.15,00,000 (before charging depreciation of Rs.9,00,000) and during the year ended 31.3.21 a profit of Rs.45,00,000 (before charging depreciation of Rs.7,50,000). Compute taxable income of the company with proper working for A.Y. 2021-22.

Solution:

Shareholding of company at end of different previous years

Previous year	**X**	**Y**	**Z**	**P**	**Q**
Ending on					
31/03/19	1/3	1/3	1/3	---	---
31/03/20	---	1/3	1/3	1/3	---
31/03/21	---	---	1/3	1/3	1/3

For AY 2020-21 at 2/3 of the shareholders are same as they were in year of loss, therefore, provisions of section 79 do not apply in this year. Computation of taxable income and carry forward and set off position is as under:

Particulars	**Rs.**
Business profits	15,00,000
Less: Depreciation for PY19-20	(9,00,000)
Profits after Depreciation	6,00,000
Less: B/F loss of PY 18-19	6,00,000
Taxable Income	Nil
Note: Unabsorbed depreciation carried forward	38,25,000
Loss of PY 18-19 carried forward	75,000
Computation of Taxable Income of AY 20-21	
Business Profits	45,00,000
Less: Depreciation for PY 20-21	(7,50,000)
Profits after depreciation	37,50,000
Less: Loss of PY 18-19 B/F	NIL*
Less: Unabsorbed depreciation B/F	(37,50,000)
Taxable Income	NIL

Note:- *As shareholders holding 51% of voting rights in PY 18-19 (i.e. year of loss) are not same in PY 20-21 (i.e. the year in which loss is sought to be b/f and set off), therefore such loss cannot be b/f and set off. However provisions of Section 79 are not applicable on unabsorbed Depreciation.

Unabsorbed Depreciation carried forward 75,000

Illustration 17:

Profit and loss account of XLtd. for the year ending March 31, 2021 shows a net profit of Rs. 75 lakh after debiting / crediting the following items:

1. Depreciation: Rs. 24 lakh (including Rs. 4 lakh on revaluation).

2. Interest to financial institution not paid before due date of filing return of income: Rs. 6 lakh.
3. Provision for doubtful debts : Rs. 1 lakh.
4. Provision for unascertained liabilities : Rs. 2 lakh.
5. Transfer to general reserve : Rs. 5 lakh.
6. Net agricultural income : Rs. 16 lakh.
7. Amount withdrawn from reserve created during 2016-17 : Rs. 3 lakh (book profit was increased by the amount transferred to such reserve in assessment year 2021-22)

Other information -

Brought forward loss and unabsorbed depreciation as per books are Rs. 12 lakh and Rs. 10 lakh, respectively.

Compute minimum alternate tax under section 115JB for the assessment year 2021-22.

Solution:

Computation of book profit

Particulars	Rs.
Net profit as per profit and loss account	75,00,000
Adjustments -	
Add: Amount transferred to general reserve	5,00,000
Add: Provision for unascertained liability	2,00,000
Add: Depreciation	24,00,000
Add: Provision for doubtful debts	1,00,000
Less: Amount withdrawn from reserve account	(3,00,000)
Less: Agricultural income	(16,00,000)
Less: Depreciation (other than depreciation which arises because of revaluation of assets)	(20,00,000)
Less: Amount of loss brought forward or unabsorbed depreciation, whichever is less	(10,00,000)
Book profit	58,00,000
Minimum alternate tax @ 18.5%	10,73,000
Add: Surcharge	nil
Total	10,73,000
Add: Health and Education cess @ 4%	42,920
Minimum alternate tax	**11,15,920**

Illustration 18:

X Ltd. has claimed exemption on the income from long-term capital gains under section 54EC by investing in bonds of National Highway Authority of India within the prescribed time. In the computation of "book profit" under section 115JB, the company claimed exclusion of long-term capital gains because of exemption available on it by virtue of section 54EC. The Assessing Officer reckoned the book profit including long-term capital gains for the purpose of levy of minimum alternate tax payable under section 115JB. Is the action of the Assessing Officer justified in law?

Solution:

Capital gain credited to profit and loss account is part of book profit even if it is exempt under section 54EC – N J. Jose & Co. (P.) Ltd. v. C/r[2008] 174 Taxman 141 (Ker.).

Illustration 19:

Examine the following, statements in the context of the provisions in the various Chapter of the Act:

1. The provisions of section 115JB are not applicable in case of foreign companies.

Solution:

1. Applicability of MAT provisions in the case of foreign companies -Foreign companies operating in India are subject to provisions of minimum alternate tax under section 115JB. However, section 115JB is not applicable to a foreign company which has no presence or PE in India—Tunken Co., In re [2010] 193 Taxman 20 (AAR-New Delhi), Praxair Pacific Ltd., [2010] 193 Taxman 1 (AAR-New Delhi).

Illustration 20: X ltd is a closely held company engaged in manufacture of garments where value of plant and machinery owned by company is Rs. 5500000. The following information for the previous year 2020-21

Particulars	Rs.
Domestic sales	2223900
Export sales	576100
Amount withdraw from General reserve (Reserve created in 1997-98 by debiting P&L account)	200000
Amount withdrawn from revaluation reserve	150000
Total	3150000
Depreciation (Normal)	616000
Depreciation (Due to revaluation)	270000
Salary and wages	210000
Income tax	360000
Outstanding custom duty not paid yet	17500
Proposed dividend	60000
Consultation fees paid to tax consultant	21000
Other exp	139000
Net Profit	1456500

The assessee claims the following as deductions:

- Deduction under section 80IB-30% of 1456500
- Depreciation under section 32 is Rs.536000
- The company wants to set off following losses

Particulars	**For Tax Purpose**	**For Accounting Purpose**
B/F loss of 2013-14	1480000	400000
Unabsorbed depreciation	Nil	70000

Compute net income and tax liability of X ltd for the AY 2021-22 assuming that X ltd gets deemed long term capital gain of Rs. 60000 under section 54D(2) which is not credited in P&L

Solution:

Statement showing computation of Taxable income and Tax Liability

Particulars	**Amount Rs**
Net Profit as per P&L	1456500
Add: ● Excess Depreciation [616000+270000-536000] ● Income tax ● Custom duty paid on paid yet ● Proposed dividend	 350000 360000 17500 60000
Total	2244000
Less: Amount withdraw from reserve (200000+150000)	(350000)
Business Income	1894000
Less: Unabsorbed loss	(1480000)
Net Business Income	414000
Long Term Gain	60000
Gross Total Income	474000
Less: Deduction under section 80C to 80U Deduction under section 80IB (30% of 414000)	(124200)
Net Income (Round off)	349800
Tax on net income ● 20% of 60000 (i.e. on LTCG) = 12000 ● 30% of 289800 (i.e. 349800-60000) = 86940	98940
Add: HEC@4%	3958
Net Tax Liability (Round off) [A]	102898

Statement showing computation of MAT

Particulars	**Amount Rs**
Net Profit	1456500

Add: ● Depreciation [616000+270000] ● Income Tax ● Proposed dividend	 886000 360000 60000
Less: ● Amount withdraw from General Reserve ● Unabsorbed depreciation ● Depreciation (Normal) ● Amount withdraw from revaluation reserve to the extent not exceed revalued depreciation	 200000 70000 616000 150000
Book Profit	1726500
Tax liability 15% of Book Profit [15%*1726500]	258975
Add: HEC@4%	10359
Tax Liability based on Book profit (Round off) [B]	269334

A. Tax as per normal Income Tax 102898

B. Tax as per 15% of Book profit 269334

Tax Payable by X ltd = A or B whichever is higher 269334

Tax Credit available [B-A] 166436

Illustration 21:

The projected P&L of A ltd and B ltd (both companies under same management) for PY 2019-20					
Particulars	**A ltd**	**B Ltd**	**Particulars**	**A ltd**	**B Ltd**
COGS	4500000	6100000	Sale	6500000	8600000
Depreciation	153000 (15.3% on Rs1000000)	198913 (13.91% of Rs1430000)	Profit on sale of plot of land [LTCG under section 48]		120000
Other Exp	200300				
Net Profit	1646700	2421087			
Total	6500000	8720000	Total	6500000	8720000

- A ltd has set up industrial undertaking in notified industrial park and eligible for 100% deduction under section 80IA and WDV of Plant and Machinery for tax purpose would be Rs. 1250000.
- B ltd is not eligible to any deduction under section 80IA and WDV of assets for income tax purpose would be Rs. 1876670.

Solution:

Statement showing computation of Taxable income and Tax Liability

Particulars	**A ltd**	**B ltd**
Net Profit	1646700	2421087
Add: Depreciation	153000	198913
Less: Depreciation	(187500)	(281500)
Less: LTCG	-	(120000)
Business Income	1612200	2218500
Income from Capital Gain (LTCG)	-	120000
Gross Total Income	1612200	2338500
Less: Deduction under section 80IA	1612200	-
Net Income	Nil	2338500
Book Profit	1646700	2421087
Tax As per Normal Income Tax Act		
Tax On Net income [For B ltd : 30% of 2218500+20% of 120000]	Nil	689550
Add: HEC @ 4%	-	27582
Tax Liability [A]	-	717130
Tax as per MAT under section 115JB		
15% of Book Profit	247005	363163
Add: HEC @ 4%	9880	14527
Tax Liability [B]	256885	377690
Tax payable		
Tax Liability = A or B whichever is higher	256885	717130

Illustration 22:

Firm Vs Private Company [Tax Planning]

Following details are identified in below case of Firm V Private Company

Particulars	**Firm**	**Private Company**
Numbers of Partners/Directors	4	4
Taxable income before interest/ Remuneration	1400000	1400000
Interest on capital to partners	180000 (12% of 1500000)	

Remuneration payable to Partners/directors	822000 (At Maximum Level) [Salary to each partner at Rs205500 payable in cash or cash/Kind]	1200000 salary to each, being Rs300000 payable in cash and kind as below: Basic Pay : 120000 Education Allow : 2400 Free Residential House : 177600 at Delhi (Rent paid by employer)

Solution:

Statement showing tax liability of Company

Particulars	**Amount Rs**
Business Income	1400000
Less: Salary and Perks to four directors	(1200000)
Taxable Income	200000
Tax Liability 30% of 200000	60000
Add: HEC@4%	2400
Net Tax liability (Round off)	62400

Statement showing tax liability of Firm

Particulars	**Amount Rs**
Income	1400000
Less: Interest on capital	(180000)
Book Profit	1220000
Less: Remuneration to partners	(822000)
Tax Income of firm	398000
Tax Liability 30% of 398000	119400
Add: HEC@4%	4776
Net Tax liability (Round off)	124180

Statement showing tax liability of Directors

Particulars	**Amount Rs**
Basic Salary	120000
Education Allowances	Exempt under section 10(14)

Perquisites [Free Residential House at Delhi] [A] Rent Paid (177600/3) 59200 [B] 15% of Salary (i.e. 15% of 120000] 18000 Taxable = A or B whichever is lower	18000
Gross Salary	138000
Less: Standard Deduction	(50000)
Income From salary	88000
Tax liability	Nil

Conclusion:

A. Tax liability of Firm 124180

B. Tax liability of Company and Directors 62400

It is advisable to convert firm into private ltd in order to reduce tax liability.

Illustration 23:

Political Party Exemption under section 13A

The books of account maintained by a Public Vikas Political Party (PVPP) registered with Election Commission for the year ending 31-3-2021 disclose the following receipts:

- Rent of property let out to a departmental store at Delhi 6,00,000
- Interest on deposits other than banks 5,00,000
- Contribution from 100 person
  (Party submitted a report to the Election Commission) 21,00,000
  of Rs 21,000 each (received through an account payee cheque)
- Net profit of cafeteria run in the premises at Delhi 3,00,000

Compute total income of the political party for the previous year 2020-21.

Solution:

Computation of total income of PVPP for the Assessment Year 2021-22

Particulars	**Amt Rs**	**Remarks**
Income from house property ● Rent of property let out to a departmental store at Delhi	Nil	Exempted u/s 13A
PGBP ● Net profit of cafeteria run in the premises at Delhi	300000	
Income from other sources ● Interest on deposits other than banks ● Contribution exceeding Rs 20,000	 Nil Nil	 Exempted u/s 13A Exempted u/s 13A

Total Income	300000	

Illustration 24:

DP Consumer Co-operative Society furnishes the following particulars of its income in respect of financial year ended on 31-3-2021, Find tax liability of the co-operative society –

- Income from business Rs 5,00,000
- Interest received on company deposits Rs100,000
- Interest on deposit with banks Rs20,000
- Income from letting of godown for storage of commodities Rs40,000
- Assuming assessee has not oped for Section 115BAC of the Income Tax Act, 1961.

Solution:

Computation of total income for the Assessment year 2021-22

Particulars	**Amt Rs**	**Remarks**
Income from house property ● Income from letting of godown for storage of commodities		40000
Income from Profit or Gain from Business		500000
Income from other sources ● Interest received on company deposits ● Interest on deposit with banks		100000 20000
Gross Total Income		660000
Less: Deduction under section 80P ● Income from letting of godown for storage of commodities ● Income from activity other than specified activity (consumer co-operative society)	40000 100000	140000
Total Income		520000

LESSON ROUNDUP

– Article 366(6) of the Constitution defines corporate tax.

– As per section 2(17) of the Income Tax Act, Company means any Indian Company, or any body corporate incorporated by or under the laws of a country outside India, or any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 (11 of 1922) or was assessed under this Act, as a company for any assessment year commencing on or before April 1, 1970; or any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the CBDT to be a company.

– Minimum Alternate Tax ("MAT") on the book profit of a Company would not apply to a Foreign Company not having any physical presence in India.

- The term ‘Hindu undivided family’ has not been defined in the Income-tax Act. However, in general parlance it means an undivided family of Hindus. Creation of a HUF is a God-gifted phenomenon. As soon as a married Hindu gets a child, a new HUF comes into existence. It is not at all necessary that every HUF must have joint property or family income.
- A Hindu Joint Family consists of Coparceners & members.
- The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assessees.
- **Partnership Firm:** Under Section 2(23) of the Income-tax Act, the terms “firm”, “partner”, and “partnership” have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.
- As per the scheme, a partnership firm shall be assessed as a firm if the following conditions are satisfied:
  - The partnership is evidenced by an instrument i.e. partnership deed.
  - The individual shares of the partners are specified in that instrument.
  - A copy of the partnership deed certified by all the partners in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.
- As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm will not be included in computing his total income. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.
- **Alternate Minimum Tax:** Where the regular income tax payable for a previous year by a person other than a company is less than the alternate minimum tax payable for such previous year then the adjusted total income shall deemed to be the total income such person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% + SC plus health and education cess @ 4%. AMT is applicable if adjusted total income exceeds Rs. 20 lakh.
- **Association of persons:** “Association of persons” means an association in which two or more persons join in a common purpose or common action to produce income, profits or gains.
- For the formation of an AOP the association need not necessarily be on the basis of a contract, consent and understanding may be presumed. Section 167B makes the following provisions as regards the incidence of charge of tax on the association of persons.
  - Where shares of members are determinate In this case, tax is chargeable on the income of the association of persons at the same rate as applicable to an individual. However, where the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate of 30%, i.e. the highest slab applicable to an individual.
  - Where the shares of the members are indeterminate In these cases, tax will be charged on the total income of the AOP at the maximum marginal rate, that is, the rate of tax as well as surcharge, if any, applicable to the highest slab of income in the case of an individual as specified in the Finance Act of the relevant year
- Co-operative Society means a co-operative society registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any State for the registration of co-operative societies.

– The income of a co-operative society is computed in the same manner as provided for other assessees.

– Section 80P provides for certain deductions from the gross total income of a Co-operative Society.

– The provision related to Charitable Trust exemptions.

– The provision related to Electoral Trust

TEST YOURSELF

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

ELABORATIVE QUESTIONS

1. What are the provisions relating to assessment of a HUF after its partition?
2. Explain the terms ‘Partition’, ‘Partial Partition’, and ‘Co-parceners’.
3. Explain Carbon Credit?
4. What is the New Scheme of Taxation of a firm?
5. Explain in brief the condition for allowability of deduction of interest to a partner.
6. Explain the difference between the change in constitution and succession of a firm. Illustrate.
7. What is meant by Association of Persons? How is it formed?
8. Discuss tax liability of an Association of Persons.
9. Discuss tax liability of the members of Association of Persons. State the circumstances, if any, under which their share of income from an association of persons is not chargeable to tax.
10. Explain the following under the Income-tax Act:

    (a) “Co-operative Society”.

    (b) “Urban Consumers” Co-operative Society”.
11. Explain the deductions which are allowed under Section 80P to arrive at the total income of a cooperative society.
12. Explain the exemption available to political parties ?
13. What do you understand by “Book Profit” in the context of Minimum Alternate Tax.
14. Explain the significance of classification of companies under the Income tax Act, 1961 and their impact on the tax liability.
15. Explain how is the residential status of a company determined under the Income tax Act, 1961.
16. Explain the concept of MAT and its rationale.
17. When will the ‘book profits’ of a company deemed to be the total income of the company for the purposes of levy of MAT under section 115JB? Indicate briefly the points to be taken into account while preparing annual accounts for the purpose of MAT. The MAT does not apply to foreign companies operating in India. Do you agree? Give reasons.
18. What is the quantum of MAT for a ‘domestic company’ and ‘foreign company’?
19. Distinguish between Domestic company and foreign company. Are they treated alike under the income- tax rate structure?

PRACTICAL QUESTIONS

1. Mr. Anil has income of Rs. 45 lakhs under PGBP. One of his business is eligible for deduction @ 100 % of profits u/s 80IB for AY 2021-22. The profits of such business is included in the business income is Rs. 20 Lakhs. Compute the tax payable by Mr. Anil during PY 2020-21.
2. C sells agricultural land situated in an urban area for ₹8,30,000 (brokerage paid @ 2 %) on March 31, 2019 (cost of acquisition : ₹1,05,000 on March 1, 2004; it was used for agricultural purposes since2001) On March 31, 2019 he owns one residential house property. On April 6, 2019, he purchases the following assets –

   a. Agricultural land: ₹1,50,000 ; and

   b. Residential house property : ₹3,00,000.

   Find out the capital gains chargeable to tax for the A/Y 2021-22.
3. A sells agriculture land situated within the municipal limits of Calcutta for ₹30,00,000 on July 4, 2018, which was purchased by him on March 1, 2002 for ₹4,00,000. On July 15, 2019 he purchases agricultural land in rural area for ₹4,30,000 and deposits ₹10,80,000 in a deposit account for availing exemption under section 54B.

   Determine the amount of capital gains.
4. T purchased a house on 28-6-2002 for ₹1,10,000 and paid ₹10,000 for getting the property registered in his name. On 15-6-2010, he spent ₹80,000 on improvement of the house. The house was sold on 21-10-2018 for ₹10,00,000. Commission of ₹4,000 was paid on the sale of the house. Compute the capital gains.

Answer:

1. Rs. 8,65,800
2. Rs. 1,93,156
3. Rs. 3,70,000
4. Rs. 5,41,868

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 9

TDS/TCS, Returns, Refund & Recovery

LESSON OUTLINE

- Tax Deduction at Source 'TDS'
- Tax Collection at Source 'TCS'
- Advance Tax & Self-Assessment Tax 'SAT'
- Returns
- Permanent Account Number (PAN)
- Signatures
- E-Filing
- Interest for default in furnishing return of Income
- Collection of Tax
- Recovery of Tax
- Refunds
- Assessment
- Appeals
- Revisions
- Settlement of Cases
- Penalties etc.
- LESSON ROUNDUP
- TEST YOURSELF

LEARNING OBJECTIVES

The Income-tax Act provides for collection and recovery of income-tax in the following ways, namely,

(i) deduction of tax at source in respect of income by way of salaries, interest on securities, interest other than interest on securities, winnings from lotteries and crossword puzzles, winnings from horse race, insurance commission, dividends, payment to contractors or subcontractors and payments to non- residents;

(ii) advance payment of income-tax before the assessment by the assessee himself;

(iii) direct payment of income-tax by the assessee on self-assessment; and

(iv) payment made after the assessment is made by the Assessing Officer.

Once the tax is deducted, it is duty to deposit the same to the credit of the Central Government under prescribed procedures stated under the Income Tax Act, 1961. In this chapter TDS related aspects of the Income Tax Act have been elaborately discussed with special emphasis on e-TDS and other relevant issues.

The provisions of the Income-Tax Act contained in Sections 117 to 136 specify the procedure relating to the appointment of the various income-tax authorities, their powers, functions, jurisdiction and control. The procedure under the Income-tax Act for making an assessment of income begins with the filing of a return of income. Section 139 of the Act contains the relevant provisions relating to the furnishing of a return of income. On the basis of return of income the income tax authority makes the assessment.

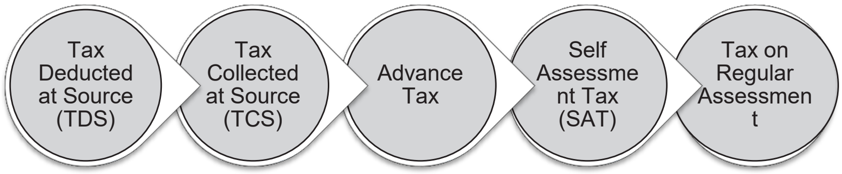
Further, the Income-tax Act provides for various remedies to an assessee on completion of the assessment. The main remedies available to an assessee on completion of the assessment are Appeals, Revision, and Rectification. All these remedies work in different areas. However, strictly speaking the remedies are not alternative to each other but at times more than one remedial proceeding may be used as complimentary to each other so as to achieve the best results. The right to appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority. Where the Assessing Officer accepts the return filed by the tax payer and passes an order making no modification, an appeal does not lie against that order as the taxpayer cannot be said to be aggrieved of that order.

At the end of this lesson, students will be able to understand;

- What is tax deducted at source and tax collected at source
- What are the rates of TDS and TCS
- The due dates for payment of TDS and TCS and Advance Tax
- The provisions related to Returns, Signature – E-Filing
- Fee and Interest
- Collection and Recovery of Tax
- Refunds
- What are the types of assessment
- When can order for re-assessment be issued.
- How the mistake in return can be rectified and by whom.
- What are the provisions for filing of appeal.
- What is the procedure to file an application before the appellate authority.
- When order of appeal can be revised.
- What is the ground and quantum of penalty imposed.

TAX DEDUCTED AT SOURCE

Income Tax Act provides for scope of the total income of a person chargeable to tax on an annual basis. The tax liability is determined as per the provisions of the Income-tax Act and such tax liability is discharged vide any of the following mode:



It is a measure, in which person who are making payment of income are responsible to deduct tax from such income (at specified rates) and pay only net amount. Tax so deducted (called TDS) shall be deposited with the Government's treasury within the stipulated time. The payer will issue a certificate in Form 16 or 16A to the payee and the payee will get credit for TDS and his tax liability shall be reduced to that extent. In nutshell, the provisions are merely a mode of collection of income tax and a check on tax evasion through proper control and information.

All deductors (including Government deductors who deposit TDS in the Central Government Account through book entry) shall issue TDS certificate generated through TIN central system and which is downloaded from the TIN website with a unique TDS certificate number.

As per provision of Section 206AA, if resident payee fails to provide his PAN, tax is required to be deducted at the rate mentioned in respective section or 20%, whichever is higher. [The Section 206AA is discussed later in the chapter]

Objects

- Quicker realisation of tax
- Effective realisation of tax

There are several provisions in the Act for TDS, being discussed infra.

Direct Payment [Section 191]

Section 191 provides that in the following cases, tax is payable by the assessee directly –

(1) in the case of income in respect of which tax is not required to be deducted at source; and

(2) income in respect of which tax is liable to be deducted but is not actually deducted.

In view of these provisions of section 191, the proceedings for recovery of tax necessarily had to be taken against the assessee whose tax was liable to be deducted, but not deducted.

In order to overcome this difficulty, the Explanation to this section provides that if any person, including the principal officer of a company –

(1) who is required to deduct tax at source; or

(2) an employer paying tax on non-monetary perquisites under section 192(1A),

does not deduct the whole or part of the tax, or after deducting fails to pay such tax deducted, 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.

TDS ON SALARY [SECTION 192]

Who is responsible to deduct tax

Any person responsible for paying any income chargeable to tax under the head "Salaries" (i.e. employer) is required to deduct tax at source on the amount payable.

When tax shall be deducted

Tax shall be deducted at the time of payment of such income.

Rate of TDS

Tax shall be deducted at the average rate of tax, computed on basis of prescribed rates in force for the relevant financial year in which payment to employee is made on the estimated total income of the assessee.

Note:

Following points shall be kept in mind by the person responsible to deduct tax at source u/s 192 –

1. Maximum exempted limit: Tax shall not be deducted if taxable salary is less than basic exemption limit.
2. Payment of tax by employer: The employer paying any income in the nature of non-monetary perquisite may pay, at his option, tax on such income without making any deduction therefrom at the time when such tax was otherwise deductible. For this purpose, tax shall be determined at the average of income-tax computed on the basis of the rates in force for the financial year, on the income chargeable under the head "Salaries". It is to be noted that tax paid on non-monetary perquisites by the employer shall not be considered as income of the employee.
3. Particulars of perquisites: The employer shall furnish a statement to the employee (whose salary exceeds Rs 1,50,000) giving correct and complete particulars of perquisites or profits in lieu of salary provided to employee and the value thereof in Form 12BA provided salary of such employee exceeds Rs 2,00,000.
4. Salary from more than one source: As per Section 192(2), where assessee is working simultaneously with more than one employer, he may furnish to any one employer at his choice, details (in Form No. 12B) of income taxable under the head "Salaries" due to or received by him from other employer(s) and such employer shall deduct tax on aggregate salary.
5. Treatment of other income: As per Section 192(2B), where an assessee who receives any income chargeable under the head "Salaries" has, in addition, any income chargeable under any other head of income for the same financial year, he may (or may not) furnish to employer the particulars (in plain paper) of –

   - such other income (only income and not loss)
   - tax deducted on such other income as per provision of this chapter;
   - the loss, if any, under the head "Income from house property" (Losses under any other head are not to be considered)

   Tax deducted u/s 192 shall be higher of the following:

   - Tax deductible from income,that would be so deductible, if loss under the head 'Income from House Property', other income (only income) and the tax deducted thereon had been taken into account.
   - Tax deductible from income under the head "Salaries", that would be so deductible (after adjusting

loss under the head Income from house property), if the other income (or loss) and the tax deducted thereon had not been taken into account.

Salaries payable in a foreign currency

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.

6. Evidence of claim: The responsible person shall, for the purposes of estimating income of the assessee or computing tax deductible, obtain the evidence or proof or particulars of prescribed claims (including claim for set-off of loss) from the assessee in such form and manner as may be prescribed.

Deferring TDS in respect of income pertaining to Employee Stock Option Plan (ESOP) of start ups: For the purposes of deducting or paying tax under section 192, a person, being an eligible start-up referred to in section 80-IAC, responsible for paying any income to the assessee being perquisite of the nature specified in Section 17(2)(vi) i.e. sweat equity shares/ESOP ,in any previous year relevant to the assessment year, beginning on or after the 1st day of April, 2021, shall deduct or pay, as the case may be, tax on such income within 14 days—

(i) after the expiry of forty-eight months from the end of the relevant assessment year; or

(ii) from the date of the sale of such specified security or sweat equity share by the assessee; or

(iii) from the date of the assessee ceasing to be the employee of the person,

whichever is the earliest, 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. **[As amended by Finance Act, 2020]**

Case Law:

Section 192(1) requires any person responsible for paying any income chargeable under the head “Salaries” to deduct tax at source at the time of payment. If an employee receives income chargeable under a head other than “Salaries”, section 192 does not get attracted at all.

In the case of ITC Ltd v. CIT (2016) 384 ITR 14, the issue under consideration before the Supreme Court was whether “tips” received by the hotel-company from its customers and distributed to the employees fell within the meaning of “Salaries” to attract tax deduction at source under section 192.

The Supreme Court observed that in respect of tips collected by the company from the customers and distributed to the employees, the person responsible for paying the employee was not the employer at all, but a third person, namely the customer. As income from tips would be chargeable in the hands of the employees as “Income from Other Sources”, on account of such tips being received from customers and not from the employer, section 192 would not get attracted at all.

The Supreme Court further observed that there was no vested right in the employee to claim any amount of tip from his employer. Tips are purely voluntary amounts that may or may not be paid by customers for services rendered to them, and hence, would not fall within the meaning and scope of section 15. Further, the amount of tips collected from the customers by the employer and paid to the employees has 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. Due to this reason the tips received by the employees could not be regarded as profits in lieu of salary in terms of section 17(3). The payments of collected tips included and paid by way of a credit card by a customer, would not be payments made “by or on behalf of” an employer. The contract of employment not being the proximate cause for the receipt of tips by the employee from a customer, such payments would be outside the scope of sections 15 and 17.

Provision Illustrated

Mr. A non-resident working in X Ltd. furnishes the following, compute the tax to be deducted at source by X Ltd.

Taxable salary	Rs 4,00,000
Loss from House Property	Rs 5,000
Loss from Business	Rs 10,000
Gross Interest Income (TDS Rs 5,000)	Rs 60,000
Investment in PPF	Rs 10,000

Solution

Computation of tax to be deducted at source by Y Ltd

Particulars	Tax on income including other income	Tax on income excluding other income
Salary income	4,00,000	4,00,000
Loss from House Property	(5,000)	(5,000)
Interest Income	60,000	Nil
Gross Total Income	4,55,000	3,95,000
Less: Deduction u/s 80C [Investment in PPF]	10,000	10,000
Total Income	4,45,000	3,85,000
Tax on above	9,750	6,750
Less: Rebate u/s 87A (not allowed to non-resident)	Nil	Nil
Tax after rebate	9,750	6,750
Add: Health and Education cess @ 4%	390	270
Tax and cess payable	10,140	7,020
Less: Tax deducted at source on other income	5,000	Nil
Balance	5,140	7,020
Tax to be deducted by Y Ltd. (Higher of Rs 5,140 or Rs 7,020)	7,020	

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorizing the payer to deduct no tax or deduct tax at lower rate. [Refer section 197]

TDS ON PAYMENT FROM EMPLOYEES PROVIDENT FUND [SECTION 192A]

Who is responsible to deduct tax

The trustees of the Employees' Provident Fund Scheme, 1952, framed u/s 5 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees.

When tax shall be deducted

The tax shall be deducted at the time of making of payment of accumulated balance due to the employee.

Deduction on which amount:

Tax is deducted on the accumulated balance due to an employee participating in a recognised provident fund includible in his total income owing to the not applicability of the provisions of rule 8 of Part A of the Fourth Schedule.

Rule 8 of Part A of the Fourth Schedule provides the accumulated balance due and becoming payable to an employee participating in a recognised provident fund shall be exempted:

1. if he has rendered continuous service with his employer for a period of 5 years or more; or
2. if, though he has not rendered such continuous service, the service has been terminated by reason of the employee's ill-health, or by the contraction or discontinuance of the employer's business or other cause beyond the control of the employee; or
3. if, on the cessation of his employment, the employee obtains employment with any other employer, to the extent the accumulated balance due and becoming payable to him is transferred to his individual account in any recognised provident fund maintained by such other employer

Rate of TDS: 10%

❖ Any person entitled to receive any amount on which tax is deductible shall furnish his Permanent Account Number (PAN) to the person responsible for deducting such tax, failing which tax shall be deducted at the maximum marginal rate.

  TDS is not applicable when amount of such payment or aggregate amount of such payment to the payee is less than Rs. 50,000/-.

TDS ON INTEREST ON SECURITIES [SECTION 193]

Who is responsible to deduct tax: Any person responsible for payment of interest on securities (other than interest on Government securities and certain specified securities) to any resident person.

Note: In the following cases tax is not required to be deducted:

1. Interest payable to a resident-individual or a resident HUF on debentures is not subject to TDS provided following conditions are satisfied –
   (a) Such debentures are issued by a company in which the public are substantially interested;
   (b) Such debentures may be listed or unlisted
   (c) The interest is paid by the company by an account payee cheque; and
   (d) The amount of such interest payable during the financial year to such individual does not exceed Rs 5,000
2. Any interest payable on any security of the Central or State Government. (However, tax is required to be deducted on interest payable on 8% Savings (Taxable) Bonds, 2003 or 7.75% Savings (Taxable) Bonds, 2018 [Finance Act, 2018] if amount of interest in a financial year exceeds Rs 10,000).
3. Any interest payable on any security issued by a company, where such security in dematerialised form and is listed on a recognised stock exchange.
4. Any interest payable on securities beneficially held by Life Insurance Corporation of India or General Insurance Corporation of India or any of the 4 companies formed by virtue of the scheme framed u/s 16(1) of the General Insurance Business (Nationalisation) Act, 1972 or any other insurer.

5. Any interest payable to Regimental Fund or non-Public Fund established by Armed Force [income of whose is exempt u/s 10(23AA).

When tax shall be deducted:

The tax shall be deducted at the time of payment or crediting the payee, whichever is earlier.

Rate of TDS : 10% (No surcharge & Health & Education Cess) both in the case of domestic companies and resident non-corporate assessees.

Exemption or relaxation from the provision:

- ❖ When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorizing the payer to deduct tax at lower rate or deduct no tax; [Refer section 197]
- ❖ When a declaration in Form 15G (in duplicate) is furnished by the assessee to the payer [Refer section 197A]

TDS ON DIVIDEND [SECTION 194]

The Company declaring and paying dividend on shares by any mode in India is required to deduct TDS under section 194 at the rate of 10%, if the following conditions are satisfied –

a. The dividend is paid to the shareholder who is resident in India; and

b. The dividend covered within the meaning of Clause (a) to (e) **section 2(22), as dividend is now taxable in the hands of recipient shareholder.**

Provided that no such deduction shall be made in the case of a shareholder, being an individual, if the dividend is paid by the company by [any mode other than cash] and the amount of such dividend distributed or paid during the financial year does not exceed Rs. 5,000. **[As amended by Finance Act, 2020]**

It is important to note that the dividend referred above covers the dividends on preference shares also.

TDS ON INTEREST OTHER THAN INTEREST ON SECURITIES [SECTION 194A]

Who is responsible to deduct tax:

Following person are responsible to deduct tax at source on interest other than interest on securities to a resident person –

- ❖ Any person, other than Individual or HUF; or
- ❖ An individual or HUF, whose books of account are required to be audited u/s 44AB (due to turnover or gross receipt criteria) during the financial year immediately preceding the financial year in which such interest is credited or paid.

However, following persons are responsible to deduct tax at source on interest other than interest on securities paid or payable to a resident person if during the financial year, interest paid/payable exceeds *Rs. 40,000:

a. A banking company;

b. Co-operative society engaged in carrying on the business of banking;

c. Post office in respect of notified scheme

*Provided that in case of payee being a senior citizen, instead of limit of “forty thousand rupees”, the limit of“fifty thousand rupees” shall apply.

To summarise, No tax is required to be deducted if aggregate amount of interest credited or paid to the payee in respect of time deposit during the financial year doesn't exceed the following limit:

Payer	**Threshold limit if Payee is**	
	Senior Citizen	**Others**
Banking Co.	50,000	40,000
Co-operative Society engaged in banking Business	50,000	40,000
Post Office	50,000	40,000
In any other case	5,000	5,000

The ceiling limit as specified above shall not be computed branch-wise if such banking company or co-operative society or public company has adopted Core Banking Solutions (CBS). For the above purposes "time deposits" means deposits including recurring deposits repayable on the expiry of fixed periods.

Note : Any Income credited or paid by 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 and any income credited or paid on deposits with a primary agricultural credit society or a primary credit society as referred to in clause (v) or clause (viia) shall be liable to deduct TDS, if –

(a) the total sales, gross receipts or turnover of the co-operative society exceeds 50 Crore rupees during the financial year immediately preceding the financial year in which the interest is credited or paid; and

(b) the amount of interest, or the aggregate of the amounts of such interest, credited or paid, or is likely to be credited or paid, during the financial year is more than 50,000 rupees in case of payee being a senior citizen and 40,000 rupees in any other case. **[As amended by Finance Act, 2020]**

When tax shall be deducted:

The tax shall be deducted at the time of payment or crediting the payee, whichever is earlier.

Rate of TDS: 10%(no surcharge and Cess) both in case of resident non-corporate assessees and domestic companies.

Other points

Following interests are not subject to TDS –

- Interest payable to –
    a. Banking company; or
    b. Co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank); or
    c. Financial corporation established by or under a Central, State or Provincial Act; or
    d. The Life Insurance Corporation of India; or
    e. The Unit Trust of India; or
    f. Any company or co-operative society carrying on the business of insurance; or
    g. Such other notified institution, association or body.
- Interest credited or paid by a firm to a partner of the firm;

- Interest credited or paid 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
- Interest credited or paid in respect of deposits under any notified scheme like NSC, Indira Vikas Patra, Kisan Vikas Patra and Post office Monthly Income Account.
- Interest credited or paid in respect of deposits (other than time deposits and recurring deposit) with a banking company. TDS is also required to be deducted on Recurring Deposits.
- Interest credited on the compensation amount awarded by the Motor Accidents Claims Tribunal;
- Interest paid 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 Rs 50,000
- Interest credited or paid by the Central Government under any provision of the Income Tax Act
- Income which is paid or payable by an infrastructure capital company or infrastructure capital fund or a public sector company or scheduled bank in relation to a Zero Coupon Bond issued on or after 1-6-2005 by such company or fund.
- Income by way of interest referred to in section 10(23FC)
- Interest on FDRs, made in the name of the 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

Exemption or relaxation from the provision

- When the recipient applies to the assessing officer in Form No. 13 and gets a certificate authorizing the payer to deduct tax at lower rate or deduct no tax. [Refer section 197]
- When a declaration in Form 15G is furnished by the assessee to the payer [Refer section 197A]

Adjustment for short-deduction

The person responsible to deduct tax may at the time of making any deduction, increase or reduce the amount to be deducted for the purpose of adjusting any excess or deficiency arising out of any previous deduction or failure to deduct during the financial year.

TDS ON WINNING FROM LOTTERIES OR CROSS WORD PUZZLES, ETC. [SECTION 194B]

Who is responsible to deduct tax:

Any person responsible for paying to any person any income by way of winning from any lottery or crossword puzzle or card game and other game of any sort, exceeding Rs 10,000 is responsible to deduct TDS at the time of payment.

If income is more than Rs 10,000 (say Rs 12,000), then tax shall be deducted on the whole amount (i.e. Rs 12,000).

Rate of TDS:

The rate of TDS 30% (in case of non-resident payee, applicable surcharge, Health & Education cess shall also be considered)

Payee	Rate of TDS as a % of amount paid or payable
Resident Person	30%
Non-Resident	30% + Surcharge + Health & Education Cess)

Other Points

- If prize is given partly in cash and partly in kind then tax on whole prize (i.e. aggregate of cash and value of prize in kind) shall be deducted from the cash prize.
- If prize is given in kind only (or cash prize is not sufficient), then payer should ensure that tax has been paid on such income before releasing such prize.
- Where a certain percentage has to be forgone either in favour of Government or an agency conducting lotteries, then such portion is not subject to deduction of tax at source.
- Where an agent receives the prize money on unsold ticket or becomes entitled to an unclaimed prize, it shall form part of his business income and therefore not liable for tax deduction u/s 194B
- If prize money is paid in instalments, then tax shall be deducted at the time of payment of each instalment.
- Tax shall be deducted on payment of commission, etc. to the lottery agent u/s 194G and not u/s 194B.

TDS ON WINNING FROM HORSE RACES [SECTION 194BB]

Who is responsible to deduct tax:

Any person responsible for paying to any person any income by way of winning from horse races, exceeding Rs 10,000 is responsible to deduct TDS

When tax shall be deducted:

At the time of payment.

Rate of TDS:

30%

Other Points

1. Any person, here means a book-maker or a person to whom a licence has been granted by the Government for horse racing or arranging for wagering, betting in any race course.
2. Race-income other than horse races like camel races etc is not covered by this section.

TDS ON PAYMENT TO CONTRACTOR [SECTION 194C]

Who is responsible to deduct tax:

Any specified person responsible for paying any sum to any resident/contractor for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract is responsible to deduct TDS.

Following are the specified person –

a. The Central Government or any State Government; or

b. Any local authority; or

c. Any corporation established by or under a Central, State or Provincial Act; or

d. Any company; or

e. Any co-operative society;

f. Any authority, constituted in India by or under any law, engaged 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; or

g. Any society registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India; or

h. Any trust; or

i. Any University established or incorporated by or under a Central, State or Provincial Act and an institution declared to be a University u/s 3 of the University Grants Commission Act, 1956; or

j. Any Government of a foreign State or a foreign enterprise or any association or body established outside India; or

k. Any firm; or

l. Individual or a HUF or an association of persons or a body of individuals (if not covered by aforesaid cases), whose books of account are required to audited u/s 44AB (due to turnover or gross receipt criteria) during the financial year immediately preceding the financial year in which such sum is credited or paid.

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.

When tax cannot be deducted

- Case 1

  When following conditions are satisfied then tax cannot be deducted:

  i. Any sum credited or paid in pursuance of any contract, the consideration for which does not exceed ₹ 30,000; and

  ii. Where the aggregate of the amounts of such sums credited or paid or likely to be credited or paid during the financial year does not exceed Rs 1,00,000

- Case 2

  When following conditions are satisfied then tax cannot be deducted:

  a. Amount is paid or payable to a resident contractor during the course of plying, hiring or leasing goods carriage (here-in-after referred to as transport operator).

  b. Such operator furnishes his Permanent Account Number (PAN) to the payer.

  c. Where such contractor owns 10 or less goods carriages at any time during the previous year and furnishes a declaration to that effect along with his PAN to the person paying or crediting such sum.

The tax shall be deducted at the time of payment or crediting the party, whichever is earlier.

Therefore, even if a single payment to a contractor does not exceed Rs. 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 Rs. 1,00,000.

Rate of TDS

Payee	Rate as a % of amount paid or payable
Individual or HUF	1%
Other Payee	2%

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax. [Refer section 197]

Other Points

- Contract shall include sub-contract.
- "Work" shall include –
  a. advertising;
  b. broadcasting and telecasting including production of programmes for such broadcasting or telecasting;
  c. carriage of goods and passengers by any mode of transport other than by railways;
  d. catering.
  e. manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer or its associate, being a person placed similarly in relation to such customer as is the person placed in relation to the assessee under the provisions contained in clause (b) of sub-section (2) of section 40A but does not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person, other than such customer or associate of such customer,
- Where any sum is paid or credited for carrying out any work mentioned in (e), tax shall be deducted at source:
  (i) on the invoice value excluding the value of material, if such value is mentioned separately in the invoice; or
  (ii) on the whole of the invoice value, if the value of material is not mentioned separately in the invoice.

TDS ON INSURANCE COMMISSION [SECTION 194D]

Any person responsible for paying to a resident person any income by way of remuneration or reward (i.e. commission etc.) for soliciting or procuring insurance business including business relating to the continuance, renewal or revival of policies of insurance need to deduct TDS at the time of payment or crediting the party whichever is earlier.

Note: Tax shall not be deducted if the aggregate amounts of remuneration or reward credited or paid during the financial year to the payee does not exceed Rs 15,000.

Rate of TDS:

Payee	Rate of TDS
Domestic Company	10%
Other Payee	5%

Exemption or relaxation from the provision

- When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorizing the payer to deduct tax at lower rate or deduct no tax; [Refer section 197]
- When a declaration in Form 15G (in duplicate) is furnished by the assessee to the payer [Refer section 197A]

TDS ON PAYMENT IN RESPECT OF LIFE INSURANCE POLICY [SECTION 194DA]

Any person responsible for paying to a resident any sum under a life insurance policy, including the sum allocated by way of bonus on such policy other than the amount not includible in the total income u/s 10(10D) is responsible to deduct TDS at the time of payment.

- TDS is not required to be deducted on any payment which is exempt u/s 10(10D).
- Tax shall not be deducted if the aggregate amounts of payments to the payee during the financial year is less than Rs 1,00,000.
- in case payee has furnished self declaration under Form 15G / Form 15H declaring that the tax on his estimated total income for the relevant previous year would be nil

Rate of TDS: 1%[w.e.f 1.09.2019 TDS rate is 5% on income comprised therein i.e., ***after deducting the amount of insurance premium paid by the resident assessee from the total sum received.*** [inserted by Finance (No. 2) Act, 2019]

PAYMENT TO A NON-RESIDENT SPORTSMEN / SPORTS ASSOCIATION [SECTION 194E]

Where any person responsible to pay any income as referred to in section 115BBA to the following persons–

a. A non-resident sportsman (including an athlete); or
b. An entertainer who is not a citizen of India; or
c. A non-resident sports association / institution.

Such person 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, shall deduct income-tax thereon at the rate of 20%+ Surcharge, if applicable + 4% HEC .

Income must be earned by sports person as referred to in section 115BBA by way of:

a. participation in India in any game (excluding any card game or other games of Gambling or bettings) or sports; or
b. advertisement; or
c. contribution of articles relating to any game or sport in India in newspapers, magazines or journals

PAYMENTS IN RESPECT OF DEPOSITS UNDER NATIONAL SAVINGS SCHEME, ETC.[SECTION 194EE]

Any person [i.e. post office] responsible for paying an amount (either principal or interest) referred to in section 80CCA(2)(a) [i.e. National Saving Scheme, 1987] shall deduct TDS at the time of payment.

Note: Tax shall not be deducted at source if the aggregate amount of such payments to the payee during the financial year is less than Rs 2,500.

Rate of TDS:

Payee	Rate of TDS as a % of amount paid or payable
Resident	10%
Non-Resident	10% (+ Surcharge + Health & Education Cess)

Exemption or relaxation from the provision

a. Where the payment is made to the heirs of the deceased assessee.

b. When a declaration in Form 15-G (in duplicate) is furnished by the assessee to the payer.

TDS ON COMMISSION ON SALE OF LOTTERY TICKETS [SECTION 194G]

Any person responsible for paying any income by way of commission, remuneration or prize (by whatever name called) on lottery tickets to any person, who is stocking, distributing, purchasing or selling such tickets shall be responsible to deduct tax at the time of payment or crediting the payee, whichever is earlier.

Rate of TDS:

Payee	Rate of TDS as a % of amount paid or payable
Resident	5%
Non-Resident	5% (+ Surcharge + Health & Education Cess)

TDS cannot be made where amount of commission, etc. on such tickets does not exceed Rs 15,000.

Exemption or relaxation from the provision

When the recipient applies to the assessing officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax. [Refer section 197]

TDS ON COMMISSION, ETC. OTHER THAN INSURANCE COMMISSION [SECTION 194H]

Following persons are responsible to deduct tax at source on commission or brokerage (other than commission on insurance) to a resident person –

- Any person, other than individual or HUF; &
- Individual or HUF, whose books of account are required to be audited u/s 44AB (due to turnover or gross receipt criteria) during the financial year immediately preceding the financial year in which such commission is credited or paid.

Note:

1. No tax shall be deducted if the aggregate amounts of commission or brokerage credited or paid during the financial year to the payee does not exceed Rs 15,000.
2. No deduction shall be made on any commission or brokerage payable by Bharat Sanchar Nigam Limited or Mahanagar Telephone Nigam Limited to their public call office franchisees.

Tax shall be deducted at the time of payment or crediting the payee, whichever is earlier @ 5%

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.

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form No. 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax [Refer section 197]

When commission is retained by an agent

Where commission or brokerage is retained by the consignee/agent while remitting the sale consideration, the consignor/principal will have to deposit the tax deductible on the amount of such retained commission - [Circular No.619]

Other Points:

Commission or brokerage includes 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 any asset, valuable article or thing, not being securities.

TDS ON RENT [SECTION 194-I]

Following persons are responsible to deduct tax at source on rent to a resident person –

- Any person, other than individual or HUF; &
- Individual or HUF, whose books of account are required to be audited u/s 44AB (due to turnover or gross receipt criteria) during the financial year immediately preceding the financial year in which such rent is credited or paid.

Note: Tax shall not be deducted if the aggregate amounts of rent credited or paid during the financial year to the payee does not exceed Rs 2,40,000 (Increased from 1,80,000 to 2,40,000 by Finance (No. 2) Act, 2019).

"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, -

<table>
<tr><td>(a) Land</td><td>(b) Building (including factory building)</td><td rowspan="2">(c) Land appurtenant to a building (including factory building)</td></tr>
<tr><td>(d) Machinery</td><td>(e) Plant</td></tr>
<tr><td>(f) Furniture</td><td>(g)Fittings</td><td>(h) Equipment</td></tr>
<tr><td colspan="3">- whether or not any or all of the above are owned by the payee.</td></tr>
</table>

Tax shall be deducted at the time of payment or crediting the account of payee, whichever is earlier.

Rate of TDS:

Nature of Assets	Rate
Machinery or plant or equipment	2%
Land or building (including factory building) or land appurtenant to a building (including factory building) or furniture or fittings	10%

When TDS cannot be made

- Where the payee is the Government, local authorities u/s 10(20) and statutory authorities u/s 10(20A), then TDS cannot be made - [Circular No. 699, dated 30-1-1995].
- Where rent is credited or paid to a business trust, being a real estate investment trust, in respect of any real estate asset, referred to in section 10(23FCA), owned directly by such business trust

Exemption or relaxation from the provision

- When a declaration in Form 15G (in duplicate) is furnished by the assessee to the payer [Refer section 197A]
- When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax. [Refer section 197]

Clarification regarding 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.

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

Clarification on applicability of TDS provisions of section 194-I on lumpsum lease premium paid for acquisition of long term lease [Circular No.35/2016, dated 13-10- 2016]

The issue of whether or not TDS under section 194-I is applicable on ‘lump sum lease premium’ or ‘one-time upfront lease charges” paid by an assessee for acquiring long-term leasehold rights for land or any other property has been examined by the CBDT.

Accordingly, the CBDT has, vide this clarified that lump sum lease premium or one-time upfront lease charges, which are not adjustable against periodic rent, paid or payable for acquisition of long-term leasehold rights over land or any other property are not payments in the nature of rent within the meaning of section 194-I. Therefore, such payments are not liable for TDS under section 194-I.

The issue as to whether the charges fixed by the Airport Authority of India (AAI) for landing and parking facility for the aircraft are for the “use of the land” by the airline company came up before the Supreme Court in *Japan Airlines Co. Ltd.* v. *CIT / CIT* v. *Singapore Airlines Ltd.* (2015) 377 ITR 372.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the “use of the land”. These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, the services are not restricted to merely permitting "use of the land" of airport. On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from the 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.

TDS ON TRANSFER OF CERTAIN IMMOVABLE PROPERTY OTHER THAN AGRICULTURAL LAND [SECTION 194-IA]

Any person, being a transferee, responsible for paying (other than the person referred to in section 194LA) to a resident transferor any sum by way of consideration for transfer of any immovable property (other than rural agricultural land) is responsible to deduct TDS at the time of payment or crediting the payee, whichever is earlier @ 1%

- "Immovable property" means any land (other than rural agricultural land) or any building or part of a building.
- "Rural agricultural land" – as discussed in Chapter 'Capital Gain'

Where the consideration for the transfer of an immovable property is less than Rs 50 lakh TDS cannot be made.

Note: The deductor is not required to obtain Tax Deduction Account Number as required u/s 203A.

Consideration for immovable property" shall include 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 similar nature, which are incidental to transfer of the immovable property. **[Inserted by Finance (No.2) Act, 2019]**

Time and mode of payment of tax deducted at source under section 194-IA to the credit of Central Government, furnishing challan-cum-statement and TDS Certificate [Rules 30, 31A & 31]

(i) Such sum deducted under section 194-IA shall be paid to the credit of the Central Government within a period of 30 days from the end of the month in which the deduction is made and shall be accompanied by a challan-cum-statement in Form No.26QB [Rule 30].

(ii) The amount so deducted has to be deposited to the credit of the Central Government by electronic remittance within the above mentioned time limit, into RBI, SBI or any authorized bank [Rule 30].

(iii) Every person responsible for deduction of tax under section 194-IA shall also furnish to the DGIT (Systems) or any person authorized by him, a challan-cum-statement in Form No.26QB electronically within 30 days from the end of the month in which the deduction is made [Rule 31A].

Every person responsible for deduction of tax under section 194-IA shall furnish the TDS certificate in Form No.16B to the payee within 15 days from the due date for furnishing the challan-cum-statement in Form

No.26QB under Rule 31A, after generating and downloading the same from the web portal specified by the DGIT (Systems) or the person authorized by him [Rule 31].

TDS ON PAYMENT OF RENT BY CERTAIN INDIVIDUAL / HUF [SECTION 194-IB]

Any person, being an individual or a Hindu undivided family (other than those referred to in section 194-I), responsible for paying to a resident any rent shall be responsible to deduct tax at the time of credit of rent for the last month of the previous year (or the last month of tenancy, if the property is vacated during the year) 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 @ 5%

- "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

TDS cannot be made where rent for a month or part thereof does not exceed Rs 50,000

Notes:

- The deductor is not required to obtain Tax Deduction Account Number as required u/s 203A.
- As per provision of section 206AA, if payee fails to provide his PAN, TDS is required to be deducted @ 20%. However, deduction under this section shall not exceed the amount of rent payable for the last month of the previous year (or the last month of the tenancy).

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.

(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.

FEES FOR PROFESSIONAL OR TECHNICAL SERVICES [SECTION 194J]

Following persons are responsible to deduct tax at source for paying fees for professional or for technical service or royalty or any sum referred to in section 28(va) (i.e., fees for non-competence) or director fees (which is not covered u/s 192) to a resident person –

- Any person, other than individual or HUF; &

- Individual or HUF, whose books of account are required to be audited u/s 44AB (due to turnover or gross receipt criteria) during the financial year immediately preceding the financial year in which such fees is credited or paid.

Note: Tax cannot be deducted if the aggregate amount of such fees credited or paid during the financial year to the payee does not exceed:

Nature of Payment	Amount
Professional fees	Rs 30,000
Fees for technical service	Rs 30,000
Royalty	Rs 30,000
Any sum referred to in sec.28(va)	Rs 30,000
Director fees by whatever name called, (which is not covered u/s 192)	Nil

Note: Rs 30,000 limit is not on individual transaction. If several professional bills in a year together exceed the amount of Rs 30,000, tax shall be deducted, even though any individual bill amount does not exceed Rs 30,000.

Tax shall be deducted at the time of payment or crediting the payee, whichever is earlier @ 10% (@ 2% *in case payee is engaged only in the business of operation of call centre*) or 2% in case of fees for technical services (not being a professional services) or royalty where such royalty is in the nature of consideration for sale, distribution or exhibition of cinematographic films and ten per cent of such sum in other cases. **[As amended by Finance Act, 2020]**

When TDS cannot be made

1. Individual or HUF shall not be liable to deduct income-tax on fees which is credited or paid exclusively for personal purposes of such individual or any member of HUF.
2. **Fees paid by non-resident:** Any fees paid through regular banking channels to any professional who is resident in India by the non-resident who does not have any agent or business connection or permanent business establish-ment in India, may not be subject to this provision [*Circular No.726 dated 16-10-1995*].

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax. [Refer section 197]

Note:

"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 (i.e. Model, photographer, artist providing service to advertising agency) or such other profession as is notified by the Board for the purposes of section 44AA or of this section;

"Fees for technical services" means any consideration (including any lump sum consideration) for rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but 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".

In the case of *CIT* v. *Kotak Securities Ltd.* (2016) 383 ITR 1 (SC) the Supreme Court dealt on 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. It 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.

(1) 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.

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 (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.

INCOME IN RESPECT OF UNITS [SECTION 194K INSERTED BY FINANCE ACT, 2020]

Any person responsible for paying to a resident any income in respect of—

(a) units of a Mutual Fund specified under section 10(23D); or

(b) units from the Administrator of the specified undertaking; or

(c) units from the specified company,

shall, at the time of credit of such income to the account of the payee (or credited into any suspense account) or at the time of payment thereof by any mode, whichever is earlier, deduct income-tax thereon at 10%:

Provided that the provisions of this section shall not apply—

(i) where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year by the person responsible for making the payment to the account of, or to, the payee does not exceed 5,000 rupees; or

(i) if the income is of the nature of capital gains.

Note: The terms "Administrator", "specified company" and "specified undertaking" are as referred to in section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002

TDS ON PAYMENT OF COMPENSATION ON ACQUISITION OF CERTAIN IMMOVABLE PROPERTY [SECTION 194LA]

Any person responsible for paying to a resident any sum, being compensation or the enhanced compensation or the consideration or the enhanced consideration on account of compulsory acquisition of any immovable property (other than agricultural land) is responsible to deduct tax 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 @ 10%.

When TDS cannot be made

Where the amount of such payment or the aggregate amount of such payments to a resident during the financial year does not exceed Rs. 2,50,000.

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax [Refer section 197]

Note:

1. Agricultural land means agricultural land in India.
2. Immovable property means any land (other than agricultural land) or any building or part of a building.
3. Deduction shall not be made where payment is made in respect of any award or agreement which has been exempted from levy of income-tax u/s 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013

TDS ON INTEREST FROM INFRASTRUCTURE DEBT FUND [SECTION 194LB]

Any person responsible for paying income by way of interest by an infrastructure debt fund referred to in section 10(47) to a non-resident or a foreign company responsible to deduct tax at the time of payment or crediting the payee, whichever is earlier @ 5% (+ SC + Health & Education Cess)

TDS ON CERTAIN INCOME FROM UNITS OF A BUSINESS TRUST [SECTION 194LBA]

Any business trust distributing income referred to in sec. 115UA [being of the nature referred to in section 10(23FC) or 10(23FCA)] to its unit holder shall be responsible to deduct tax at the time of payment or crediting the payee, whichever is earlier.

Rate of TDS:

Payee	Rate of TDS	
	Payment referred to in section 10(23FC)	**Payment referred to in section 10(23FCA)**
If payment is made to a resident unit holder	10%	10%
If payment is made to a unit holder being non- resident (not being a company)	5%	30% + Health & Education Cess
If payment is made to a unit holder being a foreign company	5%	40% + Health & Education Cess

TDS ON INCOME OF UNITS OF INVESTMENT FUND [SECTION 194LBB]

The person responsible for making the payment of any income, other than that proportion of income which is of the same nature as income referred to in section 10(23FBB), to a unit holder in respect of units of an investment fund specified in clause (a) of the Explanation 1 to section 115UB is responsible to deduct TDS at the time of payment or crediting the payee, whichever is earlier.

Rate of TDS:

Payee	Rate of TDS
Resident	10%
Non-resident (not being a company)	30%
Foreign Company	40%

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax [Refer section 197]

TDS ON INCOME FROM INVESTMENT IN SECURITIZATION FUND [SECTION 194LBC]

The person responsible for making the payment to an investor in respect of an investment in a securitisation trust, being referred to in section 115TCA shall be responsible to deduct TDS at the time of payment or crediting the payee, whichever is earlier.

Payee	Rate of TDS
Resident	
- Individual or HUF	25%
- Other resident	30%
Non-Resident	
- Foreign Company	40%
- Other than foreign company	30%

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax [Refer section 197]

TDS ON INTEREST TO NON-RESIDENT [SECTION 194LC]

Any Indian company or a business trusts responsible for paying income by way of interest to a non-resident or a foreign company shall be responsible to deduct TDS at the time of payment or crediting the payee, whichever is earlier @ 5% (+SC +Health & Education cess). Such interest is payable in respect of monies borrowed by such company at any time on or after 01/07/2012 but before 01/07/2023 in foreign currency, from a source outside India:

(a) under a loan agreement; or

(b) by way of issue of long-term bonds including long term infrastructure bonds,

(c) by way of issue of rupee denominated bond before the 1st day of July, 2023

as approved by the Central Government

However, 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.

Note: W.e.f. 01-06-2013, the provisions of section 206AA (i.e. rate of TDS will be 20% in absence of PAN) shall not apply in respect of payment of interest, on long-term bonds including long term infrastructure bonds (being referred to in sec. 194LC) to a non-resident, not being a company, or to a foreign company.

INCOME BY WAY OF INTEREST ON CERTAIN BONDS, GOVT. SECURITIES [SECTION 194LD]

Any person who is responsible for paying interest (at the rate notified by the Central Government) to a person being a Foreign Institutional Investor or a Qualified Foreign Investor shall be responsible to deduct tax @ 5% (+ SC + Health & Education cess). Such interest is payable at any time on or after 01/06/2013 but before 01/06/2020 in respect of investment made by the payee in:

(i) a rupee denominated bond of an Indian company ; or

(ii) a Government security:

"Qualified Foreign Investor" shall have the meaning assigned to it in the Circular No. Cir/IMD/DF/14/2011, dated the 9th August, 2011, as amended from time to time, issued by the Securities and Exchange Board of India, under section 11 of the Securities and Exchange Board of India Act, 1992.

PAYMENT BY INDIVIDUAL/HUF TO CONTRACTORS AND PROFESSIONALS [SECTION 194M]

Any person, being an individual or a Hindu undivided family (other than those who are required to deduct income-tax as per the provisions of section 194C or section 194J) responsible for paying :

– any sum to any resident for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract or

– by way of commission (not being insurance commission referred to in section 194D) or brokerage; or

– by way of fees for professional services during the financial year, shall, at the time of credit of such sum or at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to 5% of such sum as income -tax thereon.

Exception : 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 under section 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 who is subject to tax audit under section 44AB(a)/(b) in 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 under section 194H on commission (not being insurance commission referred to in section 194D) or brokerage i.e., an individual or a HUF whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits of Rs. 1 crore and Rs. 50 lakhs, respectively, specified under section 44AB during the immediately preceding financial year.

(iii) they are required to deduct tax at source under section 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 exceed the monetary limits of Rs. 1 crore and Rs. 50 lakhs, respectively, specified under section 44AB during the immediately preceding financial year and such amount is not exclusively credited or paid for personal purposes of such individual or HUF.

The provisions of section 203A shall not apply to a person required to deduct tax in accordance with the provisions of this section.

Explanation. – For the purposes of this section, –

(a) "contract" shall have the meaning assigned to it in clause (iii) of the Explanation to section 194C;

(b) "professional services" shall have the meaning assigned to it in clause (a) of the Explanation to section 194J;

(c) "work" shall have the meaning assigned to it in clause (iv) of the Explanation to section 194C.

TDS ON CASH WITHDRAWAL TO DISCOURAGE CASH TRANSACTION [SECTION 194N]

A. TDS to be deducted from withdrawal exceeding Rs. 1 Crore

Every person, being a banking company including any co-operative bank or a post office who is responsible for paying any sum, being the aggregate of amounts in cash exceeding Rs. 1 crore during the previous year, to any person (recipient) from **one or more accounts maintained by the recipient with it** shall, **at the time of payment** of such sum, deduct 2% of such sum, as income-tax.

B. TDS to be deducted from withdrawal exceeding Rs. 20 Lacs, if the recipient has not furnished the return of income for the last 3 Assessment years.

In case of a recipient who has not filed the returns of income for all of the 3 assessment years relevant to the three previous years, for which the time limit of file return of income under section 139(1) has expired, immediately preceding the previous year in which the payment of the sum is made to him, the provision of this section shall apply with the modification that—

S. No.	Aggregate Cash withdrawal Limit during the P.Yr.	Rate of TDS
1.	Exceeds Rs. 20 Lacs but does not exceed Rs. 1 Crore	2%
2.	Exceeds Rs. 1 Crore	5%

Provided further that the Central Government may specify in consultation with the Reserve Bank of India, by notification in the Official Gazette, the recipient in whose case reduced rate of 2% shall not apply, if such recipient satisfies the conditions specified in such notification.

Provided that nothing contained in this sub-section shall apply to any payment made to Government, banking company, cooperative society engaged in carrying on the business of banking, post office, banking correspondents and white label ATM operators.

PAYMENTS OF CERTAIN SUMS BY E-COMMERCE OPERATOR TO E-COMMERCE PARTICIPANT [SECTION194-O]

Where any sale of goods or provision of services by an Resident e-commerce participant (Example- Cloudtail) is facilitated by an e-commerce operator (Example- Amazon/Flipkart) [wherein payment made by a purchaser of goods or recipient of services directly to an e-commerce participant is also included] through its digital or electronic facility or platform (by whatever name called), such e-Commerce operator shall, at the time of credit of amount of sale or services 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, deduct TDS at the rate of 1% of the gross amount of such sales or services or both. TDS on e-commerce operators under section 194-O is applicable from 1 October 2020

E-commerce participant being a resident individual or HUF: No TDS deduction for e-commerce participant, being an individual or HUF who has furnished his PAN or Aadhaar to the e-commerce operator and where the gross amount of such sale or services during the previous year does not exceed 5 Lakh rupees. If the e-Commerce participant does not furnish his PAN or Aadhaar, TDS must be deducted at the rate of 5%, as per provisions of Section 206AA.

Any TDS deducted or TDS which is not liable to deduction under this section, shall not be liable to tax deduction at source under any other provision of this Chapter.

TDS shall not apply to any amount received by an e-commerce operator for hosting advertisements or providing any other services which are not in connection with the sale or services.

Non-resident e-Commerce participants are exempted from the scope of this section.

TDS ON OTHER SUMS PAYABLE TO NON-RESIDENT [SECTION 195]

Any person (resident or non-resident) responsible for paying any sum chargeable under this Act (excluding income chargeable under the head “Salaries”) to a non-resident is responsible to deduct tax at the time of payment or crediting the payee, whichever is earlier at the rate in force during the financial year

Exemption or relaxation from the provision

When the recipient applies to the Assessing Officer in Form 13 and gets a certificate authorising the payer to deduct tax at lower rate or deduct no tax [Refer section 197]

Other Points to be considered:

The person responsible for paying to a non-resident, not being a company, or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall furnish the information relating to payment of such sum, in such form and manner, as may be prescribed.

If a person fails to furnish such information or furnishes inaccurate information, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of Rs 1,00,000/- [Section 271-I]

The Board may notify a class of persons or cases, where the person responsible for paying to a non-resident, any sum, whether or not chargeable under the provisions of this Act, shall make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of sum chargeable, and upon such determination, tax shall be deducted on that proportion of the sum which is so chargeable.

TDS ON INCOME FROM UNITS [SECTION 196B]

Any person responsible for paying any income in respect of units referred to in section 115AB or by way of long-term capital gains arising from the transfer of such units to an Offshore Fund shall be responsible to deduct TDS at the time of payment or crediting the payee, whichever is earlier @ 10% + Surcharge + Health & Education cess.

TDS ON INCOME FROM FOREIGN CURRENCY BONDS OR GDR [SECTION 196C]

Any person responsible for paying any income by way of interest or dividends in respect of bonds or Global Depository Receipts referred to in section 115AC or by way of long-term capital gains arising from the transfer of such bonds or Global Depository Receipts to a non-resident responsible to deduct tax at the time of payment or crediting the payee, whichever is earlier @ 10% + Surcharge + Health & Education cess

TDS ON INCOME OF FII FROM SECURITIES [SECTION 196D]

Any person responsible for paying any income in respect of securities referred to in section 115AD (1)(a) to Foreign Institutional Investor shall be responsible to deduct tax at the time of payment or crediting the payee, whichever is earlier @ 20% + Surcharge + Health & Education cess

Notes

Tax shall not be deducted from any capital gains arising from the transfer of securities referred to in section 115AD, payable to a Foreign Institutional Investor.

OTHER PROVISIONS

TDS on sums payable to Government, Reserve Bank or certain corporations [Section 196]

No deduction of tax shall be made from any sums payable to following person:

(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 u/s 10(23D),

Tax deducted is income received [Section 198]

- All sums deducted shall, for the purpose of computing the income of an assessee, be deemed to be income received. E.g., If Mr. X received interest of Rs. 18,000 (after deduction of tax Rs. 2,000), then interest income of Mr. shall be considered as Rs. 20,000/-.

  Exception: The sum being the tax paid, u/s 192(1A) [i.e., tax paid by employer on non-monetary perquisite] for the purpose of computing the income of an assessee, shall not be deemed to be income received.

- Where any income is paid 'net of tax' (i.e., tax chargeable on such income shall be borne by the payer), then for the purpose of deducting tax, such income is required to be grossed up [Section 195A]. However, grossing up is not required in case of tax on non-monetary perquisite paid by the employer.

Credit for tax deducted [Section 199]

- Any deduction made in accordance with the foregoing provisions of this Chapter and paid to the Central Government shall be treated as a payment of tax on behalf of the person from whose income the deduction was made. If such income is assessable in the hands of other person, credit shall be given to such other person.
- Any sum referred to in section 192(1A) and paid to the Central Government shall be treated as the tax paid on behalf of such employee.
- The Board may, for the purposes of giving credit in respect of tax deducted or tax paid in terms of the provisions of this Chapter, make such rules as may be necessary, including the rules for the purposes of giving credit to a person other than those referred above and also the assessment year for which such credit may be given.

Certificate for deduction at lower rate [Section 197]

- Where the Assessing Officer, on an application (Form 13) made by a person, is satisfied that existing and estimated tax liability of a person justifies the deduction of tax at lower rate or no deduction of tax, as the case may be, the Assessing Officer shall issue a certificate for deduction of tax at such lower rate or no deduction of tax.
- The certificate shall be valid 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.
- The certificate shall be valid only with regard to the person responsible for deducting the tax and named therein.
- The certificate shall be issued direct to the person responsible for deducting the tax under advice to the person who made an application for issue of such certificate

Computation of lower rate [Rule 28AA]

The existing and estimated liability shall be determined by the Assessing Officer after taking into consideration the following:

(i) tax payable on estimated income of the previous year relevant to the assessment year;

(ii) tax payable on the assessed or returned income, as the case may be, of the last 3 previous years;

(iii) existing liability under the Income-tax Act,1961 and Wealth-tax Act,1957;

(iv) advance tax payment for the assessment year relevant to the previous year till the date of making application;

(v) tax deducted / collected at source for the assessment year relevant to the previous year till the date of making application In nutshell, the Assessing Officer may issue a certificate for deduction of tax at source at lower rate calculated in the manner specified below:

Calculate estimated total income of the current year	A
Calculate tax payable thereon	B
Examine the advance tax already paid or tax already deducted for the current year	C
Reduce advance tax already paid or tax already deducted from the current year estimated tax liability	D=B-C
Calculate average rate of tax	E = D / A × 100
Calculate average of the average rate of tax of preceding 3 years	F
Rate of TDS for Certificate	Higher of E and F

No deduction to be made in certain cases [Section 197A]

- No deduction shall be made under any section from any payment made to New Pension System Trust referred to in section 10(44).
- No deduction of tax shall be made u/s 194 (Dividend) and 194EE (NSS),
  - **(a)** The payee is a resident individual;
  - **(b)** The aggregate amount of income paid or credited does not exceed basic exemption limit
  - **(c)** Such individual furnishes to the payer, a declaration in writing in duplicate in the Form 15G (Form 15H in case of senior citizen).
  - **(d)** Such declaration states 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 deduction of tax shall be made u/s 192A (payment of accumulated balance of provident fund) or 193 (interest on securities) or 194A (other interest) or 194D (insurance commission) or 194DA (payment in respect of life insurance policy) or 194-I (rent),
  - **(a)** The payee is a person other than company or a firm.
  - **(b)** The aggregate amount of income paid or credited does not exceed basic exemption limit.

(c) Such person furnishes to the payer a declaration in writing in duplicate in the form 15G (Form 15H in case of senior citizen).

(d) Such declaration states 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 deduction shall be made from such specified payment to notified institution, association or body. E.g. specified payment (like bank guarantee commission, clearing charges, etc.) made to bank [Notification 47/2016 dated 17-06-2016]

DUTY OF PERSON RESPONSIBLE FOR DEDUCTING TAX AT SOURCE

Deposit of TDS within Time-Limit [Section 200 read with Rule 30]

Tax deducted by the deductor shall be deposited electronically through internet banking facility to the credit of the Central Government within following time limit –

TDS	Time limit
(a) Tax is deducted on behalf of the Government	
• Where the tax is paid without production of an income-tax challan	On the same day
• Where the tax is paid with production of an income-tax challan	On or before 7 days from the end of the month in which tax is deducted
(b) When the Assessing Officer (after obtaining prior approval from Joint Commissioner) permits quarterly payment of tax:	
• Where deduction is made u/s 192, 194A, 194D or 194H	Within July 7 (for Quarter ending on June 30), October 7 (for Quarter ending on September 30), January 7 (for Quarter ending on December 31) & April 30 (for Quarter ending on March 31)
(c) In any other case	
• For the month of March	Within forthcoming 30th April
• For the months other than month of March	Within 7 days from the *end of the month* in which tax is deducted at source.
Exception: Where tax is deducted u/s 194-IA or 194-IB, tax shall be paid to the credit of the Central Government within a period of 30 days from the end of the month in which the deduction is made and shall be accompanied by a challan-cum-statement in Form No. 26QB (for section 194-IA) / 26QC (for section 194-IB)	

Issuance of certificate to payee Any person responsible for deducting tax, shall require to issue a certificate (electronically generated) to the payee –

Nature of payment	Certificate	Time-limit
Salary	16	Annual certificate shall be issued on or before June 15 of the financial year following the financial year in which tax is deducted.
Others	16A	Quarterly certificate shall be issued within 15 days from the due date of furnishing quarterly TDS return

Duty to furnish statement: Any person after paying the tax collected to the credit of the Central Government prepare following quarterly statements:

Particulars	Form No.
Tax is deducted from salary u/s 192	24Q
Tax is deducted from payment made to non-resident, foreign company or not-ordinarily resident	27Q
In other cases	26Q

Note: The person 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 under this sub-section in such form and verified in such manner as may be specified by the authority.

Due date of furnishing quarterly statement

Particulars	Due date of submission of quarterly return
For quarter ending on 30 June	July 31 of the financial year
For quarter ending on 30 September	October 31 of the financial year
For quarter ending on 31 December	January 31 of the financial year
For quarter ending on 31 March	May 31 of the forthcoming financial year

Processing of statements of tax deducted at source [Section 200A]

- The aforesaid statement (including correction statement) shall be processed in the following manner:
  - **(a)** the sums deductible shall be computed after making the following adjustments:
    - **(i)** any arithmetical error in the statement; or
    - **(ii)** an incorrect claim, apparent from any information in the statement#;
  - **(b)** the interest, if any, shall be computed on the basis of the sums deductible as computed in the statement.
  - **(c)** the fee, if any, shall be computed in accordance with the provisions of sec. 234E;
  - **(d)** the sum payable by, or the amount of refund due to, the deductor shall be determined after adjustment of the amount computed under clause (b) and clause (c) against any amount paid u/s 200 or 201 or 234E and any amount paid otherwise by way of tax or interest or fee;
  - **(e)** an intimation shall be prepared or generated and sent to the deductor specifying the sum determined to be payable by, or the amount of refund due to, him under clause (d); and
  - **(f)** the amount of refund due to the deductor in pursuance of the determination under clause (d) shall be granted to the deductor
- Such intimation shall not be sent after the expiry of 1 year from the end of the financial year in which the statement is filed.
- For the purposes of processing of statements, the Board may make a scheme for centralised processing of statements of tax deducted at source to expeditiously determine the tax payable by or refundable to the deductor.

An incorrect claim apparent from any information in the statement shall mean a claim, on the basis of an entry, in the statement:

(i) of an item, which is inconsistent with another entry of the same or some other item in such statement;

(ii) in respect of rate of deduction of tax at source, where such rate is not in accordance with the provisions of this Act;

TAX DEDUCTION AND COLLECTION ACCOUNT NUMBER [SECTION 203A]

Every person, deducting tax or collecting tax, who has not been allotted a tax-deduction account number or tax- collection account number, shall within specified time, apply to the Assessing Officer for the allotment of a "tax- deduction and collection-account number" in Form 49B. Where such number has been allotted to a person, such person shall quote such number –

a. in all challans for the payment of tax deducted or collected;

b. in all certificates furnished u/s 203 or section 206C(5);

c. in all the statements prepared and delivered u/s 200(3) or 206C(3);

d. in all the returns delivered u/s 206 or 206C(5A) or (5B) to any income-tax authority; and

e. in all other documents pertaining to such transactions as may be prescribed in the interests of revenue.

Note: The section is not applicable to the person deducting tax u/s 194-IA or 194-IB.

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 Rs. 40,000, where the payer is a banking company or a co-operative society, and Rs. 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.

Note: The above section has been substituted with effect from 1st September, 2019 to enable online filing of such statements (where tax has not been deducted on payment of interest to residents) in the prescribed form and manner. Prior to this date, the section provided for filing of such statements on a floppy, diskette, magnetic tape, CD-ROM or any other computer readable media. The new section also provides for correction of such statements to rectify a mistake or to add, delete or update the information furnished. Consequential amendment arising out of increased in threshold limit for TDS on payment of interest by a banking company or co- operative society to Rs. 40,000 has also been made.

REQUIREMENT TO FURNISH PERMANENT ACCOUNT NUMBER [SECTION 206AA]

- Any person entitled to receive any sum or income or amount, on which tax is deductible (hereafter referred to as deductee) shall furnish his Permanent Account Number (PAN) to the person responsible for deducting such tax (hereafter referred to as deductor), failing which tax shall be deducted at the higher of the following rates:
  - (i) at the rate specified in the relevant provision of this Act; or
  - (ii) at the rate or rates in force; or
  - (iii) at the rate of 20%.
- No declaration u/s 197A shall be valid unless the person furnishes his Permanent Account Number in such declaration.
- In case any declaration becomes invalid, the deductor shall deduct the tax at source accordingly.
- No certificate u/s 197 shall be granted unless the application made for the purpose contains the Permanent Account Number of the applicant.
- The deductee shall furnish his Permanent Account Number to the deductor and both shall indicate the same in all the correspondence, bills, vouchers and other documents which are sent to each other.
- Where the Permanent Account Number provided to the deductor is invalid or does not belong to the deductee, it shall be deemed that the deductee has not furnished his Permanent Account Number to the deductor.
- In the case of a non-resident, not being a company, or a foreign company and not having PAN, the provisions of sec. 206AA shall not apply in respect of payments in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset, if the deductee furnishes the specified details and the documents to the deductor [Notification 53 dated 24-06-2016]

ELECTRONIC-PAYMENT OF TAX [RULE 125]

The following persons shall pay tax electronically:

(i) a company; and

(ii) a person (other than a company), to whom provisions of section 44AB (tax audit) are applicable.

Direct Payment [Section 191]

In the case of income in respect of which provision is not made for deducting income-tax at the time of payment; Income-tax has not been deducted in accordance with the provisions of this Chapter, tax shall be payable by the assessee direct.

If any person, including the principal officer of a company:

(a) who is required to deduct any sum in accordance with the provisions of this Act; or

(b) referred to in section 192(1A), being an employer,

does not deduct, or after so deducting fails to pay, or does not pay, the whole or any part of the tax, as required by or under this Act, then, such person shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default. [Section 201(1)].

Exception

First proviso to section 201(1) states that the payer is not deemed as an assessee in default:

- **i.** Such resident recipient has furnished his return of income u/s 139
- **ii.** Such resident recipient has taken into account such sum for computing income in such return of income; and
- **iii.** Such resident recipient has paid the tax due on the income declared by him in such return of income,
- **iv.** The payer furnishes a prescribed certificate [Form No. 26A] to this effect from a chartered accountant

No penalty shall be charged u/s 221 from such person, principal officer or company unless the Assessing Officer is satisfied that such person or principal officer or company, as the case may be, has without good and sufficient reasons failed to deduct and pay the tax. [Second Proviso to Section 201(1)]

TDS is to be deducted on amount excluding GST component: Wherever in terms of the agreement/contract between the payer and the payee, the GST component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source under Chapter XVII-B of the Act on the amount paid/ payable without including such GST component.

TAX COLLECTION AT SOURCE

1. Every seller, shall collect tax from the buyer of any specified goods, at the time of Debiting the amount payable by the buyer to the account of the buyer; or Receipt of such amount from the buyer, whichever is earlier.
2. 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
   - mine or quarry excluding mines or quarrying of mineral oil (mineral oil includes Petroleum and Natural gas), 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 purpose of business shall collect tax from the licensee or lessee at the time of:
   - Debiting the amount payable by the licensee or lessee to the account of the licensee or lessee; or
   - Receipt of such amount from the licensee or lessee, - whichever is earlier.

Here,

"Seller" means - (a) The Central Government; or (b) State Government; or (c) Local authority; or (d) Statutory corporation; or (e) Authority established by or under a Central, State or Provincial Act; or (f) Company; or (g) Firm; or (h) Co-operative society; or (i) An individual or HUF, whose books of account are required to be audited u/s 44AB during the financial year immediately preceding the financial year in which such goods are sold.

"Buyer" (for specified goods other than motor car) means a person who obtains in any sale (by way of auction, tender or any other mode) specified goods or the right to receive any such goods but does not include, — (i)

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 (ii) A buyer in the retail sale of such goods purchased by him for personal consumption.

Buyer in case of motor car means a person who obtains in any sale, motor care, 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

"Specified goods" includes: **(i)** Alcoholic Liquor for human consumption **(ii)** Tendu leaves; **(iii)** Timber; **(iv)** Any forest-produce; **(v)** Scrap. **(vi)** Specified minerals i.e., coal, lignite and iron-ore **(vii)** Motor car value of which exceeds Rs. 10 lakhs

Rate of TCS

Case 1

Particulars	**Rate as a % of the amount payable by the buyer or licensee or lessee***
Alcoholic liquor for human consumption	1%
Tendu leaves	5%
Timber obtained under a forest lease	2.5%
Timber obtained by any mode other than under a forest lease	2.5%
Any other forest produce (not being timber or tendu leaves)	2.5%
Scrap	1%
Specified minerals	1%
Motor car value of which exceeds Rs. 10 lakh	1%
Parking lot, toll plaza, mining and quarrying	2%

* However, where the purchaser or licensee or lessee is a non-resident non-corporate assessee or a non-domestic company, then surcharge (if any applicable), Health & Education Cess is also required to be deducted alongwith aforesaid rates.

Note: "Scrap" means 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.

Case 2:- Authorised dealer receiving from a buyer for remittance out of India and seller of an overseas tour program package from a buyer shall, 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, collect from the buyer **(As amended by Finance Act, 2020 this TCS** will be effective from 1st October, 2020)**:**

a. TCS @ 5% for amount exceeding Rs. 7 Lacs in a financial year and is for a purpose other than purchase of overseas tour program package. The tour operator shall collect TCS on the entire sum as there is no threshold limit for him.

b. TCS @ 0.5% if the amount exceeding Rs. 7 Lacs being remitted out is a loan obtained from any financial institution as defined in section 80E, for the purpose of pursuing any education.

c. TCS@ 10% if no PAN or Aadhaar is furnished

Note: The authorised dealer shall not collect the sum on an amount in respect of which the sum has been collected by the seller.Provisions of this sub-section shall not apply, if the buyer is liable to deduct tax at source under any other provision of this Act and has deducted such amount.

Case 3: A seller, who receives consideration for sale of any goods of the aggregate value exceeding Rs. 50 Lacs in any previous year, other than the goods being exported out of India or goods covered elsewhere under this section, at the time of receipt of such amount, collect from the buyer TCS @ 0.1 % of the sale consideration exceeding Rs 50 Lacs. **(As amended by Finance Act, 2020)**

TCS@ 10% if no PAN or Aadhaar is furnished by the buyer.

Note:

a. The provisions of this sub-section shall not apply, if the buyer is liable to deduct tax at source under any other provision of this Act on the goods purchased by him from the seller and has deducted such amount.

b. Buyer does not include Central Government, a State Government, a local authority a person importing goods into India.

c. Seller means a person whose total sales, gross receipts or turnover from the business carried on by him exceed 10 Crore rupees during the financial year immediately preceding the financial year in which the sale of goods is carried out.

REQUIREMENT TO FURNISH PAN BY COLLECTEE [SECTION 206CC]

Any person paying any sum, on which tax is collectible at source shall furnish his PAN to the person responsible for collecting such tax, failing which tax shall be collected at the higher of the following rates: (i) at twice of the specified TCS rate; or (ii) at the rate of 5%.

Where the PAN provided is invalid or does not belong to the collectee, it shall be deemed that the collectee has not furnished his PAN to the collector.

Exception The provisions of higher rate shall not be applicable to a non-resident who does not have permanent establishment in India.

CBDT Clarification relating to certain issues with respect to section 206C(1F)

These amendments in section 206C have given rise to certain issues relating to the scope and applicability of the provisions. Accordingly, the CBDT has, vide Circular No. 22/2016 dated 8.6.2016 and Circular No.23/2016 dated 24.6.2016, clarified the following issues in "Question & Answer (Q&A)" format.

Whether TCS @ 1% is on sale of motor vehicle at 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 Rs. 10 lakhs. This is brought to cover all transactions of retail sales and accordingly, it will not apply on sale of motor vehicles by manufacturers to dealers/distributors.

Whether TCS @ 1% on sale of motor vehicle is applicable only to luxury cars?

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 Rs. 10 lakhs.

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?

Government, institutions notified under 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 sub-section (IF) of section 206C.

Whether TCS is applicable on each sale of motor vehicle or on aggregate value of sale during the year?

Tax is to be collected at source@1% on sale consideration of a motor vehicle exceeding Rs. 10 lakhs. It is applicable to each sale and not to aggregate value of sale made during the year.

Whether TCS @ 1% on sale of motor vehicle is applicable in case of an individual?

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.

Accordingly, an individual who is liable to audit as per the provisions of section 44AB during the financial year immediately preceding the financial year in which the motor vehicle is sold shall be liable for collection of tax at source on sale of motor vehicle by him.

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?

The provisions of TCS on sale of motor vehicle exceeding Rs. 10 lakhs is not dependent on mode of payment. Any sale of motor vehicle exceeding Rs. 10 lakhs would attract TCS@1%.

ADVANCE TAX

Generally, tax on the income earned in the previous year is paid in the respective assessment year, but in certain cases, an assessee may be required to pay tax during the previous year itself, as Advance tax. The scheme of advance tax is based on the concept "Pay as you earn". Under this scheme assessee needs to estimate its income and tax liability of the previous year and pay tax on basis of such estimation in the previous year itself. For instance, income earned during the previous year 2019-20 is normally taxable in the assessment year 2020-21, however under the scheme of Advance tax, assessee is required to pay tax on estimated income of previous year 2019-20 in the previous year itself.

Scheme of Advance tax [Section 208]

The Advance Tax is applicable on all assessee irrespective of his residential status and citizenship.

Where the advance tax liability of the assessee is Rs 10,000 or more, the assessee should pay such tax in the previous year itself within the due date.

Advance tax liability [Section 209]

PARTICULARS	AMOUNT
Estimated Gross Total Income [other than income covered u/s 44AD]	****
Less: Deduction under chapter VIA	****
Estimated Total Income	****

Gross tax liability on Estimated Total Income	****
Less: Rebate u/s 87A	****
Tax liability after Rebate	****
Add: Surcharge (if applicable)	****
Tax and surcharge payable	****
Add: Health & Education cess	****
Tax liability after Cess	****
Less: Tax deducted or collected at source / other Rebate & Relief	****
ADVANCE TAX LIABILITY	****

Due date for payment of Advance Tax [Section 211]

Assessee	Due date of installment (of previous year)	Minimum amount payable
An eligible assessee in respect of an eligible business referred to in sec. 44AD or 44ADA	On or before March 15	100% of advance tax liability
Other Assessee	On or before June 15	Upto 15% of advance tax liability
	On or before September 15	Upto 45% of advance tax liability
	On or before December 15	Upto 75% of advance tax liability
	On or before March 15	Upto 100% of advance tax liability

Additional points:

(a) Any amount paid u/s 211 on or before 31st March of the previous year, shall be treated as advance tax paid during the financial year.

(b) Where an assessee is a senior citizen (or super senior citizen) and does not have any income chargeable under the head "Profits and gains of business or profession", provision of advance tax is not applicable. In other words, senior citizen not having business income is not liable to pay advance tax irrespective of the amount of tax liability.

(c) Every income including capital gain, winning from lotteries, etc. is subject to advance tax. However, it is not possible to estimate capital gain or casual gain or where income under the head "Profits and gains of business or profession" accrues or arises for the first time, therefore, where the assessee has paid the whole of the amount of tax payable in respect of such income:

1. As part of the remaining instalments of advance tax which were due; or
2. Where no instalments were due, by March 31 of the financial year immediately preceding the assessment year,

   - then it is deemed that all the provisions are complied.

(d) While calculating advance tax, net agricultural income shall also be taken into consideration for computing tax liability.

(e) If any assessee does not pay any instalment within due date he shall be deemed to be an assessee in default [Sec. 218]

(f) Any sum, other than a penalty or interest, paid by an assessee as advance tax shall be treated as a payment of tax and credit for such shall be given to the assessee in the regular assessment [Sec. 219]

NOTE: Nowadays due to tailor made Tax Assessment Software, all the above points are due taken care "by default". Even the Forms available on Income Tax Department Website (https://www.incometaxindiaefiling.gov.in), these provisions are taken care while computing tax liability.

ADVANCE TAX

A. On assessee's own motion [Section 210(1)]

Procedure for 1st installment

1. Make an estimate of current year's income (excluding income covered u/s 44AD or 44ADA), considering brought-forward losses, after deducting all allowable deductions under chapter VIA.

   Note: The estimate is not required to be filed with the tax authorities.

2. Compute the tax liability on above estimated income at the rates in force during the financial year and reduce rebate, If any.
3. Add surcharge (if applicable).
4. Add Health & Education Cess.
5. Deduct tax deducted or collected at source.
6. The amount so derived is the advance tax payable.

Where the advance tax payable is Rs. 10,000 or more, an appropriate percentage thereof should be deposited.

Procedure for subsequent installments

1. Check if estimate of income made earlier requires revision.
2. If not, deposit appropriate amount of second, third or fourth installment of advance tax.
3. If estimate of income needs revision then make a revised estimate and compute tax liability thereon.
4. Determine advance tax payable in subsequent installments after deducting amount paid in earlier installments.
5. Deposit such advance tax.

B. On receipt of order from the Assessing Officer [Section 210(3) or (4)]

The A.O. may pass an order and issue a notice of demand u/s 156 requiring the assessee to pay advance tax. Such order can be issued even if assessee has paid any instalment of advance tax during the year, which is, in the opinion of the Assessing Officer, not as per provision of section 211.

The amount determined by the Assessing Officer shall be the higher of the following –

- Tax on latest assessed income as per regular assessment; or
- Tax on income declared by the assessee in the return relating to the previous year subsequent to the previous year for which regular assessment has been made.

As per section 210(4), Assessing Officer can revise his order to pay advance tax at any time before 1st March of the relevant previous year.

Interest on non-payment of advance tax

Where an assessee fails to pay advance tax or defers the payment of advance tax on specified date, he shall be liable to pay interest u/s 234B & 234C.

Interest for defaults in payment of advance tax [Section 234B]

(1) Interest under section 234B is attracted for non-payment of advance tax or payment of advance tax of an amount less than 90% of assessed tax.

(2) The interest liability would be 1% per month or part of the month from 1st April following the F.Y. upto the date of determination of total income under section 143(1) and where regular assessment is made, upto the date of such regular assessment.

(3) Such interest is calculated on the amount of difference between the assessed tax and the advance tax paid.

(4) "Assessed tax" means the tax on total income determined u/s 143(1)/under regular assessment, as the case may be, less TDS & TCS, any relief of tax allowed u/s 89, any tax credit allowed to be set off in accordance with the provisions of section 115JD.

(5) Where self-assessment tax is paid by the assessee under section 140A or otherwise, interest shall be calculated upto the date of payment of such tax and reduced by the interest, if any, paid under section 140A towards the interest chargeable under this section.

Interest for deferment of advance tax [Section 234C]

(a) Manner of computation of interest u/s 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 u/s 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) below is less than the specified percentage [given in column (2) below] 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 u/s 234C.

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, as the case may be, 36% of the tax due on the returned income, then, the assessee shall not be liable to pay any interest on the amount of the shortfall on those dates.

Tax due on returned income = Tax chargeable on total income declared in the return of income – TDS – TCS - **any relief of tax allowed u/s 89** - any tax credit allowed to be set off in accordance with the provisions of section 115JD

(b) 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 provisions of section 44AD(1) or section 44ADA(1), who is liable to pay advance tax u/s 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 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.

(c) 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 –

(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) income of the nature referred to in section 115BBDA(1) i.e., dividend in aggregate exceeding of Rs. 10 lakhs including in the assessee’s total income.

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) and (iv), as the case may be, had such income been a part of the total income, as part of

Illustration 1

Find out the amount of advance tax payable by Mr. A on specified dates under the Income tax Act, 1961 for the financial Year 2020-21:

Business income	Rs 4,00,000
Long term capital gain on 31-5-2020	Rs 60,000
Winning from lotteries on 17-6-2020	Rs 50,000
(If the date of winning from lotteries is 31-03-2021)*	
Interest on loan	Rs 10,000
Other income	Rs 5,000
Investment in notified Equity Shares	Rs 10,000
Tax deducted at source:	
Case 1	Rs. 29,000
Case 2	Rs. 14,000

Solution

Computation of total income of Mr. A for the previous year 2020-21

Particulars	**Details**	**Amount**
Profits and gains of business or profession		4,00,000
Capital gains: Long term capital gains		60,000
Income from other sources		
Winning from lotteries	50,000	
Interest on loan	10,000	
Other income	5,000	65,000
Gross Total Income		5,25,000
Less: Deduction u/s 80C		(10,000)
Total Income		5,15,000

Computation of tax liability of Mr. A for the previous year 2020-21

Income	**Case 1**	**Case 2**
Long term capital gain (Rs 60,000 @ 20%)	12,000	12,000
Winning from lotteries (Rs 50,000 @ 30%)	15,000	15,000
Balance income (Rs 4,05,000)	7,750	7,750
Tax	34,750	34,750
Less: Rebate u/s 87A	Nil	Nil
Total Tax	34,750	34,750
Add: Health & Education Cess @ 4%	1,390	1,390
Total tax including cess	36,140	36,140
Less: Tax Deducted at Source	29,000	14,000
Total Advance tax payable	7,140	22,140

Advance tax to be paid on specified dates:

Case 1: Since amount of advance tax payable is less than Rs 10,000, assessee is not liable to pay advance tax.

Case 2:

Date	**Alternate 1**		**Alternate 2**	
	Working	**Amount**	**Working**	**Amount**
15-06-2020	15% of Rs 22,140	3,321	15% of Rs 22,140	3,321
15-09-2020	30% of Rs 22,140	6,642	[(45% of Rs 22,140) – Rs 3,321]	6,642
15-12-2020	30% of Rs 22,140	6,642	[(75% of Rs 22,140) – (Rs 3,321 + Rs 6,642)]	6,642

15-03-2021	25% of Rs 22,140	5,535	[100% of Rs 22,140 – (Rs 3,321 + Rs 6,642 + Rs 6,642)]	5,535
	Total	**22,140**	**Total**	**22,140**

*If the date of Winning from Lotteries is 31-03-2021:

In such cases, the assessee cannot pre-estimate his income, hence advance tax on winning from lotteries if earned on later quarters then it shall be paid as advance tax from those respective quarters itself.

Note: The solution has been made assuming the assessee has not opted to pay tax under section 115BAC of the Income tax Act, 1961.

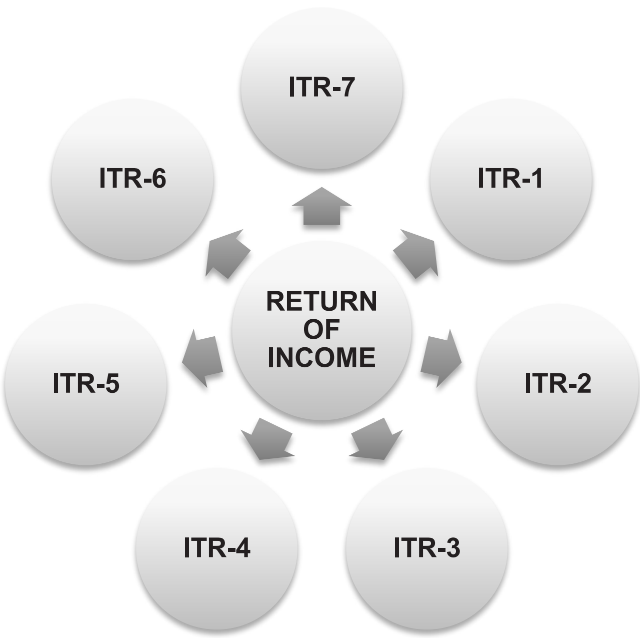
RETURNS

INTRODUCTION

Every person:

a) Being a company or a firm; or

b) Being a person other than a company or a firm, if his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax, shall, on or before the due date, furnish a return of his income or the income of such other person during the previous year, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed – [Section 139(1)]



Compulsory filing of return

(1) Any person, being resident other than not ordinarily resident, shall furnish, a return, within due date, in respect of his income or loss for the previous year irrespective of the fact that his total income does not exceed basic exemption limit or does not have any taxable income, if he:

(i) holds, as a beneficial owner or otherwise, any asset (including any financial interest in any entity) located outside India or has signing authority in any account located outside India; or

(ii) is a beneficiary of any asset (including any financial interest in any entity) located outside India.

Exception**:** An individual, being a beneficiary of any asset (including any financial interest in any entity) located outside India where, income, if any, arising from such asset is includible in the income of the person referred above in accordance with the provisions of this Act.

- "Beneficial owner" in respect of an asset means an individual who has provided, directly or indirectly, consideration for the asset for the immediate or future benefit, direct or indirect, of himself or any other person.
- "Beneficiary" in respect of an asset means an individual who derives benefit from the asset during the previous year and the consideration for such asset has been provided by any person other than such beneficiary.

(2) A person referred, who is not required to furnish a return u/s 139(1), and who during the previous year—

(i) has deposited an amount or aggregate of the amounts exceeding one crore rupees in one or more current accounts maintained with a banking company or a co-operative bank; or

(ii) has incurred expenditure of an amount or aggregate of the amounts exceeding two lakh rupees for himself or any other person for travel to a foreign country; or

(iii) has incurred expenditure of an amount or aggregate of the amounts exceeding one lakh rupees towards consumption of electricity; or

(iv) fulfils such other conditions as may be prescribed, shall furnish a return of his income on or before the due date in such form and verified in such manner and setting forth such other particulars, as may be prescribed.

It is further provided that a person who is claiming such rollover benefits on investment in a house or a bond or other assets, under sections 54, 54B, 54D, 54EC, 54F, 54G, 54GA and 54GB of the Act, shall necessarily be required to furnish a return, if before claim of the rollover benefits, his total income is more than the maximum amount not chargeable to tax. [**Inserted by Finance (No.2) Act, 2019]**

FORMS – RETURN OF INCOME

Rule 12 provides following Form for filing return of income for different assessee:

ITR - 1 (Sahaj) For Individuals being a resident other than not ordinarily resident having income from Salaries, one house property, other sources (Interest etc) and having total income upto Rs. 50 lakh

ITR - 2 For Individuals and HUFs not having income from profits and gains of business or profession.

ITR - 3 For individuals and HUFs having income from profits and gains of business or profession

ITR - 4 (Sugam) For presumptive income from Business & Profession

ITR - 5 For person other than (i) Individual; (ii) HUF; (iii) Company; & (iv) Person filing Form ITR-7

ITR - 6 For Companies other than companies claiming exemption u/s 11

ITR - 7 For persons including companies required to furnish return u/s 139(4A) or 139(4B) or 139(4C) or 139(4D) or 139(4F)

TIME LIMIT FOR FILING RETURN OF INCOME [EXPLANATION 2 TO SECTION 139(1)]

A return should be filed on or before the following due date (of respective assessment year):

Assessee	Due date
● Where the assessee is required to furnish a report in Form 3CEB u/s 92E pertaining to international transaction(s)	30th November
● Where the assessee is a company not having international transaction(s)	30th October
● *Any other assessee*	
- Where accounts of the assessee are required to be audited under any law	30th October
- Where the assessee is a *working partner* in a firm and the accounts of the firm are required to be audited under any law	30th October
- In any other case	31st July

FEE FOR DEFAULT IN FURNISHING RETURN OF INCOME [SECTION 234F]

Where a person required to furnish a return of income u/s, fails to do so within the due date, he shall pay fee of:

Case	Fee
Total income does not exceed Rs 5 lakh	Rs 1,000
Total income exceeds Rs 5 lakhs	
- If the return is furnished on or before 31st December of the assessment year	Rs 5,000
- In any other case	Rs 10,000

SPECIFIED CLASS OR CLASSES OF PERSONS TO BE EXEMPTED FROM FILING RETURN OF INCOME [SECTION 139(1C)]

(1) Under section 139(1), every person has to furnish a return of his income on or before the due date, if his total income exceeds the basic exemption limit.

(2) For reducing the compliance burden of small 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. S.O.2672(E) dated 26.7.2019, 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.2020-21 onwards.

The exemption from filing return of income would be available to such class of persons only if 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 tax-return.

Also, the exemption from the requirement of furnishing a return of income shall not be available to the said class of persons where a notice under section 142(1) or section 148 or section 153A or section 153C has been issued for filing a return of income for the assessment year specified therein.

For this purpose, “investment fund” means 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 made under the SEBI Act, 1992.

WHEN A RETURN OF LOSS SHOULD BE FILED [SECTION 139(3)]

An assessee, other than few, is not compulsorily required to furnish return of loss. However, the following losses cannot be carried forward if the return of loss is not submitted within the time allowed u/s 139(1) –

a. Business loss (speculative or otherwise)u/s 72(1) and 73(2);

b. Capital loss u/s 74)(1);

c. Loss from the activity of owning and maintaining race horses u/s 74A(3)

d. Loss from business specified u/s 35AD u/s 73A(2)

Points to be noted:

a. Loss declared in belated return cannot be carried forward. However, set-off of losses of current year is not prohibited while computing the total income, even if the return of loss is filed after the due date.

b. Delay in filing the return of loss may be condoned in certain cases

c. Unabsorbed depreciation u/s 32 and loss under the head "Income from house property" can be carried forward even if the loss return is filed after the due date u/s 139(1).

d. Although the loss of the current year cannot be carried forward unless the return of loss is submitted before the due date but the loss of earlier years can be carried forward if the return of loss of that year was submitted within the due date.

BELATED RETURN [SECTION 139(4)]

If an assessee fails to file return within the time limit allowed u/s 139(1) or within the time allowed under a notice issued u/s 142(1), he can file a belated return.

Assessee may file such return –

- before the end of the relevant assessment year; or
- before the completion of assessment (u/s 144),
  - whichever is earlier.

However, if an assessee files a belated return, he would be liable to fee u/s 234F and interest u/s 234A.

RETURN OF INCOME OF CHARITABLE TRUST [SECTION 139(4A)]

Every person who is in receipt of –

- income from property held under the trust or other legal obligation wholly or partly for charitable or religious purpose; or
- income by way of voluntary contribution on behalf of such trust or institution, and if such income before allowing exemption u/s 11 or 12 exceeds the maximum amount which is not chargeable to tax, must file a return before the due date as per section 139(1).

Where an assessee fails to file return of income under this section, within the time limit, it shall be liable to pay a penalty of Rs. 100 per day during which such failure continues [Section 272A(2)]

RETURN OF INCOME OF POLITICAL PARTY [SECTION 139(4B)]

The chief executive officer (whether such chief executive officer is known as Secretary or by any other designation) of any political party is required to furnish a return in respect of income of such political party, if the amount of gross total income before allowing exemption u/s 13A exceeds the maximum amount not chargeable to tax.

RETURN OF INCOME OF SCIENTIFIC RESEARCH ASSOCIATION, ETC. [SECTION 139(4C)]

Every –

- Research Association referred to in section 10(21);
- News agency referred to in section 10(22B);
- Association or institution referred to in section 10(23A) or section 10(23B);
- Specified Employee Welfare Fund referred to in section 10(23AAA);
- Any university or other educational institution referred to in section 10(23C)(iiiad) or (iiiab);
- Any hospital or other medical institution referred to in section 10(23C)(iiiae) or (iiiac);
- Fund or institution referred to in section 10(23C)(iv);
- Trust or institution referred to in section 10(23C)(v);
- Any university or other educational institution referred to in section 10(23C)(vi);
- Any hospital or other medical institution referred to in section 10(23C)(via);
- Mutual Fund referred to in section 10(23D);
- Securitisation trust referred to in section 10(23DA);
- Investor Protection Fund referred to in section 10(23EC) or section 10(23ED);
- Core Settlement Guarantee Fund referred to in section 10(23EE);
- Venture Capital Company or Venture Capital Fund referred to in section 10(23FB);
- Trade union or an association of such union referred to in section 10(24);
- Body or authority or Board or Trust or Commission referred to in section 10(46) or 10(29A);
- Infrastructure debt fund referred to in sec. 10(47), must file a return, if the total income without giving effect to the provisions of sec. 10, exceeds the maximum amount which is not chargeable to income-tax.

Penalty: Where an assessee fails to file return of income under this section, within the time limit, it shall be liable to pay a penalty of Rs 100 per day during which such failure continues [Section 272A(2)].

RETURN OF INCOME BY A UNIVERSITY/ COLLEGE ETC. [SECTION 139(4D)]

Every University, college or other institutions referred to in sec. 35(1)(ii) or (iii) is required to furnish a return in respect of income or loss irrespective of size of income or loss.

RETURN OF INCOME OF A BUSINESS TRUST [SECTION 139(4E)]

Every business trust, which is not required to furnish return of income or loss under any other provisions of this section, shall furnish the return of its income in respect of its income or loss in every previous year and all the provisions of this Act shall, so far as may be, apply if it were a return required to be furnished u/s 139(1).

RETURN OF INCOME OF INVESTMENT FUND [SECTION 139(4F)]

Every investment fund referred to in sec. 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 its income or loss in every previous year and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished u/s 139(1)

REVISED RETURN [SECTION 139(5)]

If an assessee discovers any omission or wrong statement (bonafide in nature) in the return filed, he can revise his return u/s 139(5).

Time limit: Assessee may file the revised return –

- before the end of the relevant assessment year; or
- before completion of regular assessment,
  - whichever is earlier.

Points to be noted:

a) **Replacement of original return:** Once a revised return is filed, it replaces the earlier return. This signifies that the revised return should be complete in itself and not merely an accessory to the original return.

b) **Revision of revised return:** A revised return can again be revised i.e. a second revised return can be filed u/s 139(5) for correcting any omission or wrong statement made in the first revised return within specified time.

c) **Revision of belated return:** A belated return u/s 139(4) can be revised.

d) **Revision of loss return:** A loss return can be revised

e) Return filed pursuant to notice u/s 142(1) cannot be revised.

DEFECTIVE RETURN [SECTION 139(9)]

When a return is termed defective - A return of income is said to be defective where all the following conditions are not fulfilled:

- The return is furnished without paying self-assessment tax along with interest, if any.
- The annexure, statements and columns in the return of income have been duly filled in.
- The return is accompanied by the following documents –

  a. a statement showing the computation of tax liability;

  b. the audit report u/s 44AB (where the report has been submitted prior to the furnishing of return, a copy of audit report together with proof of furnishing the report);

  c. the proof of tax deducted or collected at source, advance tax paid and tax paid on self-assessment;

  d. where regular books of account are maintained by the assessee:

    i. copies of Manufacturing A/c, Trading A/c, Profit and Loss A/c or Income and Expenditure A/c or any other similar account and Balance Sheet;

    ii. in the case of –

      ♦ A proprietary business or profession - the personal account of the proprietor;

      ♦ A firm, AOP or BOI - personal account of the partners or members; or

      ♦ A partner or member of the firm, AOP or BOI - his personal account in the firm, association of persons or body of individuals;

  where regular books of account are not maintained by the assessee –

e. where regular books of account are not maintained by the assessee:

i. a statement indicating the amount of turnover or gross receipts, gross profit, expenses and net profit of the business or profession and the basis on which such amount have been computed; and

ii. the amount of sundry debtors, sundry creditors, stock and cash balance as at the end of the previous year.

f. where the accounts of the assessee have been audited, copies of the audited Profit and Loss A/c, Balance Sheet and a copy of the Auditor's report;

g. Cost audit report u/s 233B of the Companies Act, 1956 (if any).

Time limit for rectification: The assessee must rectify the error within a period of 15 days from the date of intimation (served on the assessee) or within such extended time as allowed by the Assessing Officer. Where the taxpayer rectifies the defect after the expiry of the period of 15 days or such extended period but before the assessment is completed, the Assessing Officer can condone such delay.

Consequence when defect is not rectified: If defect is not rectified within the time limit, the Assessing Officer will treat the return as an invalid return and provisions of the Act will apply as if the taxpayer had failed to furnish the return at all.

PERMANENT ACCOUNT NUMBER (PAN) [SECTION 139A]

(1) 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 previous year exceeds the maximum amount which is not chargeable to income-tax	On or before 31st May of the assessment year for which such income is assessable
(ii)	Every person carrying on any business or profession whose total sales, turnover or gross receipts are or is likely to exceed Rs. 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 Rs. 2,50,000 or more in a financial year	On or before 31st May of the immediately following financial year

(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 (iv) 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 (inserted w.e.f. 1.9.2019)

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 is force. Such persons are required to apply within such time as may be mentioned in that notification to the Assessing Officer for the allotment of a PAN [Sub-section (1A)].

(2) 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)].

(3) 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)].

(4) 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.

(5) Such PAN comprises of 10 alphanumeric characters.

(6) Quoting of PAN is mandatory in all documents pertaining to the following prescribed transactions:

(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 notified the following transactions, namely:

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 Rs. 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 Rs. 50,000.
7.	Payment to a Mutual Fund for purchase of its units	Amount exceeding Rs. 50,000.
8.	Payment to a company or an institution for acquiring debentures or bonds issued by it.	Amount exceeding Rs. 50,000.
9.	Payment to the Reserve Bank of India for acquiring bonds issued by it.	Amount exceeding Rs. 50,000.
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 Rs. 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 Rs. 50,000 during any one day.
12.	A time 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); – a Post Office; – a Nidhi referred to in section 406 of the Companies Act, 2013; or – 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 Rs. 50,000 or aggregating to more than Rs. 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 in section 51 of that Act) or to any other company or institution.	Payment in cash or by way of a bank draft or pay order or banker's cheque of an amount aggregating to more than Rs. 50,000 in a financial year.

14.	Payment as life insurance premium to an insurer as defined in the Insurance Act, 1938.	Amount aggregating to more than Rs. 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 Rs. 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 Rs. 1 lakh per transaction.
17.	Sale or purchase of any immovable property.	Amount exceeding Rs. 10 lakh or valued by stamp valuation authority referred to in section 50C at an amount exceeding Rs. 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 Rs. 2 lakh per transaction.

Inter-changeability of PAN & Aadhaar and Mandatory Quoting in Prescribed Transactions

To ensure ease of compliance, it is provided for inter-changeability of PAN with the Aadhaar number. Accordingly the provisions of section 139A is amended so as to provide that,-

i. every person who is required to furnish or intimate or quote his PAN under the Act, and who, has not been allotted a PAN but possesses the Aadhaar number, may furnish or intimate or quote his Aadhaar number in lieu of PAN, and such person shall be allotted a PAN in the prescribed manner;

every person who has been allotted a PAN, and who has linked his Aadhaar number under section 139AA, may furnish or intimate or quote his Aadhaar number in lieu of a PAN.

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	Rs. 10,000
272B(2)	Failure to quote PAN/Aadhaar number in any document referred to in section 139A(5)(c)	Rs. 10,000 for each such default
	Failure to intimate PAN/Aadhaar number as required by section 139A(5A)/(5C)	
	Knowingly quoting or intimating a number which is false	
272B(2A) inserted w.e.f. 1.9.2019	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	Rs. 10,000 for each such default
272B(2B) inserted w.e.f. 1.9.2019	(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)	Rs. 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.		

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 –

(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) a chartered accountant. an employee of the 'specified class or classes of persons'.

(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,

(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	An individual, who holds a bachelor degree from a recognised Indian University or institution, or has passed the intermediate
Return Preparers	level examination conducted by the Institute of Chartered Accountants of India or the Institute of Company Secretaries of India or the Institute of Cost 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: 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.

VERIFICATION OF RETURN [SECTION 140]

The return of income is required to be verified:

Assessee	Case	Verified by
Individual	In general	Individual himself
	Where the individual concerned is absent from India	Individual himself or by the duly authorized person of such individual
	Where the individual is mentally incapacitated	Guardian of such individual or any other person competent to act on his behalf
	Where by any other reason it is not possible for the individual to verify the return.	Any person duly authorised by him
	Note: When return is verified by any authorised person in that case the return should be accompanied with power of attorney.	

HUF	In general	Karta
	Where the 'karta' is absent from India or is mentally incapacitated	Any adult member of the family.
Firm	In general	Managing partner
	If due to any reason it is not possible for managing partner to verify or where there is no managing partner	Any adult partner
Limited liability partnership	In general	Designated partner
	If due to any unavoidable reason such designated partner is not able to verify the return, or where there is no designated partner as such	Any partner
Local authority	Principal Officer	
Political party	Chief Executive Officer	
Company	In general	Managing Director (MD)
	If due to any reason it is not possible for MD to verify or where there is no MD	Any director
	Non-resident company	A person holding a valid power of attorney. Copy of such power of attorney must be attached with the return.
	Company in process of winding up	Liquidator of the company
	Where in respect of a company, an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority u/s or u/s 9or u/s 10 of the Insolvency and Bankruptcy Code, 2016,	Insolvency professional appointed by such Adjudicating Authority.
	"Insolvency professional" and "Adjudicating Authority" shall have the respective meanings assigned to them u/s 3(18) and u/s 5(1) of Insolvency and Bankruptcy Code, 2016 [Finance Act, 2018]	
	Where the management of the company has been taken over by the Central or State Government.	Principal officer
Any other association	Any member or principal officer	
Any other person	Such person or any other person competent to act on its behalf.	

QUOTING OF AADHAAR NUMBER [SECTION 139AA]

Every person who is eligible to obtain Aadhaar number shall quote Aadhaar number in the application form for allotment of permanent account number; and in the return of income.

Note:

- Where the person does not possess the Aadhaar Number, the Enrolment ID of Aadhaar application form issued to him at the time of enrolment shall be quoted.
- Every person who has been allotted PAN before 01-07-2017 and who is eligible to obtain Aadhaar number, shall intimate his Aadhaar number to such authority on or before specified date (31-12-2017). In case of failure to intimate the Aadhaar number, the PAN allotted to the person shall be inoperative after the date so notified in such manner as may be prescribed. **[Inserted by Finance (No. 2) Act, 2019]**
- The provisions of this section shall not apply to notified persons or State.

E-FILING

MODE OF FURNISHING INCOME-TAX RETURN

1. Paper Return
2. Electronic Return with Digital Signature
3. Transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V
4. Transmitting the data electronically in the return under electronic verification code

The table enumerates mode of filing of return of income:

Person	Condition	Mode
Company	-	Electronically with digital sign
Political Party	-	
Firm or LLP or Individual or HUF	Audit u/s 44AB required	
Resident Individual (other than not-ordinarily resident) or a resident HUF (other than not-ordinarily resident)	If he/it has: (a) assets (including financial interest in any entity) located outside India; or (b) signing authority in any account located outside India.	Electronically with or without digital sign
Any person	Claiming any relief u/s 90 or 90A or 91	
Individual or HUF	Where total income assessable during the previous year of a person: a. being an individual of the age of 80 years or more at any time during the previous year; or b. whose income does not exceed Rs. 5 lakh and no refund is claimed in the return of income, and who furnishes the return in Form No. ITR-1 or Form No. ITR-4	Any of the given mode

Any other case		Any mode other than paper mode

Steps for e-filing of Return (with offline utility)

Step 1:

Register with http://incometaxindiaefiling.gov.in. For registration, one requires following:

– Name of the assessee;

– PAN of the assessee;

– Date of birth (in case of person other than individual, date of incorporation)

– Mobile Number

– Email ID

– Password of your choice

After successful registration, remember the login credentials:

- User ID: PAN of the assessee (the ID is not case sensitive)
- Password: As provided
- Date of birth / incorporation

Step 2

Download appropriate form utility of return of income (or else one can fill the appropriate form online after login). For this, Go to the 'Downloads' located below the login button -> Click **'Offline Utilities' -> Click 'Income Tax Return Preparation Utilities'**

Step 3

Select the type of 'ITR' form depending on the types of income you have received in the financial year for which the return is to be filed -> **Click 'Download' link available under 'Excel Utility' or 'Java Utility' column**

Step 4

Extract the download ZIP file ⟶ Open the extracted ZIP file.

- For **Excel File** - Click **'Import Personal / Tax Details from XML'**, located at right side of the **'Income Details'** tab. The side buttons (like validate, Next, Calculate Tax, etc.) of the excel file will work only if 'Macros' and 'ActiveX' function of the Excel workbook is enabled.

Step 5

Attach the 'Pre-filled XML' file which has been downloaded. For Pre-filled XML file:

a) Login to 'e-Filing' Portal

b) Go to the 'My Account' menu located at upper-left side of the page -> Click 'Download Pre-filled XML'

c) Select the 'Assessment Year' and 'ITR Form Name' from the dropdown list

d) Click 'Continue' ⟶ Choose the type of details ⟶ Click 'Confirm' ⟶ Click 'Download XML'

Step 6

Attach the downloaded 'Pre-fill XML' file to populate the relevant details.

Step 7

Enter all the Mandatory Fields ⟶ Validate all the sheets ⟶ Calculate Tax

Step 8

Click 'Generate XML'

Step 9

Click 'Save XML' button to save the XML file at your desktop

Step 10

After saving the generated XML, Upload the XML file at e-Filing Website. For this follow these steps:

a) Login to 'e-Filing' Portal

b) Go to the 'e-File' menu located at upper-left side of the page ⟶ Click 'Income Tax Return'

c) Select the 'Assessment Year', 'ITR Form Name' from the dropdown list

d) Select the 'Submission Mode' as 'Upload XML' from the dropdown list

e) Choose any one of the following option to verify the Income Tax Return:

- Digital Signature Certificate (DSC). If you do not have DSC
- Aadhaar OTP
- EVC using Prevalidate Bank Account Details
- EVC using Prevalidate Demat Account Details
- Already generated EVC through My Account ⟶ Generate EVC Option or Bank ATM. Validity of such EVC is 72 hours from the time of generation
- Don't Want to e-verify this Income Tax Return and would like to send signed ITR-V to Bengaluru

f) Click 'Continue'

g) Attach the XML file at option 'Attach the ITR XML file

h) Taxpayer will get an option to enter OTP for e-verifying the ITR, if an EVC or Aadhaar OTP option is chosen.

Or

To attach DSC, if DSC option is chosen to e-verify the ITR.

Step 11

After successful submission, ITD will process your ITR and send an email confirmation stating the same

Steps for e-filing of Return Form 1 and Form 4 (online)

Step 1

Logon to 'e-Filing' Portal

Step 2

Go to the 'e-File' menu located at upper-left side of the page ⟶ Click 'Income Tax Return'

Step 3

Select the 'Assessment Year', 'ITR Form Name' from the dropdown list

Step 4

Select the 'Submission Mode' as 'Prepare and Submit Online' from the dropdown list

Step 5

Choose any one of the following option to verify the Income Tax Return:

- Digital Signature Certificate (DSC). If you do not have DSC
- Aadhaar OTP
- EVC using Prevalidate Bank Account Details
- EVC using Prevalidate Demat Account Details
- Already generated EVC through My Account ⟶ Generate EVC Option or Bank ATM. Validity of such EVC is 72 hours from the time of generation

● Don't want to e-verify this Income Tax Return and would like to send signed ITR-V to Bengaluru

Click 'Continue'

Step 6

Read the instructions ⟶ Fill in Required details While filling the details in ITR, under category 'Return Filed'

Note: Before submitting the data, kindly save the data you have entered by clicking on 'Save as Draft' to recheck any mistakes.

Step 7

Click 'Preview and Submit' button to preview your ITR from before submitting it.

Step 8

Click 'Submit'

Taxpayer will get an option to enter OTP for e-verifying the ITR, if an EVC or Aadhaar OTP option is chosen or To attach DSC, if DSC option is chosen to e-verify the ITR. After successful submission, ITD will process your ITR and send an email confirmation stating the same.

26AS Statement

The following details (on yearly basis) have been provided in 26AS statement:

- Advance tax, Self-Assessment Tax and Regular Assessment Tax paid by the assessee
- Tax paid through Tax Deducted at Source (TDS) or TCS on behalf of the assessee
- Refund issued by the Department to the assessee
- Information received from various agencies on high value transaction carried by the assessee.

Steps are required to follow to view or download 26AS statement:

Step 1	Logon to the 'e-Filing' Portal
Step 2	Go to the 'My Account' menu located at upper-left side of the page ⟶ Click 'View Form 26 AS (Tax Credit)' , User is redirected to TDS-CPC Portal
Step 3	View the disclaimer ⟶ Click 'Confirm' ⟶ Agree the acceptance of usage ⟶ Click 'Proceed'
Step 4	Click 'View Tax Credit (Form 26AS)'

Step 5	Select the 'Assessment Year' and 'View type' (HTML, Text or PDF)
Step 6	Click 'View / Download'

One can also view the 26AS statement from his banking portal.

Functionalities available at e-Filing Portal

Few of the functionalities available at e-filing portal are as follow:

- View Form 26AS
- View (with download facility) e-Filed Return / Form
- Tax Credit mismatch
- Download pre-filled XML
- e-Verify Return
- Generate EVC
- Add / Disengage CA or e-Return Intermediary
- Add / Register as Representative
- Filing of Returns
- Filing of Rectification
- Filing of return in response of notice u/s 139(9)
- Status of refund issue or status of demand
- Aadhar linking
- e-Proceedings
- Filing of appeal to CIT(Appeals)
- Registration or updation of Digital Sign
- Refund reissue request
- Validation of Bank Account or Demat Account
- Profile updation

INTEREST FOR DEFAULT IN FURNISHING RETURN OF INCOME [SECTION 234A]

Condition: Where a person, who is required to furnish return of income –

a) fails to furnish a return; or

b) furnishes it after the due date specified u/s 139(1).

On the amount of tax determined u/s 143(1) or on regular assessment as reduced by advance tax paid and tax deducted or collected at source, if any.

In other words, interest is to be calculated on the following amount:

Particulars	Amount	Amount
Tax determined u/s 143(1) or on Regular Assessment		***

Less: Advance Tax paid	***	
Relief u/s 90 or 90A or 91	***	
Credit allowed u/s 115JAA / 115JD (MAT or AMT Credit)	***	
Tax deducted/collected at source	***	***
Amount for interest calculation		***

Simple interest is calculated @ 1% per month or part thereof

For every month or part of a month commencing from the day immediately following the due date for furnishing return for the relevant assessment year and ending on –

- Where the return is furnished after due date : Date of furnishing return
- Where the return is not furnished at all : Date of completion of assessment u/s 144

The interest is to be charged on the amount by which tax on total income as per sec.147, exceeds the tax on the total income determined on the basis of earlier assessment

Commencing on the day immediately following the expiry of the time allowed under that notice and ending on –

- Where the return is furnished after the expiry of time allowed : Date of furnishing return
- Where the return is not furnished at all : Date of completion of reassessment u/s 147 or 153A

Where tax payable is reduced or increased by an order u/s 154, 155, 245D, 250, 254, 260, 262, 263 & 264, the amount of interest shall be reduced or increased accordingly.

ILLUSTRATION 1

Calculate interest u/s 234A in the following cases –

Name of the assessee	A	A Ltd.	B
Due date of furnishing return	31st July	30th September	31st July
Date of filing return	4th December	30th January	Not filed
Date of completion of assessment	1st March	15th April	15th February
Income as per return	Rs 5,80,000	Rs 5,00,000	-
Assessed Income	Rs 6,10,000	Rs 5,50,000	Rs 12,00,000
Advance tax paid	Rs 10,000	Rs 25,000	Rs 80,000
Tax deducted at source	Rs 10,000	Rs 15,000	Rs 80000
Tax paid along with return	Rs 6,000	Rs 1,50,000	-

Also state interest payable u/s 234A for the purpose of section 140A. Ignore interest under any other section.

Solution

Computation of interest u/s 234A

Particulars	Code	A	A Ltd.	B
Period of default	A#	5 months	4 months	7 months
		(Aug. to Dec.)	(Oct. to Jan.)	(Aug. to Feb.)

Assessed Income	B	6,10,000	5,50,000	12,00,000
Tax rate	C	Slab-rate	30%	Slab rate
Tax liability before surcharge	D=B×C	34,500	1,65,000	1,72,500
Rate of Surcharge	E	Nil	Nil	Nil
Surcharge	F=D×E	Nil	Nil	Nil
Tax and surcharge payable	G=D+F	34,500	1,65,000	1,72,500
Health & Education Cess	H=G×4%	1,380	6,600	6,900
Tax liability on assessed income	I=G+H	35,880	1,71,600	1,79,400
Less: Advance tax paid & tax deducted at source	J	20,000	40,000	1,60,000
Shortfall	K=I-J	15,880	1,31,600	19,400
Rounded off	L	15,800	1,31,600	19,400
Interest (1% × A × L)		790	5,264	1,358
Note: Tax paid along with return shall not be reduced while computing interest u/s 234A				

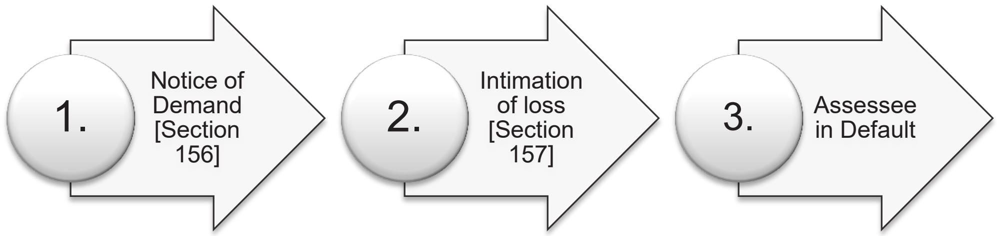
Computation of interest u/s 234A for the purpose of section 140A

Name of the assessee	Code	A	A Ltd.
Period of default	A#	5 month	4 months
		(Aug. to Dec.)	(Oct. to Jan.)
Returned Income	B	5,80,000	5,00,000
Tax rate	C	Slab-rate	30%
Tax liability before surcharge	D = B × C	28,500	1,50,000
Rate of Surcharge	E	Nil	Nil
Surcharge	F = D × E	Nil	Nil
Tax & surcharge on above	G=D+F	28,500	1,50,000
Health & Education cess	H=G×4%	1,140	6,000
Tax liability on assessed income	I=G+H	29,640	1,56,000
Less: Advance tax paid & tax deducted at source	J	20,000	40,000
Shortfall	K=I-J	9,640	1,16,000
Rounded off	L	9,600	1,16,000
Interest (1% × A × L)		480	4,640

It is to be noted that when interest is calculated on monthly basis, any fraction of the month shall be taken as full month.

Note: In case of B, return has not been filed, hence interest payable u/s 234A at the time of self-assessment cannot be computed.

COLLECTION & RECOVERY



DEMAND NOTICE [SECTION 156]

On completion of assessment, a demand notice [in Form 7] is served for additional demand raised in the assessment.

The assessee should make the payment of amount demanded within 30 days of service of notice [Section 220(1)] 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 time as may be specified by him in the notice.

On an application made by the assessee before the expiry of due date, the Assessing Officer may extend the time for payment, subject to such conditions as he may think fit to impose in the circumstances of the case.

Interest shall be payable @ 1% for every month of the delay if the payment is not made within 30 days or time specified. [Section 220(2)]

The Chief Commissioner or Commissioner may reduce or waive the amount of interest paid or payable by an assessee u/s 220(2), if he satisfied that:

a) payment of such amount has caused or would cause genuine hardship to the assessee;

b) default in the payment of the amount on which interest has been paid or was payable under the said sub-section was due to circumstances beyond the control of the assessee; and

c) the assessee has co-operated in any inquiry 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 12 months from the end of the month in which the application is received. 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.

Assessee in default [Section 220(4)]: If the amount is not paid within the time (or extended time) at the place and to the person mentioned in the said notice the assessee shall be deemed to be in default. Further, if, in a case where payment by instalments is allowed, the assessee commits default in paying any one of the instalments within the time, the assessee shall be deemed to be in default as to the whole of the amount then outstanding, and the other instalment or instalments shall be deemed to have been due on the same date as the instalment actually in default.

Exception: In the following circumstances, the assessee may not be considered as an assessee in default:

a) Where an assessee has presented an appeal u/s 246A, the Assessing Officer may, in his discretion and subject to such conditions as he may think fit to impose in the circumstances of the case, treat the assessee as not being in default in respect of the amount in dispute in the appeal, even though the time for payment has expired, as long as such appeal remains undisposed of.

b) Where an assessee has been assessed in respect of income arising outside India in a country, the laws of which prohibit or restrict the remittance of money to India, the Assessing Officer shall not treat the assessee as in default in respect of that part of the tax which is due in respect of that amount of his income which, by reason of such prohibition or restriction, cannot be brought into India, and shall continue to treat the assessee as not in default in respect of such part of the tax until the prohibition or restriction is removed.

For this purpose, income shall be deemed to have been brought into India if it has been utilised or could have been utilised for the purposes of any expenditure actually incurred by the assessee outside India or if the income, whether capitalised or not, has been brought into India in any form.

PENALTY PAYABLE WHEN TAX IN DEFAULT [SECTION 221]

When an assessee is in default or is deemed to be in default in making a payment of tax, he shall, in addition to the amount of the arrears and the amount of interest payable u/s 220(2), be liable, by way of penalty, to pay such amount as the Assessing Officer may direct, and in the case of a continuing default, such further amount or amounts as the Assessing Officer may, from time to time, direct, so, however, that the total amount of penalty does not exceed the amount of tax in arrears.

CERTIFICATE TO TAX RECOVERY OFFICER [SECTION 222]

- When an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may draw up under his signature a statement in the prescribed form (Form 57) specifying the amount of arrears due from the assessee (such statement being hereafter referred to as “certificate”) and shall proceed to recover from such assessee the amount specified in the certificate by one or more of the modes mentioned below (in accordance with the rules laid down in the Second Schedule)

    a. attachment and sale of the assessee’s movable property;

    b. attachment and sale of the assessee’s immovable property;

    c. arrest of the assessee and his detention in prison;

    d. appointing a receiver for the management of the assessee’s movable and immovable properties.

- The assessee’s movable or immovable property shall include any property which has been transferred, directly or indirectly after 31-5-1973, 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, or stands in the name of, any of the persons aforesaid. If the movable or immovable property was transferred to his minor child or his son’s minor child, it shall, even after the date of attainment of majority by such minor child or son’s minor child, as the case may be, continue to be included in the assessee’s movable or immovable property for recovering any arrears due from the assessee.

- No step in execution of a certificate shall be taken until the period of 15 days has elapsed since the date of the service of the notice. However, if the Tax Recovery Officer is satisfied that the defaulter is likely to conceal, remove or dispose of his property, he may at any time direct, for reasons to be recorded in writing, an attachment of such property.

    Further, if the defaulter whose property has been so attached furnishes security to the satisfaction of the Tax Recovery Officer, such attachment shall be cancelled from the date on which such security is accepted by the Tax Recovery Officer.

- Arrear amount includes:

  (***a***) interest upon the amount of tax or penalty or other sum to which the certificate relates as is payable in accordance with sec. 220(2); and

  (***b***) all charges incurred in respect of:

    (***i***) the service of notice and of warrants and other processes; &

    (***ii***) all other proceedings taken for realising the arrears

- The proceeds shall be disposed of in the following manner:

  (***a***) they shall first be adjusted towards the amount due under the certificate in execution of which the assets were realised and the costs incurred in the course of such execution;

  (**b**) if there remains a balance, the same shall be utilised for satisfaction of any other amount recoverable from the assessee under this Act which may be due on the date on which the assets were realised; &

  (**c**) the balance, if any, remaining after above adjustments shall be paid to the defaulter.

- The order of Tax Recovery Officer relating to the execution or discharge etc. shall be final. However, a suit may be brought in a civil court upon the ground of fraud.

- If at any time after the certificate is drawn up by the Tax Recovery Officer the defaulter dies, the proceedings (except arrest and detention) may be continued against the legal representative of the defaulter.

- An appeal from any original order passed by the Tax Recovery Officer shall lie to the Chief Commissioner or Commissioner. Such appeal must be presented within 30 days from the date of the order appealed against. Pending the decision of any appeal, execution of the certificate may be stayed if the appellate authority so directs, but not otherwise.

TAX RECOVERY OFFICER BY WHOM RECOVERY IS TO BE EFFECTED [SECTION 223]

- The Tax Recovery Officer competent to take action u/s 222 shall be:

  (a) the Tax Recovery Officer within whose jurisdiction the assessee carries on his business or profession or within whose jurisdiction the principal place of his business or profession is situate; or

  (b) the Tax Recovery Officer within whose jurisdiction the assessee resides or any movable or immovable property of the assessee is situate, the jurisdiction for this purpose being the jurisdiction assigned to the Tax Recovery Officer under the orders or directions issued by the Board, or by the Chief Commissioner or Commissioner who is authorised in this behalf by the Board in pursuance of sec. 120.

- Where an assessee has property within the jurisdiction of more than one Tax Recovery Officer and the Tax Recovery Officer by whom the certificate is drawn up:

  (a) is not able to recover the entire amount by sale of the property, movable or immovable within his jurisdiction; or

  (b) is of the opinion that, for the purpose of expediting or securing the recovery of the whole or any part of the amount, it is necessary so to do, he may send the certificate or, where only a part of the amount is to be recovered, a copy of the certificate certified in the prescribed manner and specifying the amount to be recovered to a Tax Recovery Officer within whose jurisdiction the assessee resides or has property and, thereupon, that Tax Recovery Officer shall also proceed to recover the amount as if the certificate or copy thereof had been drawn up by him.

VALIDITY OF CERTIFICATE AND CANCELLATION OR AMENDMENT THEREOF [SECTION 224]

It shall not be open to the assessee to dispute the correctness of any certificate drawn up by the Tax Recovery Officer on any ground whatsoever, but it shall be lawful for the Tax Recovery Officer to cancel the certificate if, for any reason, he thinks it necessary so to do, or to correct any clerical or arithmetical mistake therein.

STAY OF PROCEEDINGS [SECTION 225]

- It shall be lawful for the Tax Recovery Officer to grant time for the payment of any tax and when he does so, he shall stay the proceedings for the recovery of such tax until the expiry of the time so granted.
- Where the order giving rise to a demand of tax for which a certificate has been drawn up is modified in appeal or other proceeding under this Act, and, as a consequence thereof, the demand is reduced but the order is the subject-matter of further proceeding under this Act, the Tax Recovery Officer shall stay the recovery of such part of the amount specified in the certificate as pertains to the said reduction for the period for which the appeal or other proceeding remains pending.
- When the order which was the subject-matter of such appeal or other proceeding has become final and conclusive, TRO shall amend the certificate or cancel it.

OTHER MODES OF RECOVERY [SECTION 226]

- Whether or not certificate has been drawn up u/s 222, the Assessing Officer may recover the tax by any one or more of the modes provided in this section.
- **Attachment of salary:** If any assessee is in receipt of any income chargeable under the head "Salaries", the Assessing Officer or Tax Recovery Officer may require any person paying the same (i.e., the employer) to deduct from any payment subsequent to the date of such requisition, any arrears of tax due from such assessee. The employer shall comply with any such requisition and shall pay the sum so deducted to the credit of the Central Government or as the Board directs:
- **Garnishee order:** The assessing Officer or Tax Recovery Officer may by notice in writing require, any person from whom money is due or any person holds or may subsequently hold money for or on account of the assessee, to pay to the Assessing Officer or Tax Recovery Officer so much of the money (subject to maximum of amount payable to assessee) as is sufficient to pay the amount due by the assessee.

  If the person to whom a notice is sent fails to make payment in pursuance thereof to the Assessing Officer or Tax Recovery Officer, he shall be deemed to be an assessee in default in respect of the amount specified in the notice and further proceedings may be taken against him for the realisation of the amount as if it were an arrear of tax due from him, in the manner provided in section 222 to 225.

  Any person discharging any liability to the assessee after receipt of a notice shall be personally liable to the Assessing Officer or Tax Recovery Officer to the extent of his own liability to the assessee so discharged or to the extent of the assessee's liability for any sum due under this Act, whichever is less.

  A copy of the notice shall be forwarded to the assessee at his last address known to the Assessing Officer or Tax Recovery Officer.

  Where a person to whom a notice is sent objects to it by a statement on oath that the sum demanded or any part thereof is not due to the assessee or that he does not hold any money for or on account of the assessee, then, nothing shall be deemed to require such person to pay any such sum or part thereof. But if it is discovered that such statement was false in any material particular, such person shall be personally liable to the Assessing Officer or Tax Recovery Officer to the extent of his own liability to the assessee on the date of the notice, or to the extent of the assessee's liability for any sum due under this Act, whichever is less.

- The Assessing Officer or Tax Recovery Officer may apply to the court in whose custody there is money belonging to the assessee for payment to him of the entire amount of such money, or, if it is more than the tax due, an amount sufficient to discharge the tax.
- The Assessing Officer or Tax Recovery Officer may, if authorised by the Chief Commissioner or Commissioner by general or special order, recover any arrears of tax due from an assessee by distraint and sale of his movable property in the manner laid down in the Third Schedule.

RECOVERY THROUGH STATE GOVERNMENT [SECTION 227]

The recovery of tax in any area has been entrusted to a State Government, the State Government may recovers any arrears of tax in the same manner as the municipal tax or local rate is recovered.

RECOVERY OF TAX IN PURSUANCE OF AGREEMENTS WITH FOREIGN COUNTRIES [SECTION 228A]

Where an agreement is entered into by the Central Government with the Government of any country outside India for recovery of income-tax under this Act and the corresponding law in force in that country and the Government of that country or any authority under that Government which is specified in this behalf in such agreement sends to the Board a certificate for the recovery of any tax due under such corresponding law from a person having any property in India, the Board may forward such certificate to any Tax Recovery Officer within whose jurisdiction such property is situated and thereupon such Tax Recovery Officer shall:

(*a*) 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 u/s 222; and

(*b*) remit any sum so recovered by him to the Board after deducting his expenses in connection with the recovery proceedings.

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 has property in a country outside India (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), forward to the Board a certificate drawn up by him u/s 222 and the Board may take such action thereon as it may deem appropriate having regard to the terms of the agreement with such country.

RECOVERY OF PENALTIES, FINE, INTEREST AND OTHER SUMS [SECTION 229]

Any sum imposed by way of interest, fine, penalty, or any other sum payable under the provisions of this Act, shall be recoverable in the manner provided for the recovery of arrears of tax.

TAX CLEARANCE CERTIFICATE [SECTION 230]

Person not domiciled in India

- No person,—
  a. who is not domiciled in India;
  b. who has come to India in connection with business, profession or employment; and
  c. 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:

(i) an undertaking in the prescribed form [Form 30A] from his employer; or

(ii) through whom such person is in receipt of the income,

to the effect that tax payable by such person who is not domiciled in India shall be paid by the employer or the payer, and the prescribed authority shall, on receipt of the undertaking, immediately give to such person a no objection certificate [Form 30B], for leaving India.

♦ The aforesaid provision is not applicable 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.

Person domiciled in India

♦ Every person, who is domiciled in India at the time of his departure from India, shall furnish, in the prescribed form [Form 30C] to the income-tax authority or such other prescribed authority.

(a) the permanent account number allotted to him u/s 139A

However, where permanent account number has not been allotted to him, or his total income is not chargeable to income-tax or he is not required to obtain a permanent account number under this Act, such person shall furnish a certificate in the prescribed form.

(b) the purpose of his visit outside India;

(c) the estimated period of his stay outside India:

♦ No person:

(i) who is domiciled in India at the time of his departure; and

(ii) in respect of whom circumstances exist which, in the opinion of an income-tax authority render it necessary for such person to obtain a certificate under this section,

shall leave the territory of India by land, sea or air unless he obtains a certificate from the income-tax authority stating that he has no liabilities under direct tax, or 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.

No such order shall be made unless such income tax authority records the reasons therefor and obtains the prior approval of the Principal Chief Commissioner or Chief Commissioner of Income-tax.

Liability of the carrier

If the owner or charterer of any ship or aircraft carrying persons from any place in the territory of India to any place outside India allows any of the aforesaid person to travel by such ship or aircraft without first satisfying himself 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 amount of tax, if any, payable by such person as the Assessing Officer may, determine.

In respect of any sum payable by the owner or charterer of any ship or aircraft, the owner or charterer, as the case may be, shall be deemed to be an assessee in default for such sum, and such sum shall be recoverable from him as if it were an arrear of tax.

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.

RECOVERY BY SUIT OR UNDER OTHER LAW NOT AFFECTED [SECTION 232]

The several modes of recovery specified in this Chapter shall not affect in any way:

(a) any other law for the time being in force relating to the recovery of debts due to Government; or

(b) the right of the Government to institute a suit for the recovery of the arrears due from the assessee;

and it shall be lawful for the Assessing Officer or the Government, as the case may be, to have recourse to any such law or suit, notwithstanding that the tax due is being recovered from the assessee by any mode specified in this Chapter.

PROVISIONAL ATTACHMENT TO PROTECT REVENUE IN CERTAIN CASES [SECTION 281B]

Where, during the pendency of any proceeding for the assessment or reassessment, the Assessing Officer is of the opinion that for the purpose of protecting the interests of the revenue it is necessary so to do, he may, with the previous approval of the Chief Commissioner, Commissioner, Director General or Director, by order in writing, attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.

Every such provisional attachment shall cease to have effect after the expiry of a period of 6 months from the date of such order.

However, Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director may, for reasons to be recorded in writing, extend the aforesaid period by such further period or periods as he thinks fit, so, however, that the total period of extension shall not in any case exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

Where the assessee furnishes a guarantee from a scheduled bank for an amount not less than the fair market value of the property provisionally attached, the Assessing Officer shall, by an order in writing, revoke such attachment. However, where the Assessing Officer is satisfied that a guarantee from a scheduled bank for an amount lower than the fair market value of the property is sufficient to protect the interests of the revenue, he may accept such guarantee and revoke the attachment.

The Assessing Officer may, for the purposes of determining the value of the property provisionally attached, make a reference to the Valuation Officer referred to in sec. 142A, who shall estimate the fair market value of the property in the manner provided under that section and submit a report of the estimate to the Assessing Officer within a period of 30 days from the date of receipt of such reference.

An order revoking the provisional attachment shall be made:

– within 45 days from the date of receipt of the guarantee, where a reference to the Valuation Officer has been made; or

– within 15 days from the date of receipt of guarantee in any other case.

Where a notice of demand specifying a sum payable is served upon the assessee and the assessee fails to pay that sum within the time specified in the notice of demand, the Assessing Officer may invoke the guarantee furnished, wholly or in part, to recover the amount.

The Assessing Officer shall, in the interests of the revenue, invoke the bank guarantee, if the assessee fails to renew the guarantee, or fails to furnish a new guarantee from a scheduled bank for an equal amount, 15 days before the expiry of the guarantee.

The amount realised by invoking the guarantee shall be adjusted against the existing demand which is payable by the assessee and the balance amount, if any, shall be deposited in the Personal Deposit Account of the

Principal Commissioner or Commissioner in the branch of the 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 situate.

Where the Assessing Officer is satisfied that the guarantee is not required anymore to protect the interests of the revenue, he shall release that guarantee forthwith.

CERTAIN TRANSFERS TO BE VOID [SECTION 281]

Where, during the pendency of any proceeding under this Act or after the completion thereof, but before the service of notice by TRO, any assessee creates a charge on or parts with the possession (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 charge or transfer shall be void as against any claim in respect of any tax or any other sum payable by the assessee as a result of the completion of the said proceeding or otherwise.

Assets means land, building, machinery, plant, shares, securities and fixed deposits in banks, to the extent to which any of the assets aforesaid does not form part of the stock-in-trade of the business of the assessee.

However such charge or transfer shall not be void if it is made:

(i) for adequate consideration and without notice of the pendency of such proceeding or without notice of such tax or other sum payable by the assessee; or

(ii) with the previous permission of the Assessing Officer.

This section applies to cases where the amount of tax or other sum payable or likely to be payable exceeds Rs. 5,000 and the assets charged or transferred exceed Rs. 10,000 in value.

SERVICE OF NOTICE GENERALLY [SECTION 282]

The service of a notice or summon or requisition or order or any other communication under this Act (hereafter in this section referred to as "communication") may be made by delivering or transmitting a copy thereof, to the person therein named:

a) by post or by such courier services as may be approved by the Board; or

b) in such manner as provided under the Code of Civil Procedure, 1908 for the purposes of service of summons; or

c) by e-mail; or

d) by any other means of transmission of documents as provided by rules made by the Board in this behalf.

AUTHENTICATION OF NOTICES AND OTHER DOCUMENTS [SECTION 282A]

- Where the Act requires a notice or other document to be issued by any income-tax authority, such notice or other document shall be signed and issued in paper form or communicated in electronic form by that authority in accordance with such procedure as may be prescribed.
- Every notice or other document 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.

RETURN OF INCOME, ETC., NOT TO BE INVALID ON CERTAIN GROUNDS [SECTION 292B]

No return of income, assessment, notice, summons or other proceeding, furnished or made or issued or taken or purported to have been furnished or made or issued or taken in pursuance of any of the provisions of this Act shall be invalid merely by reason of any mistake, defect or omission in such return of income, assessment, notice, summons or other proceeding if such return of income, assessment, notice, summons or other proceeding is in substance and effect in conformity with or according to the intent and purpose of this Act.

NOTICE DEEMED TO BE VALID IN CERTAIN CIRCUMSTANCES [SECTION 292BB]

Where an assessee has appeared in any proceeding or co-operated in any inquiry relating to an assessment or reassessment, it shall be deemed that any notice, which is required to be served upon him, has been duly served upon him in time in accordance with the provisions of this Act and such assessee shall be precluded from taking any objection in any proceeding or inquiry under this Act 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, aforesaid provision is not applicable, where the assessee has raised such objection before the completion of such assessment or reassessment.

REFUND [SECTION 237]

As per section 237, if any person satisfies the Assessing Officer that the amount of tax paid by him (or on his behalf) for any assessment year, exceeds the amount with which he is chargeable under this Act, then he shall be entitled to a refund of such excess amount.

Tax paid by the assessee includes the following –

1. Advance tax;
2. Tax deducted at source (TDS);
3. Tax collected at source (TCS);
4. Self-assessment tax; and
5. Tax paid on demand

Following person can claim refund –

1. A person who has paid tax more than the amount for which he is chargeable under this Act [Section 237];
2. Where the income of one person is included in the total income of other person, such other person is entitled to claim refund on tax paid on such income [Section 238(1)]
3. Where due to death, incapacity, insolvency, liquidation or any other cause, a person is unable to claim or receive any refund due to him, his legal representative, trustee, guardian or receiver, as the case may be, can claim and receive such refund for the benefit of such person or his estate [Section 238(2)]

FORM AND TIME LIMIT FOR CLAIMING REFUND [SECTION 239]

A claim for refund should be made in Form 30. Such form should be verified in the prescribed manner and shall be accompanied by the return of income except in cases where return had already been filed.

Refund shall be claimed within 1 year from the end of relevant assessment year [Section 239]

REFUND ON APPEAL, ETC. [SECTION 240]

Where any refund becomes due as a result of any order passed in appeal or other proceedings, the Assessing

Officer shall refund the amount to the assessee *suomoto* i.e. without any claim being made by the assessee in this behalf. Such refund shall become due on –

Case	**When refund becomes due**
Where an assessment is set aside or cancelled and an order of fresh assessment is directed to be made	The refund shall become due on completion of such fresh assessment and amount of refund shall be decided as per the fresh assessment.
Where the assessment is annulled	The refund shall become due when such assessment is annulled. The refund shall be only of the amount of the tax paid in excess of tax as per return.

CORRECTNESS OF ASSESSMENT NOT TO BE QUESTIONED [SECTION 242]

In a claim of refund, it shall not be open to the assessee to question the correctness of any assessment or other matter decided which has become final and conclusive or ask for a review of the same, and the assessee shall not be entitled to any relief on such claim except refund of tax wrongly paid or paid in excess.

INTEREST ON REFUND [SECTION 244A]

An assessee who is entitled to get refund shall also be entitled to interest on such refund. Provision relating to interest is enumerated below –

Rate of interest: Simple interest @ ½% per month or part thereof

Period for calculation of interest

Case	Period
1. Refund is out of TDS or TCS or Advance tax (Note 1)	
- Where return of income is furnished within due date	From first day of relevant assessment year to the date on which such refund is granted.
- Where return is after due date	From the date of furnishing return to the date on which such refund is granted.
2. Refund is out of self-assessment tax (Note 1)	From the date of furnishing return or payment of tax, whichever is later to the date on which such refund is granted.
3. Refund due to any other reason	From date of payment of such tax to the date on which such refund is granted.
4. Refund due to excess payment of TDS by deductor	From the date on which claim for refund is made (however, where refund arise on account of giving effect to an order u/s 250 or 254 or 260 or 262, from date of payment of tax) to the date on which refund is granted.

Notes

1. **Interest on refund due to TDS or TCS:** In case (1) and (2), no interest on refund shall be allowed if the amount of refund is less than 10% of the tax determined u/s 143(1) or on regular assessment.

2. **Interest on Refund arising out of giving effect to an order:** In a case where a refund arises as a result of giving effect to an order u/s 250 or 254 or 260 or 262 or 263 or 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 (as aforesaid), an additional interest on such amount of refund calculated at the rate of 3% p.a., for the period beginning from the date following the date of expiry of the time allowed u/s 153(5) [i.e., 3 months from the end of the month in which appellate order is received by the CIT) to the date on which the refund is granted

3. **Taxability of refund and interest on refund:** It is to be noted that refund of tax itself is not taxable. However, interest received on delayed refund is taxable under the head "Income from other sources".

4. **Adjustment in interest:** Where tax payable is reduced or enhanced by an order u/s 143(3), 144, 147, 154, 155, 250, 254, 260, 262, 263, 264 & 245D(4), the amount of interest shall be reduced or enhanced accordingly.

5. **Delay in refund due to reason attributable to the assessee:** Where the refund are delayed for the reason attributable to the assessee (or deductor), the period of delay so attributable to him shall be excluded from the period for which interest is payable. Further, where any question arises as to the period to be excluded, it shall be decided by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner whose decision shall be final.

SET-OFF OF REFUND AGAINST TAX REMAINING PAYABLE [SECTION 245]

If a refund is due to an assessee, it can be set-off against the sum payable under this Act. However, tax authorities must give a written intimation to the assessee before such set-off.

WITHHOLDING OF REFUND IN CERTAIN CASES [SECTION 241A]

If the following conditions are fulfilled, the Assessing Officer, may, for reasons to be recorded in writing and with the previous approval of the Principal Commissioner or Commissioner, withhold the refund due to the assessee u/s 143(1) up to the date on which the assessment u/s 143(3) is made:

a. Refund of any amount becomes due to the assessee u/s 143(1);

b. The Assessing Officer is of the opinion, having regard to the fact that a notice has been issued u/s 143(2) [i.e., notice for scrutiny assessment u/s 143(3)] in respect of such return; and

c. The Assessing Officer is of the opinion that the grant of the refund is likely to adversely affect the revenue.

Payment of interest on refund u/s 244A of excess TDS deposited u/s 195 [Circular 11/2016 dated 26-04-2016]

The procedure for refund of tax deducted at source u/s 195, to the person deducting the tax is delineated in CBDT Circular No. 7/2007 dated 23-10-2007. Circular No. 7/2007 states that no interest u/s 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 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 Hon'ble Supreme Court of India in the case of *Tata Chemical Limited*', Civil Appeal No. 6301 of 2011 vide order dated 26-02-2014, held that:

Refund due and payable to the assessee is debt-owed and payable by the Revenue. The Government, there being no express statutory provision for payment of interest on the refund of excess amount / tax collected by the Revenue, cannot shrug off its apparent obligation to reimburse the deductors lawful monies with the accrued interest for the period of undue retention of such monies. 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 resident deductor is entitled for the refund of tax deposited u/s 195, then it has to be refunded with interest u/s 244A, from the date of payment of such tax.

ASSESSMENT

Assessment means to compute the income & tax of the assessee. It begins with self-assessment and ends with the assessment by the authority. From classification point of view following are the types of assessment.

1. SELF-ASSESSMENT [SECTION 140A]

Provision of section 140A is as follows –

a) Where any tax is payable (after deducting relief, rebate, advance payment of tax or tax deducted or collected at source or MAT or AMT credit, if any) on the basis of return furnished the assessee is required to pay such tax before filing the return.

b) If any interest is payable for delayed filing of return (u/s 234A) or default in payment of advance tax (u/s 234B) or for deferment of advance tax (u/s 234C) or fee (u/s 234F) is payable for filing return after due date, then such interest or fee should be paid along with self-assessment tax.

c) Where the amount paid by the assessee falls short of the aggregate of tax, interest and fee, the amount so paid shall first be adjusted towards fee and thereafter towards interest payable and the balance, if any, shall be adjusted towards tax payable.

d) After assessment, any amount paid under this section shall be deemed to have been paid towards such assessment.

e) If an assessee fails to pay whole or any part of such tax or interest or both in accordance with the provisions of sec. 140A, he shall be deemed to be an assessee in default.

2. ASSESSMENT BY INCOME TAX DEPARTMENT

After submission of return or on non-submission of return by the assessee, assessment is made by the Income tax department. The Assessing Officer can assess the income of the assessee in any of the following manner:

1. Intimation u/s 143(1);

2. Scrutiny Assessment u/s 143(3);

3. Best Judgment Assessment u/s 144;

4. Income Escaping Assessment u/s 147

While assessing the income by the Assessing Officer the inquiry can be sought by him. He can inquiry in the following manner:

1. Pre-Assessment Inquiry
    - Issue of notice to the assessee [Section 142(1)] to submit a return [Section 142(1)(i)] or to produce accounts, documents etc. [Section 142(1)(ii) & (iii)]
    - Making inquiry [Section 142(2)]
    - Giving direction to get books of account audited [Section 142(2A) to (2D)]
    - Opportunity of being heard [Section 142(3)]

- Estimate by Valuation Officer in certain cases [Section 142A]

INTIMATION BY ASSESSING OFFICER

The Assessing Officer makes the following order:

Intimation [Section 143(1)] : No intimation shall be **sent** after the expiry of 1 year from the end of the financial year in which the return is made. The period of limitation will run from the date of filing of latest revised return.

Regular assessment:

- On the basis of further evidence gathered by him [Scrutiny Assessment u/s 143(3)]
- On the basis of best of his judgement [Best Judgement Assessment u/s 144]

SCRUTINY ASSESSMENT [SECTION 143(3)]

A return has been furnished u/s 139 or in response to a notice u/s 142(1); and Assessing Officer considers it necessary or expedient to ensure that the assessee has not understated his income, declared excessive loss or under-paid the tax.

Procedure

Notice for scrutiny [Section 143(2)] : Assessing Officer shall serve on the assessee a notice requiring the assessee, on a date specified in the notice, to produce, or cause to be produced, any evidence on which assessee may rely, in support of the return.

Time limit of notice: No notice shall be served on the assessee after the expiry of 6 months from the end of the financial year in which the return is furnished.

Order: After collecting such information and hearing such evidence as the assessee produces in response to the notice u/s 143(2) and after taking into account all relevant materials, which the Assessing Officer has gathered;

The Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee and determine the sum payable by him or refund of any amount due to him on the basis of such assessment

Time limit for completion of scrutiny assessment

Assessment u/s 143(3) should be completed within 18 months (from A.Y. 2020-21: 12 months) from the end of the relevant assessment year.

Special procedure in case of research association etc. [Proviso to Section 143(3)]

Applicable to

- Research association referred in section 10(21);
- News agency referred in section 10(22B);
- Association or institution referred in section 10(23A);
- institution referred in section 10(23B);
- fund or institution referred in section 10(23C)(iv);
- trust or institution referred in section 10(23C)(v);
- any university or other educational institution referred in section 10(23C)(vi);

- any hospital or other medical institution referred in section 10(23C)(via)
- any university or college u/s 35(1)(ii) or (iii) - which is required to furnish the return of income u/s 139(4C) or (4D)

E-Assessments : The Finance Act, 2018 has inserted a new sub-section (3A) in Section 143 that the Central Govt. may make a scheme for the purpose of making assessment so as to impart greater efficiency, transparency and accountability by:

(a) Eliminating the interface between the Assessing Officer and the assessee in the course of proceeding to the extent technologically feasible.

(b) Optimising utilization of the resources through economies of scale and functional specialization.

(c) Introducing a team-based assessment with dynamic jurisdiction.

As part of e-governance initiative to facilitate conduct of assessment proceedings electronically, Income-tax department has launched 'E-Proceeding' facility. Under this initiative, CBDT has made it mandatory for the tax officers to take recourse of electronic communications for all limited and complete scrutiny. The CBDT had issued the instructions and notice formats for conducting scrutiny assessments electronically. As per the instruction, except search related assessments, all scrutiny assessments shall be conducted only through the 'E-Proceeding' functionality available at e-filing website of Income-tax Department.

An amendment has been made in sub-section (3A) of section 143 of the Act to,-

i. expand the scope so as to include the reference of section 144 of the Act relating to best judgement assessment in the said sub-section;

ii. (ii) provide that Central Government may issue any direction under sub-section (3B) of the said section upto 31st March, 2022.

This amendment will take effect from 1st April, 2020.

BEST JUDGMENT ASSESSMENT [SECTION 144]

In the following situations assessment shall be made under this section –

a. If the person fails to file the return u/s 139(1), 139(4) or 139(5); or

b. If the person fails to comply with the terms of notice u/s 142(1); or

c. If the person fails to comply with the directions u/s 142(2A) requiring him to get his accounts audited; or

d. If the person fails to comply with the terms of notice u/s 143(2), requiring his presence or production of evidence and documents.

In any of the given situation, the Assessing Officer is *under an obligation* to make an assessment under this section. In other words, Best judgment assessment is not the discretionary power of the Assessing Officer but mandatory in nature.

Opportunity of being heard : The assessment u/s 144 can only be made after giving the assessee a reasonable opportunity of being heard. Such opportunity shall be given by serving a "*Show cause notice*" calling upon the assessee to show cause(s), on a date and time specified in the notice, why the assessment should not be completed to the best of judgment of the Assessing Officer.

Exception: Such opportunity need not be given, where notice u/s 142(1) has already been issued.

Time limit for completion of assessment [Section 153(1)]:18 months (from A.Y. 2020-21: 12 months) from the end of relevant assessment year

POWER OF JOINT COMMISSIONER TO ISSUE DIRECTIONS IN CERTAIN CASES [SECTION 144A]

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) –

a) Call for and examine the record of any proceeding in which an assessment is pending; and

b) Having regard to the nature of the case or the amount involved or for any other reason,

- issue such directions as he thinks fit for the guidance of the Assessing Officer to enable him to complete the assessment and such directions shall be binding on the Assessing Officer.

REFERENCE TO DISPUTE RESOLUTION PANEL [SECTION 144C]

The Income-tax Act is amended to provide for an alternate dispute resolution mechanism which will facilitate expeditious resolution of disputes in a fast track basis. The provision relating to alternate dispute resolution mechanism are as under:

1. The Assessing Officer shall, in the first instance, forward a draft of the proposed order of assessment (hereafter in this section referred to as the draft order) to the eligible assessee# if he proposes to make any variation in the income or loss returned which is prejudicial to the interest of such assessee.

   # Eligible assessee means:

   (i) Any person in whose case the variation referred to arises as a consequence of the order of the Transfer Pricing Officer passed u/s 92CA(3); and

   (ii) Any foreign company

2. On receipt of the draft order, the eligible assessee shall, within 30 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.

   $ Dispute Resolution Panel means a collegium comprising of 3 Commissioners of Income-tax constituted by the Board for this purpose.

3. The Assessing Officer shall complete the assessment on the basis of the draft order, if: (a) The assessee intimates to the Assessing Officer the acceptance of the variation; or (b) No objections are received within 30 days as specified above.

   Time limit for passing of order: The Assessing Officer shall pass such order within 1 month from the end of the month in which,—

   (i) The acceptance is received; or

   (ii) The period of filing of objections (i.e. 30 days) expires.

   The time limit is irrespective of time limit given u/s 153 (or 153B) for passing an assessment order.

4. 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.

5. The Dispute Resolution Panel shall issue the directions, for guidance of the Assessing Officer, after considering the following:

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;

e. Records relating to the draft order;

f. Evidence collected by it; and

g. Result of any enquiry made by it.

6. The Dispute Resolution Panel may, before issuing any 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.

7. The Panel may confirm, reduce or enhance the variations proposed in the draft order so, however, that it shall not set aside any proposed variation or issue any direction for further enquiry and passing of the assessment order.

8. If the members of the Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.

9. Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.

10. No direction shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interest of the revenue, respectively.

11. No direction shall be issued after 9 months (irrespective of any limitation given u/s 153) from the end of the month in which the draft order is forwarded to the eligible assessee.

12. Upon receipt of the directions, the Assessing Officer shall, in conformity with the directions, complete, the assessment without providing any further opportunity of being heard to the assessee, within 1 month from the end of the month in which the direction is received.

13. 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 sec. 144BA

14. The Board may make rules for the efficient functioning of the Dispute Resolution Panel and expeditious disposal of the objections filed by the eligible assessee.

INCOME ESCAPING ASSESSMENT [SECTION 147]

The Assessing Officer may assess or reassess an income, if he has reason to believe# that such income though chargeable to tax has escaped assessment$ for any assessment year.

Tax point: A reassessment proceeding may end without creating a tax liability.

Income chargeable to tax has escaped assessment

Following shall deem to be the cases where income chargeable to tax has escaped assessment –

1. Where no return of income has been furnished by the assessee although his total income (or the total

income of any other person in respect of which he is assessable under this Act) exceeded the maximum amount which is not chargeable to tax;

2. Where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return;

3. Where the assessee has failed to furnish a report in respect of any international transaction which he was so required u/s 92E;

4. Where an assessment has been made, but—
   - income chargeable to tax has been under-assessed; or
   - such income has been assessed at too low a rate; or
   - such income has been subject to excessive relief under this Act; or
   - excessive loss or depreciation allowance or any other allowance under this Act has been computed.

5. Where a return of income has not been furnished by the assessee or a return of income has been furnished by him and on the basis of information or document received from the prescribed income-tax authority, u/s 133C(2), it is noticed by the Assessing Officer that the income of the assessee exceeds the maximum amount not chargeable to tax, or as the case may be, the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return.

6. Where a person is found to have any asset (including financial interest in any entity) located outside India.

Reason to believe escapement: Section 147 can be applied only on 'reason to believe' that income chargeable to tax has escaped assessment. It cannot be applied merely on suspicion, gossip or rumour. There must be nexus between material and belief. Furthermore, before issuing any notice for assessment or reassessment, Assessing Officer must record the reasons for doing so.

Treatment of new information subsequently found

Once an assessment has been reopened, any income –

- which has escaped assessment; and
- which comes to the notice of the Assessing Officer subsequently,

may also be included in the assessment in the course of the proceedings of this section.

When can a reassessment proceeding be dropped [Section 152(2)]

Where an assessment is reopened u/s 147 and the assessee –

a) has not opposed any part of the original assessment order for that year either u/s 246 to 248 or u/s 264; and

b) shows that he had been assessed on an amount or to a sum not lower than what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account, or the assessment or computation had been properly made.

   – then the proceedings u/s 147 shall be dropped.

Rate of taxation [Section 152(1)]: If an assessment/reassessment is made u/s 147, then tax shall be chargeable at the rates at which it would have been charged had the income not escaped assessment.

Issue of notice [Section 148]: Before making the assessment u/s 147, the Assessing Officer shall serve on the assessee a notice requiring him to furnish a return within such period, as may be specified in the notice.

Note: Notice u/s 148 cannot be issued during pendency of assessment proceedings

TIME LIMIT FOR NOTICE [SECTION 149]

Notice u/s 148 can be issued subject to the following time limit –

Time limit for issue of notice	Size of escaped income	Person authorised to issue notice
Where assessment has already been completed u/s 143(3) or 147		
Upto 4 years from the end of the relevant assessment year	Any amount	Any Assessing Officer with the permission of Joint Commissioner
Beyond 4 years and upto 6 years from the end of relevant assessment year.	Rs. 1,00,000 or more	Assessing Officer after approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.
In case income is in relation to any asset (including financial interest in any entity) located outside India has escaped assessment		Notice u/s 148 has to be issued within 16 years from the end of the relevant A.Y.
Where assessment has not been completed u/s 143(3) or 147		
Upto 4 years from the end of relevant assessment year	Any amount	Any Assessing Officer with the permission of Joint Commissioner.
Beyond 4 years and upto 6 years from the end of relevant assessment year.	Rs. 1,00,000 or more	Assessing Officer after approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.
If the person on whom a notice u/s 148 is to be served, is a person treated as the agent of a non-resident u/s 163		
Up to 6 years from the end of relevant assessment year	Escaped income is of any amount	Assessing Officer
Tax point: The above time limit is for issuance of notice and not for service of notice. If the notice is issued within the above time limit but served to the assessee after the above time limit, shall be a valid notice.		

Exceptions to the above time limit: Where an assessment u/s 143(3) or 147 has been made for the relevant assessment year, no action shall be taken under this section after the expiry of 4 years from the end of relevant assessment year, unless any income chargeable to tax has escaped assessment by reason of failure on the part of the assessee –

- to file a return u/s 139 or in response to a notice issued u/s 142(1) or u/s 148; or
- to disclose fully and truly all material facts necessary for his assessment for that assessment year.

Time limit for completion of assessment u/s 147: No order of assessment, reassessment shall be made u/s 147 after the expiry of 9* months from the **end of the financial year** in which notice u/s 148 was **served**.

SUMMARY OF TIME LIMIT FOR VARIOUS PURPOSES [SECTION 153]

Particulars	Section	Time limit
Intimation of summary assessment	143(1)	Must be send within 1 year from the end of financial year in which return of income is filed.
Issuance of notice for scrutiny assessment	143(2)	Must be served within 6 months from the end of the financial year in which return of income is filed.
Completion of Scrutiny assessment u/s 143(3)	153(1)	Assessment must be completed within 18 months (from A.Y. 2020-21: 12 months) from the end of the relevant assessment year.
Completion of Best judgment assessment u/s 144		
Issuance of notice for Income escaping assessment u/s 147	149	Notice must be issued within 6 years (maximum; 6years, in some cases 16 years) from the end of the relevant assessment year
Completion of Income escaping assessment u/s 147	153(2)	Assessment must be completed within 9 months from the end of the financial year in which notice for such assessment u/s 148 was served.

FRESH ASSESSMENT [SECTION 153(3)]

An order of fresh assessment in pursuance of an order u/s 254, 263 or 264 may be made for setting aside or canceling an assessment.

Time limit for making fresh assessment

In case of the order passed	**Time limit**
U/s 254	Within 9[1] months from the end of the financial year in which such order is *received* by the Principal Chief Commissioner or Principal Commissioner or Chief Commissioner or Commissioner
U/s 263 or 264	Within 9[2] months from the end of the financial year in which such order is *passed* by the Principal Commissioner or Commissioner.

1 Where such order is received on or after 01-04-2020: Within 12 months

2 Where such order is passed on or after 01-04-2020: Within 12 months

RECTIFICATION OF MISTAKE [SECTION 154]

An income-tax authority, is empowered (*suo moto* or on application by assessee) to –

a) rectify any mistake apparent in an order passed by him; or

b) amend any intimation issued u/s 143(1) or deemed intimation

c) amend any intimation issued u/s 200A(1) or 206CB(1).

Time limit for Rectification [Section 154(7)] : Within 4 years from the end of the financial year in which the order sought to be amended was passed.

However, in respect of an application made by the assessee or deductor or collector, the authority shall, within a period of 6 months from the end of the month in which the application is received by it, pass an order –

a. making the amendment; or

b. refusing to allow the claim.

Opportunity of being heard [Section 154(3)]: If such rectification order is prejudicial to the assessee or deductor or collector, an opportunity of being heard must be given to the assessee, before passing such order.

DEMAND NOTICE [SECTION 156]

On completion of assessment, a demand notice is served for additional demand raised in the assessment.

Time limit for payment of tax: The assessee should make the payment of amount demanded within 30 days of service of notice [Section 220(1)] Where the Assessing Officer has any reason to believe that it will be detrimental to revenue if the full period of 30 days is allowed, then he may with the previous approval of the Joint Commissioner direct that the sum specified in the notice of demand shall be paid within such time as may be specified by him in the notice. **Interest on delay in payment:** If the payment is not made within 30 days (or time allowed in the notice), interest shall be payable @ 1% for every month (or part thereof) of the delay [Section 220(2)]

An assessee in default shall be liable to a penalty of an amount not exceeding the amount of tax in arrears. [Section 221(1)]

Note: Where any sum is determined to be payable by the assessee or by the deductor or collector u/s 143(1) or 200A(1) or 206CB(1), the intimation under those sections shall be deemed to be a notice of demand for the purposes of this section.

APPEALS

The expression “Appeal” has been defined in Mozley and Whiteley’s Law Dictionary as “a complaint to a superior court of an injustice done by an inferior one”. The party complaining is styled as the “appellant”. The other party is known as “respondent”. The right to appeal must be given by express enactment and cannot be implied- Harihar Gir vs CIT [1941] 9 ITR 246 (Pat.).

APPELLATE HIERARCHY

Appellate Authorities in Income-tax Act

<table>
<tr><th>Appeal</th><th>Appellate authority</th><th>Against which order</th><th>Appellant</th></tr>
<tr><td>1st</td><td>Commissioner (Appeals)</td><td>Against specified order of the Assessing Officer</td><td>Assessee only</td></tr>
<tr><td>2nd</td><td>Income Tax Appellate Tribunal (ITAT)</td><td>Against the order of Commissioner (Appeals)</td><td rowspan="3">Assessee or the Commissioner (or Principal Commissioner) of Income tax</td></tr>
<tr><td>3rd</td><td>High Court</td><td>Against the order of ITAT (the case must involve substantial question of law)</td></tr>
<tr><td>Final</td><td>Supreme Court</td><td>Against the order of High Court</td></tr>
</table>

APPEALS TO COMMISSIONER (APPEALS) [SECTION 246A TO 250]

Aggrieved tax payer can file appeal before the Commissioner (Appeals) having, jurisdiction over the tax payer. Designation of the Commissioner (Appeals), with whom appeal is to be filed is also mentioned in the notice issued by the Assessing Officer u/s 156.

Appealable Orders

1. U/s 246A

- Order passed by a Joint Commissioner u/s 115VP(3)(ii);
- Order against the assessee, where the assessee denies his liability to be assessed under this Act;
- Intimation u/s 143(1) or 143(1B) or 200A(1) or 206CB(1) or Order of assessment u/s 143(3) [Scrutiny assessment] [except an order passed in pursuance of directions of the Dispute Resolution Panel or an order referred to in sec. 144BA(12)] or u/s 144 [Best judgment assessment] in respect of income assessed or tax determined or loss computed or residential status;
- Order of assessment, reassessment or recomputation u/s 147 [(except an order passed in pursuance of directions of the Dispute Resolution Panel or an order referred to in sec. 144BA(12)], 150 & 153A [except an order passed in pursuance of directions of the Dispute Resolution Panel or an order referred to in sec. 144BA(12)];
- Order u/s 154 (Rectification of Mistake) or u/s 155 (other amendments) having the effect of enhancing the assessment or reducing a refund or an order refusing to allow the claim made by the assessee [except where it is in respect of an order referred to in sec. 144BA(12)]
- Order of assessment or reassessment u/s 92CD(3)
- Order u/s 163 treating assessee as an agent of a non-resident;
- Order u/s 170 relating to assessment on succession;
- Order u/s 171 refusing to recognize partition of an HUF;
- Order u/s 201 or 206C(6A) for default of provisions of TDS/TCS;
- Order u/s 237 relating to refunds;
- Order relating to Penalty;
- Order imposing penalty under chapter XXI;
- An order of penalty imposed under chapter XXI or an order of imposing or enhancing penalty u/s 275(1A)
- Any order made by an Assessing Officer other than a Joint Commissioner, as the Board may direct.

2. U/s 248

Where under an agreement or other arrangement –

- the tax deductible u/s 195 on any income (other than interest) is to be borne by the person by whom the income is payable; &
- such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income,

he may appeal to the Commissioner (Appeals) for a declaration that no tax was deductible on such income

Notes:

a) Even when reassessment proceedings have been initiated u/s 147, an appeal can still be filed against the original assessment order passed u/s 143(3)

b) Assessee has the right to appeal against an order of the Assessing Officer which is passed while giving effect to the decision of the appellate authority.

Time limit for filing appeal: Appeal should be filed within 30 days from –

Where the appeal is u/s 248	The date of payment of the tax
Where the appeal relates to any assessment or penalty	The date of service of notice of demand relating to the assessment or penalty
In any other case	The date on which intimation of the order, sought to be appealed against, is served.

Period to be excluded [Section 268]: While calculating the above time limit, following period shall be excluded –

a) The day on which order complained of was served; and

b) Time required for obtaining a copy of the order, where a copy of the order was not furnished with notice of demand.

c) Where an application has been made u/s 270AA (seeking immunity from penalty and prosecution), the period beginning from the date on which the application is made, to the date on which the order rejecting the application is served on the assessee.

Delay in filing appeal: The Commissioner (Appeals) may admit belated application on sufficient cause being shown.

Note: It is statutory obligation of the appellate authority (where an application for condonation is filed) to consider whether sufficient cause was shown by the appellant

Form of appeal: Form 35 (Mode of filing depends i.e., electronically or in paper form, on mode of filing return of income of the assessee)

Documents to be submitted

- Order against which appeal is made
- Statement of facts
- Grounds of appeal
- Notice of demand (in Original)
- Challan

Verification of Form: Form & grounds of appeal must be verified by the person authorised to verify the return of income u/s 140

Payment of tax before filing of appeal

If a return has been filed – Tax as per the return should be paid.

If no return has been filed – The assessee should pay an amount equal to the advance tax which was payable by him. However, CIT(A) may, for any good and sufficient reason (recorded in writing), accept the appeal without payment of such advance tax.

Power of Assessing Officer: As per section 220(6), where an assessee has presented an appeal u/s 246A, Assessing Officer may treat the assessee as not being in default in respect of the amount in dispute in the appeal.

It may be applied –

- at the discretion of the Assessing Officer;

- subject to such conditions as Assessing Officer may think fit to impose;
- even though the time for payment has expired;
- as long as such appeal remains undisposed of.

Where assessee has not made an application u/s 220(6) or his application u/s 220(6) has been rejected, he can approach the appellate authority for stay order against collection

Fee for filing an appeal: Where assessed income as computed by the Assessing Officer is –

● Up to Rs 1,00,000	- Rs 250
● Exceeds Rs 1,00,000 but does not exceed Rs 2,00,000	- Rs 500
● Exceeds Rs 2,00,000	- Rs 1000
Where the subject matter of appeal is not covered in above cases -	Rs 250

Procedure

1. Fixation of Day & Place: The Commissioner (Appeals) shall fix a day and place for the hearing of the appeal, and shall give notice of the same to the appellant and to the Assessing Officer against whose order the appeal is preferred.

2. Hearing: The appellant (either in person or by an authorised representative) and the Assessing Officer (either in person or by an authorised representative) shall have the right to be heard at the hearing of the appeal.

Tax point: Where the assessee does not insist on a personal hearing the appeal may be decided on the basis of written submission made by him. [Letter No. 277/7/84 of November, 1985]

3. Adjournment: The Commissioner (Appeals) shall have the power to adjourn the hearing of the appeal from time to time.

4. Inquiry: The Commissioner (Appeals) may, before disposing of any appeal, make such further inquiry as he thinks fit, or may direct the Assessing Officer to make further inquiry and report the result of the same to the Commissioner (Appeals).

5. Order: Commissioner (Appeals) must dispose of the appeal by passing an order which shall –

- be in writing;
- mention the points for determination;
- mention the decision thereon; and
- mention the reason for the decision.

6. Communication of Order: The Commissioner (Appeals) shall communicate the order passed by him to the assessee and to the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

Note: If during pendency of an appeal, provision of any law has changed with retrospective effect, then such changed law shall be applicable on such appeal too. Law amended retrospectively would be a good law for applicability during the pendency of the appeal

New grounds during hearing: The Commissioner (Appeals) may, at the hearing of an appeal, allow the appellant to go into any ground of appeal not specified in the 'grounds of appeal', if he is satisfied that the omission of that ground from the Form of appeal was not wilful or unreasonable.

Time limit for disposal of appeal: Within one year from the end of financial year in which appeal is filed (if possible).

Production of additional evidence: Appellate authority has the power to accept additional evidence (after recording reason for its admission in writing) and may make further enquiry at his discretion before disposing of the appeal

In the following circumstances additional evidence shall be admitted by the Commissioner (Appeals):

- **a)** Where the Assessing Officer has refused to admit evidence which ought to have been admitted; or
- **b)** Where appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence, which is related to any ground of appeal; or
- **c)** Where the appellant was prevented by sufficient cause from producing the evidence, which he was called upon to produce by the Assessing Officer; or
- **d)** Where the Assessing Officer has made an order (appealed against) without giving sufficient opportunity to the appellant to produce evidence relevant to any ground of appeal.

Tax point: Before taking into account the additional evidence filed, Commissioner (Appeals) is to provide reasonable opportunity to the Assessing Officer for examining the additional evidence or the witness as well as to produce evidences to rebut additional evidences filed by the tax payer.

E-Appeal: An Amendment has been made vide Finance Act, 2020 by inserting sub-section 250(6A) of the Income tax Act, 1961 to provide the following:

- Empowering Central Government to notify an e-appeal scheme for disposal of appeal so as to impart greater efficiency, transparency and accountability.
- Eliminating the interface between the Commissioner (Appeals) and the appellant in the course of appellate proceedings to the extent technologically feasible.
- Optimizing utilization of the resources through economies of scale and functional specialisation.
- Introducing an appellate system with dynamic jurisdiction in which appeal shall be disposed of by one or more Commissioner (Appeals).

It also empowered the Central Government, for the purpose of giving effect to the scheme made under the said sub-section, by notification in the Official Gazette, to direct that any of the provisions of this Act relating to jurisdiction and procedure of disposal of appeal shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in the notification. Such directions are to be issued on or before 31st March 2022. It is proposed that every notification issued shall be required to be laid before each House of Parliament.

This amendment will take effect from 1st April, 2020

Powers of Commissioner (Appeals) u/s 251

1. Against an order of assessment: To confirm, reduce, enhance or annul the assessment
2. Against an order imposing a penalty: To confirm or cancel such order or vary it so as either to enhance or to reduce the penalty;
3. Against the order of assessment in respect of which the proceeding before the Settlement Commission abates u/s 245HA: To confirm, reduce, enhance or annul the assessment after taking into consideration all the material and other information produced by the assessee before, or the results of the inquiry

held or evidence recorded by, the Settlement Commission, in the course of the proceeding before it and such other material as may be brought on his record

4. Relating to any other case: To pass such orders as he thinks fit.

Notes:

1. The Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant.
2. Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction.
3. An assessment order, which is void ab initio cannot become a valid order simply by virtue of the fact that it has been confirmed by an appellate authority.
4. Appeal once filed cannot be withdrawn.

APPEALS TO INCOME TAX APPELLATE TRIBUNAL (ITAT) [SECTION 252 TO 255]

Appeal against an order of Commissioner (Appeals) lies with the Income Tax Appellate Tribunal (ITAT). Both tax payer and the Assessing Officer can file appeal before the Appellate Tribunal. Several Benches of the Appellate Tribunal constituted all over India by the Central Government and it functions under the Ministry of Law. It consists of as many judicial and accountant members as the Central Government thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act.

Qualification of members

Member	Qualification
Judicial	● He has held a post of Judicial Officer in the territory of India for at least 10 years; or ● He has been served as a member of the Indian Legal Service in Grade II post or any higher post for at least 3 years; or ● He has been an advocate for at least 10 years.
Accountant	● He has practiced as a Chartered Accountant for at least 10 years; or ● He has practiced as a registered accountant for at least 10 years; or ● He has practiced partly as a registered accountant and partly as a Chartered Accountant for at least 10 years; or ● He has been a member of the Indian Income-tax Service, Group A and has held the post of the Additional Commissioner of Income tax or any equivalent or higher post for at least 3 years.

President of the ITAT

- The Central Government shall appoint:
  - **a.** a person who is a sitting or retired Judge of a High Court and who has completed not less than 7 years of service as a Judge in a High Court; or
  - **b.** one of the Vice-Presidents of the Appellate Tribunal, - to be the President thereof.

- The Central Government may appoint one or more members of the Appellate Tribunal to be the Vice-President(s) thereof.
- The Vice-President shall exercise such of the powers and perform such of the functions of the President as may be delegated to him by the President by a general or special order in writing.

Appealable Orders

A. Appeal by assesse

1. An order passed by a Commissioner (Appeals) u/s 154, 250, 270A, 271, 271A or 272A; or
2. An order passed by a Principal Commissioner or Commissioner u/s 12AA [registration of trust], 80G(5)(vi), 263 [revision order], 154, 270A or 271 or 272A; or
3. An order passed by an Assessing Officer u/s 143(3) or 147 or 153A or 153C in pursuance of the directions of the Dispute Resolution Panel or with the approval of the Commissioner (or Principal Commissioner) as referred to in sec. 144BA(12) or an order passed u/s 154 or 155 in respect of such order.
4. An order passed by an Assessing Officer u/s 115VZC(1)
5. An order passed by the prescribed authority u/s 10(23C)(iv) or (v) or (vi) or (via)
6. An order passed by Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Director or Director u/s 272A [penalty].

B. Appeal by the Principal Commissioner or Commissioner

The Principal Commissioner or Commissioner may direct the Assessing Officer to appeal against the order passed by the Commissioner (Appeals) u/s 154 or 250 [The Board has directed that the appeal shall be filed by the department only if tax effect exceeds Rs 10,00,000]

Time limit for filing appeal: Within 60 days. The period shall start from the date on which order sought to be appealed is communicated to the assessee or Commissioner.

Delay in filing appeal: Tribunal may admit belated application on sufficient cause being shown.

Withdrawal of appeal: An assessee cannot withdraw an appeal filed to Tribunal

Form - Form 36

Documents to be submitted and number of copies thereof

1. Memorandum of Appeal
2. Order appealed against (including one certified copy)
3. Order of Assessing Officer
4. Grounds of appeal before first appellate authority
5. Statement of facts filed before first appellate authority
6. In case, appeal against order levying penalty, relevant order

Fee payable by assessee: Where assessed income as computed by the Assessing Officer is –

• Upto Rs 1,00,000	Rs 500
• Exceeds Rs 1,00,000 but does not exceed Rs 2,00,000	Rs 1500

• Exceeds Rs 2,00,000	1% of Assessed income [Max. Rs 10,000]
• Stay petition	Rs 500
• Any other case	Rs 500
• Upto Rs 1,00,000	Rs 500
• Exceeds Rs 1,00,000 but does not exceed Rs 2,00,000	Rs 1500
• Exceeds Rs 2,00,000	1% of Assessed income [Max. Rs 10,000]
• Stay petition	Rs 500
• Any other case	Rs 500

Fee payable by CIT: No fees shall be payable in case of appeal by Commissioner

Verification of Form: Form 36 and grounds of appeal should be verified by the person authorized to verify the return of income u/s 140 [Rule 47]

Cross objection: Assessing Officer or the assessee, as the case may be, on receipt of notice that an appeal against the order of the Commissioner (Appeals) has been filed by the other party, may file a memorandum of cross objection with the Tribunal.

Time limit for filing of cross-objections: Within 30 days of receipt of notice that appeal has been filed by the other party. However, Tribunal may admit belated memorandum of cross objection on sufficient cause being shown.

Form for filing of cross-objections: Form 36A

Fee for cross objection: Nil

Order of tribunal: The Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders as it thinks fit. Tribunal must record its reasons for its decisions. Order should set out all facts and contentions.

Communication of order: Tribunal shall send a copy of the order passed by it to the assessee and to the Principal Commissioner or Commissioner.

Notes:

a) Decision of Tribunal on matter involving question of fact is final. However, one can file a writ petition.

b) A decision of the tribunal, when passed in appeal, is final not only for the assessee but also for the tribunal itself.

c) The assessee cannot seek to reopen and reargue the whole matter. i.e. order of Tribunal cannot be reviewed by Tribunal.

d) On a question of fact determined by ITAT, a writ petition can be filed to the High Court challenging the fact finding process adopted by the ITAT. If the High Court is satisfied that the fact finding process was not correct, then it will quash the order passed by the ITAT and direct the ITAT to do the fact finding in the proper manner and/or as per the direction of the High Court.

If the writ petition is dismissed by the High Court then the assessee can file a Special Leave Petition to the Apex Court challenging the fact finding process of the ITAT. If the Apex Court is satisfied that the fact finding process was incorrect then the Apex Court quash the order passed by the ITAT and direct the ITAT to do the fact finding in the proper manner and/or as per the direction of the Apex Court.

Rectification of mistake (Miscellaneous Application)

- The Tribunal may, at any time within 6 months from the end of the month in which the order was passed, with a view to rectify any mistake apparent from the record, amend any order passed by it.
- Mistake may be brought to the notice of the Tribunal by the assessee or the Assessing Officer.
- Where assessee applies for any rectification, it shall be accompanied by a fee of Rs. 50.
- An amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee, shall not be made unless the Appellate Tribunal has given notice to the assessee of its intention to do so and has allowed the assessee a reasonable opportunity of being heard.
- It is to be noted that income tax authority [including CIT(A)] can rectify order u/s 154, however in that case:
  - **a.** Assessee is not required to pay any fee; and
  - **b.** Time limit is 4 years from the end of the financial year in which the order sought to be rectified was passed.

Additional grounds which may be taken in appeal: Tribunal has discretionary power to refuse additional ground to be raised. Tribunal may permit the assessee to urge grounds of appeal not mentioned in the memorandum of appeal.

Additional evidence: The parties to the appeal are not entitled to produce additional evidence of any kind, either oral or documentary before the Tribunal. However, if the Tribunal requires production of any document, examination of any witness or filing of any affidavit to enable it to pass orders, it may allow such document to be produced, witness to be examined, affidavit to be filed and such evidence to be adduced.

Paper Book: The appellant or the respondent, as the case may be, may submit a paper book in duplicate containing documents or statements or other papers referred to in the assessment or appellate order, which it may wish to rely upon. The paper book duly indexed and page numbered is to be filed at least a day before the hearing of the appeal along-with proof of service of copy of the same on the other side at least a week before. The Bench may in appropriate cases condone the delay and admit the paper book. The Tribunal can also, on its own direct preparation of paper book in triplicate by and at the cost of appellant or the respondent as it may consider necessary for disposal of appeal. Each paper in the paper book is to be certified as true copy by the party filing the same. Additional evidence, if any, should not be part of the paper book and it should be filed separately.

Time limit for passing order: Appellate Tribunal, where it is possible, may hear and decide such appeal within a period of 4 years from the end of the financial year in which such appeal is filed.

However, the Tribunal may pass an order of stay in any proceedings for a period not exceeding 180 from the date of such order and the Tribunal shall dispose of the appeal within the said period of stay specified in that order.

Further where such appeal is not so disposed of within the said period of stay as specified in the order of stay, the Tribunal may, on an application made in this behalf by the assessee and on being satisfied that the delay in disposing of the appeal is not attributable to the assessee, extend the period of stay, or pass an order of stay for a further period or periods as it thinks fit; so, however, that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed 365 days and the Tribunal shall dispose of the appeal within the period or periods of stay so extended or allowed.

Further if such appeal is not so disposed of within the period allowed (original and extended), the order of stay shall stand vacated after the expiry of such period (i.e., 365 days), even if the delay in disposing of the appeal is not attributable to the assessee.

Cost of appeal: Cost of appeal shall be borne by the person as decided by the Tribunal.

Procedure

- ♦ The powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of the Appellate Tribunal from among the members thereof.
- ♦ A Bench shall consist of one judicial member and one accountant member. However, in some case, single member bench may be constituted.
- ♦ The President or any other member of the Appellate Tribunal authorised in this behalf by the Central Government may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose total income as computed by the Assessing Officer in the case does not exceed Rs 50 lakh.
- ♦ The President may, for the disposal of any particular case, constitute a Special Bench consisting of 3 or more members, one of whom shall necessarily be a judicial member and one an accountant member.
- ♦ If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority. But if the members are equally divided, then the case shall be referred by the President of the Appellate Tribunal for hearing on such point by one or more of the other members of the Appellate Tribunal, and such point shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.

APPEAL TO HIGH COURT [SECTION 260A]

Who can file appeal: Assessee or the Principal Chief Commissioner / Chief Commissioner / Principal Commissioner / Commissioner, being aggrieved by the order of ITAT.

Tax point: Only order passed by the ITAT (which involves substantial question of law) can be appealed in the High court.

[The Board has directed that the appeal shall be filed by the department only if tax effect exceeds Rs 20,00,000.]

Appealable order: Any order of the Tribunal, if the High Court is satisfied that the case involves a substantial question of law.

Substantial question of law

- The word "substantial" means having substance, essential, real, of sound worth, important or considerable;
- The substantial question of law, need not necessarily be a substantial question of law of general importance (i.e. it should be a question of law between the parties);
- To be "substantial", a question of law must be debatable, not previously settled by law of the land or a binding precedent, and must have a material bearing on the decision of the case.

Time limit for filing appeal: 120 days from the date on which order of the Tribunal is received by the assessee or Principal Chief Commissioner / Chief Commissioner / Principal Commissioner / Commissioner.

The High Court may admit an appeal after the expiry of said period, if it is satisfied that there was sufficient cause for not filing the same within that period.

Court Fee: The Court fee shall be as specified in relevant law relating to Court fees for filing an appeal to High Court.

Manner of appeal: The appeal shall be in form of a memorandum of appeal, precisely stating the substantial question of law involved in the appeal.

Formulation of question of law:

- Where the High Court is satisfied that a substantial question of law is involved, it shall formulate the question.
- The appeal is to be heard only on the questions formulated. However, the respondents shall, at the hearing of appeal, be allowed to argue that the case does not involve such question.

Hearing of appeal

- The appeal is to be heard by a bench of not less than 2 judges of the High Court. Decision will be in accordance with opinion of the majority of judges.
- Where judges are equally divided in their opinions, the case on the point on which they differ shall be heard by one or more other judges of the High Court.

Hearing of other substantial question of law: The Court has the 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.

Decision: The High Court shall decide the question of law so formulated and deliver such judgment thereon containing the ground on which such decision is founded and may award such cost as it deems fit. The High Court may determine any issue which –

a) has not been determined by the Tribunal; or

b) has been wrongly determined by the Tribunal, by reason of a decision on such question of law .

Stay of recovery proceedings: High Court has power to stay proceedings for recovery of demand arising out of the assessment order, pending disposal of appeal.

APPEAL TO THE SUPREME COURT [SECTION 261]

Who can file appeal: Assessee or the Principal Chief Commissioner / Chief Commissioner / Principal Commissioner / Commissioner aggrieved from the judgment of High Court.

[The Board has directed that the appeal shall be filed by the department only if tax effect exceeds Rs 25,00,000.]

Order against which appeal is possible: Any order passed in the High Court, provided that High Court

- is satisfied that the case involves a substantial question of law; and
- certifies the case is fit for appeal to the Supreme Court.

If High Court refuses to certify the case: The aggrieved party may make an application to the Supreme Court under Article 136 of the Constitution of India.

Cost of appeal: The costs of the appeal shall be borne by the person as decided by the Supreme Court.

Effect of judgment: Where the judgment of the High Court is varied or reversed by the Supreme Court, Tribunal should pass necessary order to dispose the case in conformity with such judgment.

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. 3/2018, Dated 11-7-2018, F. No. 279/Misc. 142/2007-ITJ (Pt), Dated 20-8-2018, Circular No. 17/2019, Dated 8-8-2019 and F. No. 279/Misc./M-93/2018-ITJ (Pt), Dated 16-9-2019.

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 (Rs.)
1.	Before Appellate Tribunal	50,00,000
2.	Before High Court	1,00,00,000
3.	Before Supreme Court	2,00,00,000

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.

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.		

SPECIAL PROVISION FOR AVOIDING REPETITIVE APPEALS [SECTION 158A]

Where an assessee claims (a declaration in the Form 8 and verified in the prescribed manner) that:

- any question of law arising in his case for an assessment year which is pending before the Assessing Officer or any appellate authority (such case being hereafter in this section referred to as the relevant case) is identical with a question of law arising in his case for another assessment year which is pending before the Supreme Court, against the order of the High Court in favour of the assessee (such case being herein referred to as the other case),

he may, instead of directing the Assessing Officer to appeal to the Appellate Tribunal, direct the Assessing Officer to make an application to the Appellate Tribunal in the prescribed form within 60 days from the date of receipt of the order of the Commissioner (Appeals) 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.

The Commissioner or Principal Commissioner shall direct the Assessing Officer to make 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.

Where the order of the Commissioner (Appeals) is not in conformity with the final decision on the question of law in the other case, the Commissioner or Principal Commissioner may direct the Assessing Officer to appeal to the Appellate Tribunal against such order and save as otherwise provided in this section all other provisions of Part B of Chapter XX shall apply accordingly.

Aforesaid appeal shall be filed within 60 days from the date on which the order of the Supreme Court in the other case is communicated to the Commissioner or Principal Commissioner.

REVISIONS

REVISION BY THE COMMISSIONER OF INCOME TAX [SECTION 263 & 264]

The right to file such appeals against the orders of the Assessing Officer is not available to the Department. It is for this reason that the Commissioner has been vested with revisional powers under Section 263, where the order of Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue. But such revisional power can be exercised only in respect of orders which are not the subject matter of appeals. The reason is that once an assessment order is appealed against, the Commissioner (Appeals) has got the powers to enhance the assessment under Section 263 and a right of appeal upto the Tribunal is provided to the assessee against the orders of the Assessing Officer. In the following cases Commissioner of Income-tax can revise an order passed by the Assessing Officer:

REVISION OF ORDER PREJUDICIAL TO THE REVENUE [SECTION 263]

Orders which may be revised

Any order passed by the Assessing Officer, which is –

- **a)** Erroneous;
- **b)** Prejudicial to the interests of the revenue; and
- **c)** Passed by an authority subordinate to the Principal Commissioner or Commissioner

Notes

- **a)** Orders passed by the Assessing Officer includes –
  - **i.** An order of assessment made by the Assistant Commissioner on the basis of the directions issued by the Joint Commissioner u/s 144A;
  - **ii.** An order made by the Joint Commissioner as an Assessing Officer.
- **b)** Even an intimation u/s 143(1) can be revised

Tax point

- Order made by the Assessing Officer after making proper enquiries and considering relevant details and decisions of Supreme Court cannot be said to be erroneous and prejudicial to the interest of the revenue, hence such order cannot be revised.
- An order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if, in the opinion of the Principal Commissioner or Commissioner:
  - **a)** the order is passed without making inquiries or verification which should have been made;
  - **b)** the order is passed allowing any relief without inquiring into the claim;

c) the order has not been made in accordance with any order, direction or instruction issued by the Board under section 119; or

d) the order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person

Treatment of an order, which is subject matter of the appeal

Revision u/s 263 of an order, which is subject matter of appeal, cannot be made.

Notes

- The Principal Commissioner or Commissioner can revise such order (which has been a subject matter of appeal) which had not been considered and decided in such appeal.

  E.g., From the perusal of the order u/s 143(3) passed by the Assessing Officer following was observed:

  – Point A: Against the assessee

  – Point B: In favour of the assessee

  The assessee being aggrieved with point A in the order passed by the Assessing Officer, preferred an appeal to the Commissioner (Appeals). However, the Commissioner wants to revise the order u/s 263 for point B (subject to other conditions being fulfilled). It is possible as doctrine of partial merger of the order is applicable in case of sec. 263. However, the Commissioner cannot revise the order for point A (as the same is subject matter of an appeal)

- An order cannot be said to have been made subject of an appeal if the appeal has been disposed of by the appellate authority without passing an order

Procedure to be followed

1. **Examination of Records:** The Principal Commissioner or Commissioner may call for and examine the records of any proceeding under the Act. If he considers that any order passed by the Assessing Officer is prejudicial to the interest of the revenue, he can revise and rectify the assessment.

   Record shall include all records relating to any proceeding under this Act available at the time of examination by the Principal Commissioner or Commissioner. This means that any material, which was not available at the time of assessment but available at the time of examination by the Principal Commissioner or Commissioner, shall also be considered for order u/s 263.

2. **Inquiry:** He must make or cause to be made such inquiry as he deems necessary.

3. **Opportunity of being Heard:** No revision order shall be passed u/s 263 without giving the assessee an opportunity of being heard.

Order: Finally, he may pass such revision order as the circumstances of the case justify including an order enhancing, modifying or cancelling the assessment and directing a fresh assessment.

Time limit for passing revision order: 2 years from the end of the financial year in which the order sought to be revised was passed.

In computing the above period of limitation following period shall be excluded-

- Time taken in giving an opportunity to the assessee of being re-heard u/s 129; &
- Any period during which any proceeding under this section is stayed by an order or injunction of any court.

Exception: There is no time limit for passing a revision order to give effect to, or in consequence of, an order of the ITAT, the High Court or the Supreme Court.

Appeal against order u/s 263: A revisional order passed by the Principal Commissioner or Commissioner u/s 263 can be appealed to the Tribunal.

Section 263 vs. Section 154: Principal Commissioner or Commissioner can exercise the power even in a case where the issue is debatable. Revisional power u/s 263 is not comparable with the power of rectification of mistake u/s 154.

REVISION OF ORDER IN FAVOUR OF ASSESSEE [SECTION 264]

Orders which may be revised

Any order which is –

- erroneous;
- not covered u/s 263 (i.e. not prejudicial to the interest of the revenue);
- passed by an authority subordinate to the Principal Commissioner or Commissioner.

Taxpoint: No order under this section can be passed which is prejudicial to the assessee.

Notes:

a) Order which is not appealable before the Commissioner (Appeal) can also be referred to the Commissioner for revision.

b) For the purposes of this section, the Deputy Commissioner (Appeals) shall be deemed to be an authority subordinate to the Commissioner.

On whose motion is revision possible: Either on own motion of the Principal Commissioner / Commissioner or on an application by the assessee for revision.

Procedure to be followed

1. **Examination of Records:** Once revision proceedings have been initiated, the Principal Commissioner or Commissioner may call for and examine the record of any proceeding.
2. **Inquiry:** He must also make or cause to be made such inquiry as he deems necessary
3. **Order:** He may pass such revision order as the circumstances of the case justify. However, the order passed should not be prejudicial to the assessee.

Time limit for filing an application: Where revision has been initiated by the assessee, the application must be made within 1 year from the date on which the order in question was communicated to the assessee or the date on which he otherwise came to know of it, whichever is earlier.

However, the Principal Commissioner or Commissioner can admit a belated application if the assessee was prevented by sufficient cause from making the application within time. In computing the above period of limitation following time shall be excluded:

- The day on which the order complained of was served; and
- If the assessee had not received the copy of the order, the time required to obtain copy of such order.

Time limit for passing a revisional order: Where the Principal Commissioner or Commissioner acts on his own motion, Within 1 year from the date of original order.

Where the application is made by the assessee, Within 1 Year from the end of the financial year in which such application is made.

In computing the above period of limitation following period shall be excluded.

- Time taken in giving an opportunity to the assessee of being re-heard u/s 129; &
- Any period during which any proceeding under this section is stayed by an order or injunction of any court. [Section 264(6)]
- However, there is no time limit for passing a revision order for giving effect to, or in consequence of, an order of the ITAT, the High Court or the Supreme Court.

Orders which cannot be revised [Section 264(4)]

a) Where an order is appealable but no appeal has been made to CIT (Appeals) or to the Tribunal and time within which such appeal can be made, has not expired.

Note: Where an appeal lies to the Commissioner (Appeals) or to the Appellate Tribunal and the right of appeal is waived by the assessee, the Principal Commissioner or Commissioner may revise the order even before the expiry of time limit of appeal.

b) Where the order has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal.

E.g., the assessee has been aggrieved with point A and point B in the order passed by the Assessing Officer. He preferred an appeal to the Commissioner (Appeals) in respect of point A and seeks to file revision petition u/s 264 in respect of point B. It is not possible, he cannot file revision petition u/s 264 due to doctrine of total (or complete) merger of the order. He has to choose either way of the course.

It is to be noted that for the purpose of sec. 264, doctrine of total merger is applicable, on the other hand, for the purpose of sec. 147, 154 and 263, doctrine of partial merger is applicable.

Note

The assessment order could not be said to have been made subject matter of appeal, where an appeal was dismissed –

a) on the ground that the same was incompetent; or

b) as barred by limitation; or

Fee: Rs 500 where the application for revision is made by the assessee.

Appeal against order u/s 264: A revisional order passed by the Principal Commissioner or Commissioner u/s 264 cannot be appealed to the Tribunal or the High Court. However, a petition for a writ of certiorari under Article 226 is maintainable

Other points

- The assessee cannot claim the right of revision in respect of an earlier year on the basis of finding of the Tribunal for a subsequent year.
- An order by the Principal Commissioner or Commissioner declining to interfere shall not be deemed to be an order prejudicial to the assessee.

SETTLEMENT OF CASES

The provisions related to settlement of cases are contained in Chapter XIX-A consisting of sections 245 A to 245 M.

An assessee can make an application to the Settlement Commission at any stage of a "case" relating to him. The Finance Act, 2007 substituted clause (b) of section 245A which has changed the meaning of term "case" and reduced the scope for settlement of cases to great extent. However, the Finance (No 2) Act, 2014 and Finance Act, 2015 further amended section 245 A to increase the scope of settlement of cases.

A pending proceeding is a "case"- An assessee can make an application to the Settlement Commission at any stage of a "case" relating to him. A "case" means any proceeding for assessment under the Act of any person, in respect of any assessment year which may be pending before the Assessing Officer on the date on which an application under section 245 C(1) is made. In respect of all pending cases, one can have recourse to the Commission for settlement-

Taken as pending proceeding and consequently settlement is possible in the cases given below-	During the period given below settlement application can be filed
1. Income escaping assessment- A proceeding for assessment or reassessment or re-computation under section 147	Period commencing on the date of issue of notice under section 148 and ending with the date of assessment/ reassessment order.
2. Fresh Assessment- A proceeding for making fresh assessment in pursuance of an order under section 254 or section 263 or section 264, setting aside or cancelling an assessment.	Period commencing on the date on which order under section 254 or 263 or 264, setting aside or cancelling the assessment is passed and ending with the date on which fresh assessment is made.
3. Search Assessment- A proceeding for assessment/ reassessment for any assessment year referred to in section 153A(1)(b) in the case of a searched person (section 153A) or other person (section 153C)	Period commencing on the date of issue of notice initiating search proceedings and concluded on the date on which the assessment is made.
4. Regular Assessment- A regular Assessment (other than proceedings of assessment/ reassessment is given above)	• Up to May 31, 2015 – Period Commencing on first day of the assessment year and ending on the date on which assessment is made. • From June 1, 2015- Period commencing on the date on which return of income is furnished under section 139 (or in response to a notice under section 142) and ending on the date on which assessment is made [or the time specified under section 153(1) if no assessment is made.

Provisions Illustrated- Consider the following cases-

1. In the case of X Ltd., assessment is completed under section 143 (3) for the assessment year 2011-12 on April 20, 2013 (order is passed on April 20, 2013 but it is served on the assessee on April 26, 2013). Reassessment notice under section 148 is issued on November 13, 2014 (date of service: November 20, 2014). Reassessment is completed on December 4, 2015 (order dated December 4, 2015 is served on December 10, 2015). In this case, X Ltd. can have recourse to the Settlement Commission on or after April 1, 2011 but before April 20, 2013. Further, Settlement Commission can be approached on or after November 13, 2014 but before December 4, 2015.

2. For the assessment year 2016-17, Y Ltd submits return of income under section 139 on December 2, 2016. The Assessing Officer completes the assessment under section 143(3) on February 15, 2018 (date of service of assessment order February 19, 2018). In case, Y Ltd. can have recourse to the Settlement Commission on or after December 2, 2016 but before February 15, 2018. If, however,

no assessment is made, Y Ltd cannot have recourse to the Settlement Commission after March 31, 2019.

- Amendment by the Finance Act, 2015- The proceeding for assessment or reassessment under section 147 is deemed to commence from the date of issue of notice under section 148. Issue relating to escapement of income is often involved in more than one assessment year. In such a case the assessee becomes eligible to approach Settlement Commission only for the assessment year for which notice under section 148 has been issued. Therefore, to take the proceeding for all other assessment years where there is escapement, the assessee becomes eligible only after notice under section 148 has been issued for all such assessment years.

In order to obviate the need for issue of notice in all such assessment years for commencement of pendency. Explanation (i) to section 245A(b) has been amended by the Finance Act, 2015 (with effect from June 1, 2015). After the amendment, a proceeding for assessment or reassessment or recomputation under section 147 shall be deemed to have commenced-

a. From the date on which a notice under section 148 is issued for any assessment year;

b. From the date of issuance of such notice referred to in (a) (supra) for any other assessment years for which notice under section 148 has been issued but such notice could have been issued on such date, if the return of income for the other assessment year has been furnished under section 139 or in response to a notice under section 142.

In other words, where a notice under section 148 is issued for any assessment year, the assessee can approach Settlement Commission for other assessment years as well (for which notice could I have been issued on such date) even if notice under section 148 for such other assessment years has not been issued. However, a return of income for such other assessment years should have been furnished under section 139 or in response to notice under section 142.

Settlement Commission [Section 245B]

Chapter XIXA provides for settlement of cases pending before income-tax authority. For this purpose, the Central Government constituted the '*Settlement Commission*'. The Commission shall consist of a Chairman and as many Vice-Chairmen and other members as the Central Government thinks fit. It shall function within the Department of the Central Government dealing with direct taxes.

The members shall be appointed by the Central Government from amongst persons of integrity and outstanding ability, having special knowledge of, and, experience in, problems relating to direct taxes and business accounts.

Where a member of the Board is appointed as a member of the Commission, he shall cease to be a member of the Board.

Jurisdiction and powers of Settlement Commission [Section 245BA]

♦ The jurisdiction, powers and authority of the Settlement Commission may be exercised by Benches thereof.

♦ A Bench shall be presided over by the Chairman or a Vice-Chairman and shall consist of 2 other Members.

♦ The Bench for which the Chairman is the Presiding Officer shall be the principal Bench and the other Benches shall be known as additional Benches.

- The Chairman may authorise the Vice-Chairman or other Member appointed to one Bench to discharge also the functions of the Vice-Chairman or, as the case may be, other Member of another Bench.
- When one of the persons constituting a Bench (whether such person be the Presiding Officer or other Member of the Bench) is unable to discharge his functions owing to absence, illness or any other cause or in the event of the occurrence of any vacancy either in the office of the Presiding Officer or in the office of one or the other Members of the Bench, the remaining two persons may function as the Bench and if the Presiding Officer of the Bench is not one of the remaining two persons, the senior among the remaining persons shall act as the Presiding Officer of the Bench.
- If at any stage of the hearing of any such case or matter, it appears to the Presiding Officer that the case is ought to be heard of by a Bench consisting of 3 Members, the case may be referred by the Presiding Officer of such Bench to the Chairman for transfer to such Bench as the Chairman may deem fit.
- The Chairman may, for the disposal of any particular case, constitute a Special Bench consisting of more than 3 Members.
- The places at which the principal Bench and the additional Benches shall ordinarily sit shall be such as the Central Government may, by notification in the Official Gazette, specify and the Special Bench shall sit at a place to be fixed by the Chairman.
- Transfer of cases: On the application of the assessee or the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner and after notice to them, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairman may transfer any case pending before one Bench, for disposal, to another Bench [Section 245BC]
- Decision by majority: If the Members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority. But if the Members are equally divided, they shall refer the point to the Chairman who shall either hear the point himself or refer the case for hearing on such point by one or more of the other Members of the Settlement Commission and such point shall be decided according to the opinion of the majority of the Members of the Settlement Commission who have heard the case, including those who first heard it [Section 245BD]

Application for Settlement of Cases [Section 245C & Rule 44C]

Who can apply	**Any assessee**
When to apply	At any stage of a Case1
Conditions to be satisfied for application	a) The additional amount of income-tax2 payable on the income disclosed in the application exceeds specified amount3 b) such tax and the interest thereon, which would have been paid under the provisions of this Act had the income disclosed in the application been declared in the return of income before the Assessing Officer on the date of application, has been paid on or before the date of making the application and the proof of such payment is attached with the application

Submission of application form	A settlement application shall be presented in Form No. 34B (in quintuplicate) by the applicant in person or by his agent, to the Secretary at the headquarters of the Commission at New Delhi or of the Bench within whose jurisdiction his case falls or to any officer authorised in this behalf by the Secretary, or shall be sent by registered post addressed to the Secretary, or to such officer. A settlement application sent by post shall be deemed to have been presented on the day on which it is received in the office of the Commission.
Information to be given in the form	Following information are required to be given in application form – ● Full and true disclosure of his income which has not been disclosed before the AO; ● The manner in which such income has been derived; ● The additional amount of income-tax payable on such income; and ● Such other particulars as may be prescribed.
Fees	The application should be accompanied by fee of Rs. 500.
Verification of the application	Every application and other document accompanied with such application must be verified by the person who is authorised to verify return of income u/s 140
Intimation to the AO	An assessee shall, on the date on which he makes an application, also intimate the AO in the prescribed manner of having made such application to the Commission.

1. Case means any proceeding for assessment, of any person in respect of any assessment year or assessment years which may be pending before an Assessing Officer on the date on which an application is made.

Points need to be consider:

1. A proceeding for assessment or reassessment or recomputation u/s 147 shall be deemed to have commenced:

   a. from the date on which a notice u/s 148 is issued for any assessment year;

   b. from the date of issuance of the notice referred above, for any other assessment year or assessment years for which a notice u/s 148 has not been issued, but such notice could have been issued on such date, if the return of income for the other assessment year or assessment years has been furnished u/s 139 or in response to a notice u/s 142;

2. A proceeding for making fresh assessment in pursuance of an order u/s 254 or sec. 263 or sec. 264, setting aside or cancelling an assessment shall be deemed to have been commenced from the date on which such order, setting aside or cancelling an assessment was passed;

3. A proceeding for assessment or reassessment for any of the assessment years u/s 153A / 153C shall be deemed to have commenced on the date of issue of notice initiating such proceeding and concluded on the date on which the assessment is made;

4. A proceeding for assessment for any assessment year, other than aforesaid proceedings shall be deemed to have commenced from the date on which the return of income for that assessment year is furnished u/s 139 or in response to a notice served u/s 142 and concluded on the date on which the assessment is made; or on the expiry of the time specified for making assessment u/s 153(1), in case where no assessment is made.

Additional amount of Income Tax : The additional amount of income-tax payable shall be calculated in accordance with the following provisions –

a. Where the income disclosed in the application relates to only one previous year –

Situation	Income for the purpose	Additional amount of tax	
Col. 1	**Col. 2**	**Col. 3**	
If return of such year has not been filed u/s 139 (whether or not assessment has been made)	Income disclosed in the application	Tax as calculated on income shown in col. 2	
If return of such income has been submitted (whether or not assessment has been made)	Income disclosed in the application as well as in the return	Tax as calculated on income shown in col. 2 Less: Tax calculated on the total income returned for that year	**** (****)

b. Where the income disclosed in the application relates to more than one previous year –

(i) Calculate additional amount of income tax payable (as mentioned above) in respect of each year for which the application has been made.

(ii) The aggregate amount of the additional income tax of each of the years shall be the additional amount of income-tax payable.

Specified Amount

Particulars	Amount
Where an application before the Commission is filed in a case where proceedings for assessment or reassessment have been initiated as a result of search or as a result of requisition of books of account or assets, etc	Additional amount of income tax payable on the income disclosed in application should exceeds Rs. 50 lakh
Where the applicant is related to the aforesaid person and in whose case proceedings have been initiated as a result of search	Additional amount of income tax payable on the income disclosed in application should exceeds Rs. 10 lakh
In any other case	Additional amount of income tax payable on the income disclosed in application should exceeds Rs. 10 lakh

Procedure on Receipt of an Application [Section 245D]

- Admission or Rejection of Application: On receipt of an application, the Settlement Commission shall within 7 days from the date of receipt of the application, issue a notice to the applicant requiring him to explain as to why the application made by him be allowed to be proceeded with, and on hearing the applicant, the Settlement Commission shall, within a period of 14 days from the date of the application, by an order in writing, reject the application or allow the application to be proceeded with.
- Report from the Commissioner
  - The Commission shall (in respect of an application which is allowed to be proceeded) within 30 days from the date on which the application was made call for a report from the Principal Commissioner or Commissioner, and the Principal Commissioner or Commissioner shall furnish the report within a period of 30 days of the receipt of communication from the Settlement Commission.
  - On the basis of the report and within a period of 15 days of the receipt of the report, by an order

in writing (and after giving an opportunity of being heard), declare the application in question as invalid and shall send the copy of such order to the applicant and the Commissioner.

- Where the Principal Commissioner or Commissioner has not furnished the report within the aforesaid period, the Settlement Commission shall proceed further in the matter without the report of the Commissioner

- Examination of Records and Passing of Order
  - The Commission in respect of an application which has not been declared invalid may call for the records from the Principal Commissioner or Commissioner.
  - After examination of such records, if the Settlement Commission is of the opinion that any further enquiry or investigation in the matter is necessary, it may direct the Principal Commissioner or Commissioner to make such further enquiry or investigation and furnish a report on the matters covered by the application and any other matter relating to the case.
  - The Principal Commissioner or Commissioner shall furnish the report within a period of 90 days of the receipt of communication from the Settlement Commission. Where the Principal Commissioner or Commissioner does not furnish the report within the aforesaid period, the Settlement Commission may proceed to pass an order without such report.
  - After –

    (a) examination of the records and the report of the Principal Commissioner or Commissioner if any, received;

    (b) giving an opportunity to the applicant and to the Principal Commissioner or Commissioner to be heard (either in person or through a representative)

    (c) and after examining such further evidence as may be placed before it or obtained by it,

  the Settlement Commission may, in accordance with the provisions of this Act, pass such order as it thinks fit on the matters covered by the application and any other matter relating to the case not covered by the application, but referred to in the report of the Principal Commissioner or Commissioner.

- Every such order shall provide for –

  (a) The terms of settlement including any demand by way of tax, penalty or interest;

  (b) The manner in which any sum due under the settlement shall be paid;

  (c) All other matters to make the settlement effective; and

  (d) The settlement shall be void if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

- Such order shall be passed within 18 months from the end of the month in which the application was made

- Time Limit for Payment of Tax: Any tax payable in pursuance of order of settlement commission must be paid within 35 days of the receipt of a copy of the order.

- Interest on Late Payment of Tax due on Settlement: Where tax, as settled by the Commission, is not paid within 35 days of the receipt of a copy of the order (whether or not the Commission has extended the time for payment), the assessee shall be liable to pay simple interest @ 1.25% p.m. on the amount remaining unpaid from the date of expiry of the period of 35 days.

- Settlement obtained by Fraud, etc.: The settlement shall be void, if it is subsequently found by the Settlement Commission, that it has been obtained by fraud or misrepresentation of facts.

- ♦ Consequences where the Settlement becomes Void

  Where a settlement becomes void, the proceedings shall be deemed to have been revived from the stage at which the application was allowed to be proceeded with by the Settlement Commission.

  The income-tax authority concerned may complete such proceedings before the expiry of two years from the end of the financial year in which the settlement became void.

- ♦ Rectification of Order: The Settlement Commission may, with a view to rectifying any mistake apparent from the record, amend any order passed by it:

  (a) at any time within a period of 6 months from the end of the month in which the order was passed; or

  (b) at any time within the period of 6 months from the end of the month in which an application for rectification has been made by the Principal Commissioner or the Commissioner or the applicant, as the case may be.

However, no application for rectification shall be made by the Principal Commissioner or the Commissioner or the applicant after the expiry of 6 months from the end of the month in which an order for settlement is passed by the Settlement Commission.

An amendment which has the effect of modifying the liability of the applicant shall not be made unless the Settlement Commission has given notice to the applicant and the Principal Commissioner or Commissioner of its intention to do so and has allowed the applicant and the Principal Commissioner or Commissioner an opportunity of being heard.

Power of Settlement Commission

♦ To order Provisional Attachment to protect Revenue [Section 245DD]

Where, during the pendency of any proceeding, the Settlement Commission is of the opinion that for the purpose of protecting the interests of the revenue it is necessary to do so, it may, by order, attach provisionally (in the manner provided in the Second Schedule) any property belonging to the applicant.

Cessation of Attachment: Every provisional attachment shall cease to have effect after the expiry of a period of 6 months from the date of such order. However, the Commission may, for reasons to be recorded in writing, extend the period by such further period(s) as it thinks fit.

♦ Re-Opening of Completed Proceedings [Section 245E]

The Settlement Commission shall not have any power to reopen the proceedings in respect of an application made on or after 1.6.2007.

♦ To provide Inspection, etc., of Reports [Section 245G]

No person shall be entitled to inspect or obtain copies of, any reports given by any income-tax authority to the Commission. However, on an application, the Commission may furnish copies thereof to any such person on payment of the prescribed fee.

For the purpose of enabling assessee to rebut any evidence brought on record against him in any such report, the Settlement Commission **shall** furnish him with a certified copy of any such report or part thereof relevant for the purpose. For this purpose, assessee needs to make an application and payment of the prescribed fee.

♦ To grant Immunity from Prosecution and Penalty [Section 245H]

The Settlement Commission may grant immunity (subject to such conditions as it may think fit to impose for the reasons to be recorded in writing) from –

(a) Prosecution for any offence under this Act or under the Wealth Tax Act; and

(b) Imposition of any penalty (wholly or partly) under this Act,

– with respect to the case covered by it.

- Such immunity can be granted by the Commission, if the assessee –

  (a) has co-operated with the Settlement Commission in the proceedings before it;

  (b) has made a full and true disclosure of his income; and **(c)** has made a full and true disclosure of the manner in which such income has been derived.

♦ Withdrawal of Immunity Granted

An immunity granted to a person shall stand withdrawn if –

(1) Such person fails to –

  (a) Pay any sum specified in the order of settlement within the time allowed by the Settlement Commission; or

  (b) Comply with any other condition(s) subject to which the immunity was granted.

(2) Such person had, in the course of the settlement proceedings, concealed any particulars material to the settlement or had given false evidence.

♦ Consequences of Withdrawal of Immunity Granted

On withdrawal of immunity granted the provisions of this Act shall apply as if such immunity had not been granted.

♦ Other Power [Section 245F]

(1) In addition to the powers conferred on the Settlement Commission under this Chapter, it shall have all the powers, which are vested in an income-tax authority under this Act.

(2) The Commission shall have exclusive jurisdiction from the date on which the application was made. Where an application is rejected or not allowed to be further proceeded or declared invalid, the Commission shall have such exclusive jurisdiction upto the date on which application is rejected, etc.

(3) The Commission shall have power to regulate its own procedure and the procedure of Benches thereof in all matters or of the discharge of its functions, including the places at which the Benches shall hold their sittings.

(4) In the absence of any express direction to the contrary by the Settlement Commission, nothing contained in this section shall affect the operation of any other provision of this Act –

- Requiring the applicant to pay tax on the basis of self-assessment in relation to the matters before the Settlement Commission; and
- Related to any matters other than those before the Settlement Commission.

Abatement of Proceeding [Section 245HA]

♦ Where an application has been rejected or not been allowed to be proceeded or declared as invalid or has been allowed but no order has been passed within prescribed time or an order u/s 245D(4) has been passed not providing for the terms of settlement, the proceedings before the Settlement Commission shall abate on the specified date (i.e. the day on which application is rejected or declared invalid or time limit of 18 months expires).

- Where a proceeding before the Commission abates, the AO before whom the proceeding at the time of making the application was pending, shall dispose of the case in accordance with the provisions of this Act as if no application u/s 245C had been made.
- The AO shall be entitled to use all the material and other information produced by the assessee before the Commission or the results of the inquiry held or evidence recorded by the Commission in the course of the proceedings before it, as if such material, information, inquiry and evidence had been produced before the AO or held or recorded by him in the course of the proceedings before him.
- For the purposes of the time-limit u/s 149, 153, 153B, 154, 155, 158BE & 231 and for the purposes of payment of interest u/s 244A, for making the assessment or reassessment, the period commencing on and from the date of the application to the Settlement Commission and ending with specified date shall be excluded.
- Where a proceeding before the Settlement Commission abates, the period of limitation available u/s 153 to the AO for making an order of assessment shall, after the exclusion of the said period, be not less than 1 year; and where such period of limitation is less than 1 year, it shall be deemed to have been extended to 1 year.

Credit for Tax paid in case of Abatement of Proceedings [Section 245 HAA]

Where an application made u/s 245C is rejected or not allowed to be proceeded or declared invalid or an order has not been passed within the time of 18 months, the Assessing Officer shall allow the credit for the tax and interest paid on or before the date of making the application or during the pendency of the case before the Settlement Commission.

Order of Settlement to be Conclusive [Section 245-I]

Every order of settlement shall be conclusive as to the matter stated therein. Any matter covered by such order shall not be reopened in any proceeding under this Act or under any other law for the time being in force.

Note: An order, which have a mistake apparent from the record, can be rectified by Commission u/s 154

Recovery of Sums due under Order of Settlement [Section 245-J]

Any sum specified in an order of settlement may, subject to such conditions, if any, as may be specified therein, be recovered, and any penalty for default in making payment of such sum may be imposed and recovered in accordance with the provisions of Chapter XVII, by the Assessing Officer having jurisdiction over the person who made the application for settlement.

Restriction on Subsequent Application for Settlement in certain cases [Section 245K]

♦ Where —

(a) an order of settlement provides for the imposition of a penalty on the person who made the application for settlement, on the ground of concealment of particulars of his income; or

(b) after the passing of an order of settlement, such person is convicted of any offence under Chapter XXII in relation to that case; or

then, he or any person related to such person shall not be entitled to apply for settlement in relation to any other matter.

♦ Where a person has made an application and if such application has been allowed to be proceeded with, such person (or related person) shall not be subsequently entitled to make an application for settlement. That means, settlement can be made once in life time.

♦ Related person with respect to a person means:

(i) where such person is an individual, any company in which such person holds more than 50% of the shares or voting rights at any time, or any firm or association of persons or body of individuals in which such person is entitled to more than 50% of the profits at any time, or any Hindu undivided family in which such person is a karta;

(ii) where such person is a company, any individual who held more than 50% of the shares or voting rights in such company at any time before the date of application before the Settlement Commission by such person;

(iii) where such person is a firm or association of persons or body of individuals, any individual who was entitled to more than 50% of the profits in such firm, association of persons or body of individuals, at any time before the date of application before the Settlement Commission by such person;

(iv) where such person is a Hindu undivided family, the karta of that Hindu undivided family

PENALTY

In Income Tax Act, 1961 provides for the imposition of a penalty on an assessee who commits any offences under the provisions of the Act. Penalty 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 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 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 mistake in proceedings. The penalty to be levied on an assessee is to be based upon 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.

Penalty is imposed on an assessee for violating the different provisions of the Act. The provisions of penalty are tabulated below:

Section	Nature of default	Penalty		Levied by (Authority)
		Minimum	Maximum	
221(1)	Failure in making the payment of tax, interest or any demand within the prescribed time limit	Amount decided by the Assessing Officer	Tax or interest or both in arrears Assessing Officer	Assessing Officer or Commissioner (Appeals)
140A(3)	Failure to pay whole or any part of income tax and/or interest as per sec.140A(1)			
270A	Penalty for under-reporting and misreporting of income	50% of the tax on under-reported income	200% of the tax on misreported income	

Section	Nature of default	Penalty		Levied by (Authority)
		Minimum	Maximum	
271A	Failure to comply with sec. 44AA i.e. to keep or maintain books of account, documents, etc.	Rs 25,000	Rs 25,000	Assessing Officer or Commissioner (Appeals)
271AA(1)	Failure to keep and maintain, information and documents for international transactions or specified domestic transaction or fails to report such transaction	-	2% of the value of each international transaction or specified domestic transaction	Assessing Officer or Commissioner (Appeals)
271AA(2)	Fails to furnish the information and the document as required u/s 92D(4)		Rs 5,00,000	Assessing Officer or Commissioner (Appeals)
271AAB(1A)	Undisclosed income in case of search initiated on or after 15-12-2016 However, if the assessee: a) in the course of the search, in a statement u/s 132(4), admits the undisclosed income and specifies the manner in which such income has been derived. b) substantiates the manner in which the undisclosed income was derived; and c) on or before the specified date:	60% of the undisclosed income of the specified previous year 30% of the undisclosed income of the specified previous year		
	A. pays the tax, together with interest in respect of the undisclosed income; and B. furnishes the return of income for the specified previous year declaring such undisclosed income therein			

Section	Nature of default	Penalty		Levied by (Authority)
		Minimum	Maximum	
271AAC	Where the income determined includes any income referred to in sec. 68, 69, 69A, 69B, 69C or 69D for any previous year	10% of tax payable u/s 115BBE No penalty shall be levied if such income has been included by the assessee in the return of income furnished u/s 139 and the tax thereon (as per sec. 115BBE) has been paid on or before the end of the relevant previous year.		
271B	Failure to comply with sec. 44AB i.e. to get accounts audited or to furnish such audit report.	½% of the total sales or turnover or gross receipts		Assessing Officer
271BA	Failure to furnish report from an accountant as per sec.92E	Rs 1,00,000		Assessing Officer
271C	Failure to deduct part or whole of tax u/s 192 to 196C	Amount of tax failed to deduct		Assessing Officer
	Failure to pay tax on dividends u/s 115-O or under second proviso to sec. 194B	Amount of tax failed to pay		
271CA	Failure to collect tax at source	Amount of tax failed to collect		Imposed by Joint Commissioner
271D	Taking or accepting any loan or deposit or specified sum in contravention of the provisions of sec.269SS	Amount of the loan or deposit or specified sum so taken/ accepted		Imposed by Joint Commissioner
271DA	Receives any sum in contravention of section 269ST	Amount equal to such receipt		Imposed by Joint Commissioner
271DB [Inserted vide FA, 2019]	Failure to comply with provisions of section 269SU	Rs. 5,000 for every day during which such failure continues		Imposed by Joint Commissioner

Section	Nature of default	Penalty		Levied by (Authority)
		Minimum	Maximum	
271E	Repayment of any loan or deposit or specified advance in contravention of the provisions of sec.269T	Amount of loan or deposit or specified advance so repaid.		Imposed by Joint Commissioner
271FA	Failure to furnish a statement of financial transaction or reportable account as required u/s 285BA(1) within the prescribed time limit	Rs 500 for every day during which the failure continues		Imposed by Joint Commissioner
Proviso to section 271FA	Failure to furnish the statement of financial transaction or reportable account as within the period specified in the notice issued u/s 285BA(5)	Rs 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 expires		Imposed by Joint Commissioner
271FAA	Person referred to in section 285BA(1) provides inaccurate information in the 'statement of financial transaction or reportable account'	Rs 50,000		Prescribed income tax authority
271FAB	Fails to furnish information or document as required u/s 9A(5) within the prescribed time limit	Rs 500000		
271G	Failure to furnish information or documents as required u/s 92D(3)	2% of the value of the international transaction or specified domestic transaction.		Transfer Pricing Officer as referred to in Section 92CA
271GA	Failure to furnish information or documents as required u/s 285A	2% of the value of the transaction, if such transaction had the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern; In other case: Rs. 5,00,000		

Section	Nature of default	Penalty		Levied by (Authority)
		Minimum	Maximum	
271GB(1)	Failure by any reporting entity to furnish the report referred to in sec. 286(2) in respect of a reporting accounting year	▸ Failure does not exceed one month: Rs.5,000 per day ▸ Failure continues beyond the period of one month: Rs. 15,000 per day ▸ Failure continues after an order of penalty has been served on the entity: Rs.50,000 per day from the date of service of such order		
271GB(2)	Failure by any reporting entity to produce the information and documents within the period specified u/s 286(6)	▸ Rs 5,000 per day ▸ Failure continues after an order of penalty has been served on the entity: Rs.50,000 per day from the date of service of such order		
271GB(4)	Reporting entity provides inaccurate information in the report referred to in sec. 286(2)	Rs 5,00,000 Penalty shall be levied if: a) the entity has knowledge of the inaccuracy at the time of furnishing the report but fails to 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 15 days of such discovery; or c) the entity furnishes inaccurate information or document in response to the notice issued u/s 286(6),		
271H	Failure to furnish TDS / TCS Return or furnishing inaccurate details in these Return	Rs 10,000		

Section	Nature of default	Penalty		Levied by (Authority)
		Minimum	Maximum	
	However, no penalty shall be payable if tax along with interest has been deposited and the statement has been furnished within one year from the time prescribed.			
271-I	Fails to furnish information, or furnishes inaccurate information as required u/s 195(6)	Rs 1,00,000		Assessing Officer
271J	Furnishing incorrect information in reports or certificates by an accountant or merchant banker or registered valuer	Rs 10,000 for each report Penalty is leviable by the AO or the Commissioner (Appeals) who in the course of any proceedings finds that such report has incorrect information		Assessing Officer or the Commissioner (Appeals)
272A(1)(a)	Failure to answer any question (related to assessment) of an income-tax authority	10,000 for each default		Joint Director or Joint Commissioner
272A(1)(b)	Refuse to sign any statement made by the assessee in course of income tax proceedings			
272A(1)(c)	Failure to comply with summons u/s 131(1) to attend office or to give evidence or to produce books of account or other documents, at certain place & time			
272A(1)(d)	Fails to comply with a notice u/s 142(1) or 143(2) or fails to comply with a direction issued u/s 142(2A) [Penalty shall be levied by such authority]			

Section	Nature of default	Penalty		Levied by (Authority)
		Minimum	Maximum	
272A(2)(a)	Failure to comply with a notice issued u/s 94(6)	A sum of Rs. 100, for every day during which the failure continues: However, the amount of penalty for failures in relation to a declaration mentioned in sec. 197A, a certificate as required by sec. 203 and returns or statement u/s 200 or 206 and 206C shall not exceed the amount of tax deductible or collectible.		
272A(2)(b)	Failure to give notice of discontinuance of his business or profession as required u/s 176(3)			
272A(2)(c)	Failure to furnish in due time any of the returns, statements or particulars mentioned in section 133, 206, 206C or 285B			
272A(2)(d)	Failure to allow inspection of any register u/s 134 or of any entry in such register or to allow copies of such register or of any entry therein to be taken			
272A(2)(e)	Failure to furnish the return of income which he is required to furnish u/s 139(4A) or (4C) within time allowed and in the manner required.			
272A(2)(f)	Failure to deliver or cause to be delivered in due time a copy of the declaration mentioned in sec. 197A			
272A(2)(g)	Failure to furnish a certificate u/s 203 or 206C			
272A(2)(h)	Failure to deduct and pay tax u/s 226(2)			
272A(2)(i)	Failure to furnish a statement u/s 192(2C)			
272A(2)(j)	Failure to deliver a copy of declaration referred u/s 206C(1A) within due time			

Section	Nature of default	Penalty		Levied by (Authority)
		Minimum	Maximum	
272A(2)(l)	Failure to deliver or cause to be delivered the quarterly return within the time prescribed u/s 206A(1)			
272A(2)(m)	Failure to deliver a statement within the time prescribed u/s 200(2A) or 206C(3A)			
272AA	Failure to comply with the provisions of sec. 133B	Maximum up to Rs. 1,000		
272B	Failure to comply with the provisions of sec. 139A	Rs. 10,000 per each defaults		
272BB(1A)	Failure to quote Tax deduction or collection number	Rs. 10,000		
272BBB	Failure to comply with the provisions of sec. 206CA	Rs. 10,000		

Notes:

1) Specified previous year means previous year:

(i) which has ended before the date of search, but the date of filing the return of income u/s 139(1) for such year has not expired before the date of search **and** the assessee has not furnished the return of income for the previous year before the said date; or

(ii) in which search was conducted.

2) As per section 274(2), in the following cases, penalty can be imposed only with the prior approval of the Joint Commissioner:

Where penalty is imposed by the Income-tax Officer	Exceeds Rs 10,000
Where penalty is imposed by the Assistant Commissioner or Deputy Commissioner	Exceeds Rs 20,000

PENALTY FOR UNDER-REPORTING AND MISREPORTING OF INCOME [SECTION 270A]

The

– Assessing Officer; or

– Commissioner (Appeals); or

– Principal Commissioner or Commissioner

may, during the course of any proceedings under this Act, direct that any person who has under-reported his income shall be liable to pay a penalty in addition to tax, if any, on the under-reported income.

Quantum of penalty [Section 270A(7) & (8)]

- **50%** of the amount of tax payable on under-reported income [Sec. 270A(7)]
- **200%** of the amount of tax payable on under-reported income,

where under-reported income is in consequence of any misreporting thereof by any person - [Sec. 270A(8)]

Cases of under-reporting of income [Section 270A(2)]

A person shall be considered to have under-reported his income, if:

a. the income assessed is greater than the income determined in the return processed u/s 143(1)(a);

b. the income assessed is greater than the maximum amount not chargeable to tax, where no return of income has been furnished;

c. the income reassessed is greater than the income assessed or reassessed immediately before such reassessment;

d. the amount of deemed total income assessed or reassessed u/s 115JB or 115JC is greater than the deemed total income determined in the return processed u/s 143(1)(a);

e. the amount of deemed total income assessed u/s 115JB or 115JC is greater than the maximum amount not chargeable to tax, where no return of income has been filed;

f. the amount of deemed total income reassessed u/s 115JB or 115JC is greater than the deemed total income assessed or reassessed immediately before such reassessment;

g. the income assessed or reassessed has the effect of reducing the loss or converting such loss into income.

Computation of amount of under-reported income [Section 270A(3)]

The amount of under-reported income shall be:

- in a case where income has been assessed for the first time:

▸ If return has been furnished	Assessed Income – Income determined u/s 143(1)a)
▸ If return has not been furnished	In case of company, firm or local authority: Assessed Income Other persons: Assessed Income – Basis Exemption Limit

- in a case where income has been assessed for the first time: Income reassessed or recomputed **-** Income assessed, reassessed or recomputed in a *preceding order*
  - Preceding order means an order immediately preceding the order during the course of which the penalty has been initiated.
- in a case where under-reported income arises out of determination of deemed total income in accordance with sec. 115JB or 115JC, the amount of total under-reported income shall be determined in accordance with the following formula:

  (A — B) + (C — D)

  Where, A = Total income assessed as per the provisions other than the provisions contained in section 115JB or 115JC (herein called general provisions) B = 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 = Total income assessed u/s 115JB or 115JC D = Total income that would have been chargeable had the total income assessed u/s 115JB or 115JC been reduced by the amount of under-reported income. However, where the amount of under-reported income on any issue is considered both u/s 115JB / 115JC and under general provisions, such amount shall not be reduced from total income assessed while determining the amount under item D.

- in a case where an assessment or reassessment has the effect of reducing the loss declared in the return or converting that loss into income:

The income or loss assessed or reassessed - Loss claimed

Meaning of under-reported income in a case where source is linked to earlier year [Section 270A(4)]

Where: - the source of any receipt, deposit or investment in any 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 year prior to the assessment year in which such receipt, deposit or investment appears (hereinafter referred to as “preceding year”) - and no penalty was levied for such preceding year, then, the under-reported income shall include such amount as is sufficient to cover such receipt, deposit or investment.

Cases not considered as under-reported income [Section 270(6)]

The under-reported income shall not include the following:

a. **Proper Explanation:** The amount of income in respect of which the assessee offers an explanation and the Assessing Officer or the Commissioner (Appeals) or the Commissioner or the Principal Commissioner, as the case may be, is satisfied that the explanation is bona fide and the assessee has disclosed all the material facts to substantiate the explanation offered.

b. **Estimate by the authority:** 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 Assessing Officer or the Commissioner (Appeals) or the Commissioner or the Principal Commissioner, as the case may be, but the method employed is such that the income cannot properly be deduced therefrom;

c. **Estimate by the assessee:** 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, has included such amount in the computation of his income and has disclosed all the facts material to the addition or disallowance.

d. **Arm’s length price:** 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 u/s 92D, declared the international transaction under Chapter X, and, disclosed all the material facts relating to the transaction; and

e. **Undisclosed income in search operation:** The amount of undisclosed income referred u/s 271AAB

Cases of misreporting of income [Section 270A(9)]

The cases of misreporting of income shall be the following: 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 books of account having a bearing on total income; and 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.

Computation of tax payable on under-reported income [Section 270A(10)]

The tax payable in respect of the under-reported income shall be:

Where no return of income has been furnished and the income has been assessed for the first time	Tax calculated on the under-reported income as increased by the maximum amount not chargeable to tax as if it were the total income	
Where the total income determined u/s 143(1)(a) or assessed, reassessed or recomputed in a preceding order is a loss	Tax calculated on the under-reported income as if it were the total income	
In any other case	Tax on (Under-reported income + Income determined u/s 143(1(a) or income assessed, reassessed or recomputed in a preceding order) Less: Tax on Income determined u/s 143(1(a) or income assessed, reassessed or recomputed in a preceding order	***** *****

Other Points

- **No double penalty on same amount:** 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)].
- **Written order:** The penalty shall be imposed, by an order in writing, by the Assessing Officer, the Commissioner (Appeals), the Commissioner or the Principal Commissioner, as the case may be – [Sec. 270A(12)]

IMMUNITY FROM IMPOSITION OF PENALTY, ETC. [SECTION 270AA]

- An assessee may make an application to the Assessing Officer to grant immunity from imposition of penalty u/s 270A and initiation of proceedings u/s 276C or 276CC, if he fulfils the following conditions:
  a. the tax and interest payable as per the order of assessment or reassessment u/s 143(3) or 147, as the case may be, has been paid within the period specified in such notice of demand; and
  b. no appeal against aforesaid order has been filed.
- An application shall be made within 1 month from the end of the month in which the said order has been received and shall be made in such form (Form 68) and verified in prescribed manner.
- The Assessing Officer shall (on fulfilment of the aforesaid conditions) and after the expiry of the period of filing the appeal to the Commissioner (Appeals), grant immunity from imposition of penalty u/s 270A and initiation of proceedings u/s 276C or 276CC, where the proceedings for penalty u/s 270A has **not** been initiated due to misreporting of income.
- The Assessing Officer shall, within a period of 1 month from the end of the month in which the application is received, pass an order accepting or rejecting such application after giving an opportunity of being heard to the assessee.
- The order made by the assessing officer in this regard is final.
- Where immunity is granted to the assessee, then appeal to Commissioner (Appeals) or an application for revision u/s 264 shall not be admissible against the order of assessment or reassessment.

POWER TO REDUCE OR WAIVE PENALTY, ETC., IN CERTAIN CASES [SECTION 273A]

Power u/s 273A(1): The Principal Commissioner or Commissioner may, in his discretion, whether on his own motion or otherwise reduce or waive the amount of penalty imposed or imposable on a person u/s 270A* for concealment of income (not other penalty) if he is satisfied that such person:

(a) has, prior to the detection by the Assessing Officer, of the concealment of particulars of income or of the inaccuracy of particulars furnished in respect of such income, voluntarily and in good faith, made full and true disclosure of such particulars;

Note: A person shall be deemed to have made full and true disclosure of his income or of 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 provisions of sec. 270A.

(b) has, co-operated in any enquiry relating to the assessment of his income; and

(c) has either paid or made satisfactory arrangements for the payment of any tax or interest payable in consequence of an order passed under this Act in respect of the relevant assessment year.

However, where 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 a sum of Rs. 5,00,000, no order reducing or waiving the penalty shall be made by the Principal Commissioner or Commissioner except with the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General, as the case may be.

Where an order of waiver u/s 273A(1) has been made 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. That means such waiver can be done once in life of assessee.

Power u/s 273A(4): The Principal Commissioner or Commissioner may, on an application (not suo motu) made in this behalf by an assessee, and after recording his reasons for so doing, reduce or waive the amount of any penalty payable by the assessee under this Act, or stay or compound any proceeding for the recovery of any such amount, if he is satisfied that—

i. to do otherwise would cause genuine hardship to the assessee, having regard to the circumstances of the case; and

ii. the assessee has co-operated in any inquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

Where the amount of any penalty payable under this Act or, where such application relates to more than one penalty, the aggregate amount of such penalties exceeds Rs. 1,00,000, no order reducing or waiving the amount or compounding any proceeding for its recovery shall be made by the Principal Commissioner or Commissioner except with the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General, as the case may be.

The order, either accepting or rejecting the application in full or in part, shall be passed within a period of 12 months from the end of the month in which the application is received by the Principal Commissioner or the Commissioner. 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.

POWER OF PRINCIPAL COMMISSIONER OR COMMISSIONER TO GRANT IMMUNITY FROM PENALTY [SECTION 273AA]

1. A person may make an application to the Principal Commissioner or Commissioner for granting immunity from penalty, if —

- **(a)** he has made an application for settlement u/s 245C and the proceedings for settlement have abated u/s 245HA; and
- **(b)** the penalty proceedings have been initiated under this Act.

2. The application to the Principal Commissioner or Commissioner shall not be made after the imposition of penalty after abatement.

3. The Principal Commissioner or Commissioner may, subject to such conditions as he may think fit to impose, grant to the person immunity from the imposition of any penalty under this Act, if he is satisfied that the person has, after the abatement, co-operated with the income-tax authority in the proceedings before him and has made a full and true disclosure of his income and the manner in which such income has been derived.

4. The order, either accepting or rejecting the application in full or in part, shall be passed within a period of 12 months from the end of the month in which the application is received by the Principal Commissioner or the Commissioner. 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.

5. The immunity granted to a person shall stand withdrawn, if such person fails to comply with any condition subject to which the immunity was granted and thereupon the provisions of this Act shall apply as if such immunity had not been granted.

6. The immunity granted to a person may, at any time, be withdrawn by the Principal Commissioner or Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, concealed any particulars material to the assessment from the income-tax authority or had given false evidence, and thereupon such person shall become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

PENALTY NOT TO BE IMPOSED IN CERTAIN CASES [SECTION 273B]

Penalty referred to in section 271A, 271AA, 271B, 271BA, 271BB, 271C, 271CA, 271D, 271E, 271FA, 271FAB, 271FB, 271G, 271GA, 271GB, 271H, 271-I, 271J, 272A(1)(c), 272A(1)(d), 272A(2), 272AA, 272B, 272BB or 272BBB, shall not be imposable on the person or the assessee, as the case may be, for any failure referred to in the said provisions if he proves that there was reasonable cause for the said failure.

PROCEDURE [SECTION 274]

No order imposing a penalty under this Chapter shall be made unless the assessee has been heard, or has been given a reasonable opportunity of being heard. No order imposing a penalty under this Chapter shall be made:

- **(a)** by the Income-tax Officer, where the penalty exceeds Rs. 10,000;
- **(b)** by the Assistant Commissioner or Deputy Commissioner, where the penalty exceeds Rs. 20,000, except with the prior approval of the Joint Commissioner.

An income-tax authority on making an order under this Chapter imposing a penalty (unless he is himself the Assessing Officer) shall send a copy of such order to the Assessing Officer.

BAR OF LIMITATION FOR IMPOSING PENALTIES [SECTION 275]

No order imposing a penalty under this Chapter shall be passed after following time limit:

Where the relevant assessment or other order is the subject-matter of an appeal to the Commissioner (Appeals) and the Commissioner (Appeals) passes the order on or after 01-06-2003 disposing of such appeal	An order imposing penalty shall be passed a. before the expiry of the financial year in which the proceedings, in the course of which action for imposition of penalty has been initiated, are completed; or b. within 1 year from the end of the financial year in which the order of the Commissioner (Appeals) is received by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, whichever is later
Where the relevant assessment or other order is the subject-matter of revision u/s 263 or 264	Penalty order shall not be passed after the expiry of 6 months from the end of the month in which such order of revision is passed
In any other case	Penalty order shall not be passed: a. 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 b. six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later

Revision of penalty order [Section 275(1A)]

Case:

Where the relevant assessment or other order is the subject-matter of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal or to the High Court or to the Supreme Court [here-in-after referred to as ‘appeal’] or revision u/s 263 or 264.

An order imposing or enhancing or reducing or cancelling penalty or dropping the proceedings for the imposition of penalty is passed before appeal order is received by the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner or the order of revision is passed,

Then

An order imposing or enhancing or reducing or cancelling penalty or dropping the proceedings for the imposition of penalty may be passed on the basis of assessment as revised by giving effect to such appeal and revision.

However, no order of imposing or enhancing or reducing or cancelling penalty or dropping the proceedings for the imposition of penalty shall be passed after the expiry of 6 months from the end of the month in which the appeal order is received by the Principal Chief Commissioner or Chief Commissioner or the Principal Commissioner or Commissioner or the order of revision is passed.

Further, no penalty order is passed unless the assessee has been heard, or has been given a reasonable opportunity of being heard.

Provision for E-Penalty [Section 274(2A)]

The Central Government may notify an e-scheme for the purposes of imposing penalty so as to impart greater efficiency, transparency and accountability by,—

(a) eliminating the interface between the Assessing Officer and the assessee in the course of proceedings to the extent technologically feasible;

(b) optimising utilisation of the resources through economies of scale and functional specialisation;

(c) introducing a mechanism for imposing of penalty with dynamic jurisdiction in which penalty shall be imposed by one or more income-tax authorities.

It also empower the Central Government, for the purpose of giving effect to the scheme made under the sub-section, for issuing notification in the Official Gazette, to direct that any of the provisions of this Act relating to jurisdiction and procedure of imposing penalty shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in the notification. Such directions are to be issued on or before 31st March, 2022. It is further provided that every notification issued shall be required to be laid before each House of Parliament.

This amendment will take effect from 1st April, 2020.

PROSECUTION

WHEN ASSESSEE BECOMES LIABLE FOR PROSECUTION

The Department is empowered to put on prosecution proceedings for offences committed by taxpayers. Prosecution details are tabulated below:

<table>
<tr><th rowspan="2">Section</th><th rowspan="2">Nature of offence</th><th colspan="2">Rigorous Imprisonment and Fine</th></tr>
<tr><th>Minimum</th><th>Maximum</th></tr>
<tr><td>275A</td><td>Contravention of any order referred to in the second proviso to sec. 132(1) or (3)</td><td colspan="2" rowspan="3">Any period up to 2 years (and fine also)</td></tr>
<tr><td>275B</td><td>Failure to comply with provision of sec. 132(1)(iib)</td></tr>
<tr><td>276</td><td>Removal, concealment, transfer or delivery of property or any interest therein to prevent tax recovery.</td></tr>
<tr><td>276A</td><td>Failure to comply with provision of sec. 178(1)/(3) by liquidator of a company.</td><td colspan="2">Any period up to 2 years</td></tr>
<tr><td>276B</td><td>Failure to pay to the credit of Central Government - tax deducted at source or tax on dividend u/s 115-O or tax payable under second proviso to sec.194B</td><td rowspan="2">3 months (with fine)</td><td rowspan="2">7 years (with fine)</td></tr>
<tr><td>276BB</td><td>Failure to pay to the credit of Central Government tax collected at source u/s 206C</td></tr>
<tr><td rowspan="2">276C(1)</td><td rowspan="2">Attempt to evade tax, penalty or interest chargeable/ imposable, or under-reports income
Case I: If amount sought to be evaded exceeds Rs. 25,00,000
Case II: If such amount involved does not exceed Rs. 25,00,000</td><td>6 months (with fine)</td><td>7 years (with fine)</td></tr>
<tr><td>3 months (with fine)</td><td>2 years (with fine)</td></tr>
</table>

276C(2)	Attempt to evade the payment of any tax, penalty or interest.	3 months (with fine)	3 years (with fine)
276CC	Willful failure to file return of income in time u/s 139(1), or in response to notice u/s 142(1) or u/s 148 or u/s 153A		
	Case I: If amount of tax sought to be evaded exceeds Rs. 25,00,000	6 months (with fine)	7 years (with fine)
	Case II: If amount of tax sought to be evaded does not exceed Rs. 25,00,000	3 months (with fine)	2 years (with fine)
276D	Wilful failure to produce books of account and documents as required u/s 142(1) or wilful failure to comply with direction u/s 142(2A) to get the accounts audited	Any period up to one year (and with fine)	
277	Makes false statement in any verification or delivers a false account or statement under this Act or rules there under		
	Case I: If amount of tax sought to be evaded exceeds Rs. 25,00,000	6 months (with fine)	7 years (with fine)
	Case II: If amount of tax sought to be evaded does not exceed Rs. 25,00,000	3 months (with fine)	2 years (with fine)
277A	Where any person (hereafter referred to as the first person) wilfully and with intent to enable any other person (hereafter referred to as the second person) to evade any tax or interest or penalty chargeable and imposable under this Act, makes any entry or statement which is false and which the first person either knows to be false or does not believe to be true, in any books of account or other document being useful in any proceedings against the first person or the second person. For establishing the charge, it shall not be necessary to prove that the second person has actually evaded any tax, penalty or interest chargeable or imposable under this Act.	The first person shall be punishable with rigorous imprisonment for 3 months and with fine.	The first person shall be punishable with rigorous imprisonment for 2 years with fine.
278	Abetment or inducement in any manner to another person to make false statement or declaration relating to any income or any fringe benefits chargeable to tax. Case I: Where the amount of tax, penalty or interest which would have been evaded due to such false presentation, exceeds Rs. 25,00,000	6 months (with fine)	7 years (with fine)
	Case II: In any other case	3 months (with fine)	3 months (with fine)

<table>
<tr><td>278A</td><td>Punishment for second and subsequent offences u/s 276B, 276C(1), 276CC, 277 or 278</td><td>6 months for every offence (with fine)</td><td>7 years for every offence (with fine)</td></tr>
<tr><td>278B</td><td>Where an offence under this Act has been committed by a company –
● The company itself; and
● 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,
– shall be deemed to be guilty of the offence
Note: Company includes firm, AOP/BOI.</td><td colspan="2" rowspan="2">Liable to be proceeded against and punished accordingly.
Note: Where the punishment for an offence is imprisonment and fine, then such company shall be punished with fine only.</td></tr>
<tr><td>278C</td><td>Where an offence under this Act has been committed by an HUF, the Karta thereof shall be deemed to be guilty of the offence</td></tr>
<tr><td>280</td><td>Disclosure of any information by public servants in contravention of sec. 138(2)</td><td colspan="2">Upto 6 months (with fine)
(With previous sanction of the Central Government)</td></tr>
</table>

POWER OF COMMISSIONER TO GRANT IMMUNITY FROM PROSECUTION [SECTION 273AB]

A person may make an application to the Principal Commissioner or Commissioner for granting immunity from prosecution, if he has made an application for settlement u/s 245C and the proceedings for settlement have abated u/s 245HA.

The application to the Principal Commissioner or Commissioner shall not be made after institution of the prosecution proceedings after abatement.

The Principal Commissioner or Commissioner may, subject to such conditions as he may think fit to impose, grant to the person immunity from prosecution for any offence under this Act, if he is satisfied that the person has, after the abatement, co-operated with the income-tax authority in the proceedings before him and has made a full and true disclosure of his income and the manner in which such income has been derived:

The immunity granted to a person shall stand withdrawn, if such person fails to comply with any condition subject to which the immunity was granted and thereupon the provisions of this Act shall apply as if such immunity had not been granted.

The immunity granted to a person may, at any time, be withdrawn by the Principal Commissioner or Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, concealed any particulars material to the assessment from the income-tax authority or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the proceedings.

LESSON ROUNDUP

- The Income-tax Act provides for collection and recovery of income-tax in the following ways, namely,
  - (i) Tax Deduction at Source / Tax Collection at source
  - (ii) Advance Tax
  - (iii) Self Assessment Tax
  - (iv) Payment of Tax after the assessment is made by the Assessing Officer.
- Sections 192 to 206 of the Income-tax Act lay down the provisions relating to deduction of tax at source.
- Section 197A provides that no deduction of tax at source is to be made from (i) interest on securities, (ii) dividends, and (iii) payments in respect of deposits under NSS, etc. if the following conditions are satisfied:
  - a) The recipient of such income is an individual and resident in India.
  - b) Such person furnishes a declaration in writing in duplicate, in the prescribed form and verified in the prescribed manner, to the payer of such income to the effect that the tax on his estimated total income of the previous year in which such income is to be included for computing his total income will be nil.
- Section 207-219 of the Income Tax Act deals with the provisions relating to advance payment of tax. In advance payment of tax, the assessee has to pay tax in a financial year under estimated income which is to be taxed in the subsequent assessment year. It follows the doctrine known as pay as you earn scheme. It is obligatory for an assessee to pay advance tax where the advance tax payable is Rs. 10,000 or more (Section 208).
- **Filing of Return:** The procedure under the Income-tax Act for making an assessment of income begins with the filing of a return of income. Section 139 of the Act contains the relevant provisions relating to the furnishing of a return of income.
- E-Filing of Return: The Income Tax Department has introduced on line facility in addition to conventional method to file return of income. The process of electronically filing of Income Tax return through the mode of internet access is called e-filing of return.
- Refund means “to repay” or restore what was taken under the income-tax law. Refunds arise in those cases where the amount of tax paid by a person or on his behalf is greater than the amount with which he is properly chargeable for that year.
- Types of Assessment

  Self assessment (Section 140A)

  Regular assessment (Section 143)

  Best judgment assessment (Section 144)

  Income escaping assessment or re-assessment (Section 147)

  Precautionary assessment.

  Self assessment is the first step in the process of assessments.
- Self Assessment is simply a process where a person himself assesses his tax liability on the income earned during the particular previous year and submits Income Tax Return to the department.

- Under summary assessment, Assessing Officer completes the assessment without passing a regular assessment order. The Assessing Officer issue an acknowledgement/intimation under section 143(1) of tax payable or refundable as the case may be on the basis of Return of Income filed by the assessee under section 139 or in response to a notice issued under section 142(1).
- Where a return has been made under Section 139, or in response to a notice under sub–section (1) of Section 142, the Assessing Officer shall, if he considers necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner, serve on the assessee a notice requiring him, on a date to be specified therein, either to attend his office or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return.
- Best Judgment Assessment: The Assessing Officer, after taking into account all relevant material which he has gathered, and after giving the assessee an opportunity of being heard, makes the assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee on the basis of such assessment.
- Income Escaping Assessment : If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153.
- The right to appeal must be given by express enactment in the Act. Therefore, in case there is no provision in the Act for filing an appeal regarding a particular matter, no appeal shall lie. The right to appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority.
- The assessee may prefer an appeal against the orders of the Assessing Officer to the Commissioner (Appeals), in accordance with the relevant provisions under Section 246 and appeal against the order of the Commissioner (Appeals) can be preferred by the Assessee or the Commissioner of Income Tax and such appeal lies with the Appellate Tribunal.
- The Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act.
- Section 260A provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law.
- The aggrieved party is entitled to appeal to the Supreme Court against the judgment delivered by the High Court.
- Chapters XVII and XXI of Income-tax Act, 1961, contain various provisions empowering an Income tax Authority to levy penalty in case of certain defaults.

TEST YOURSELF

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

ELABORATIVE QUESTIONS

1. What is Tax deducted at Source?
2. Explain the procedures regarding refund of excess tax paid by the assessee to the Department.

3. State the provisions regarding deduction of tax at source in respect of the following incomes:
   (i) Rent
   (ii) Professional or technical fees.
   (iii) Winning from horse races.
4. State the income-tax authorities who are empowered to administer the Income-tax Act and explain their powers, functions and jurisdiction in relation to assessment of income.
5. Discuss the statutory obligations of an assessee to file a return of his income and indicate the time-limits for filing the return.
6. Explain the following :
   (a) Return of loss;
   (b) Belated return;
   (c) Revised return; and
   (d) Voluntary return.
7. What is self-assessment? What are the consequences of non-payment of tax on "Self-assessment"?
8. Discuss how regular assessments and best judgment assessments are made under the Act?
9. Under what circumstances is the Assessing Officer empowered to reopen the assessment made by him? Give example.
10. Explain the circumstances under which income is said to have escaped assessment and state the power of the Assessing Officer to assess such escaped income. Illustrate.
11. Specify the time limits within which -
    (a) notice should be issued by the Assessing Officer for making an assessment or re-assessment;
    (b) the assessment or re-assessment should be completed.
12. What is a mistake apparent from the record? Explain the specific cases of mistakes given in the Act which are to be rectified and state the time limits for rectification in each case.
13. Write a lucid note on best judgment assessment with suitable illustration.
14. Explain the provisions with respect to appeals and revisions with reference to tax planning.
15. Explain the provisions relating to revision of assessment order prejudicial to the interest of assessee.
16. What are the various grounds of appeals available before different types of authorities to the assessee?
17. Under what circumstances the assessment order can be revised on the basis of applications of the assessee? Under what circumstances the revision cannot be made?
18. Under what circumstances can an assessee appeal to the Appellate Tribunal? What documents are to be attached in mailing an appeal to the Tribunal?
19. When can an aggrieved party appeal to the Supreme Court against the judgment delivered by the High Court?
20. Compliance with legal formalities is less costly than the payment of penalty or interest due on taxes. Explain the statement briefing the defaults and penalties under the Income-tax Act.

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 10
Tax Planning and Tax Management

LESSON OUTLINE

- Tax Planning
- Doctrine of Form and Substance
- Test to be applied – Tax Planning
- Systems to Method of Tax Planning
- Tax Planning and Retrospective Legislation
- Tax Planning and Administrative Legislation
- Legal effect of a circular
- Tax Planning and Systems of Advance ruling
- Tax Planing and Interpretation
- Doctrine of Precedence
- Tax Planning & Diversion of Income V/s Application of Income
- Various Avenues of Tax Planning
- Tax Planning and Management/Investment Decision
- Tax Planning for Foreign Collaboration
- Tax Planning in case of Losses
- LESSON ROUNDUP
- TEST YOURSELF

LEARNING OBJECTIVES

Tax planning is an activity undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions etc., while Tax management consists of steps taken to comply with Income Tax law e.g. maintaining of books of account, computing the income , deposit of tax, filing of returns etc.

At the end of this lesson, students will be able to understand

- what is tax planning, tax avoidance and tax evasion and their difference
- what are the tools of tax planning
- Determine how tax planning can be implemented
- which are the major areas of tax planning
- How to do tax planning with respect to Non-Resident

TAX PLANNING

Tax planning is application of the various provisions of tax laws to reduce the tax impact on the assessee to the minimum with the help of deductions, exemptions, rebates, reliefs etc.

Tax planning requires latest knowledge of tax laws, circulars issued by the CBDT and various decisions of the Courts. Tax Planning is a system which in its implementation is designed to achieve a specific result.

Tax planning aims to reduce the outflow of cash resources made available to the Government by way of taxes so that the same may be effectively utilised for the benefit of the individual or the business, as the case may be.

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.

Saving of taxes by legal means may take two forms — **Tax Planning and Tax Avoidance.**

'Tax planning' is wider in range. The dividing line between tax evasion and tax avoidance is very thin. Tax planning involves reduction of taxes by taking benefits expressly provided under the Law but Tax Evasion involves reduction of taxes by using loopholes/lacunas in law. Tax avoidance defeats the object of law and not the law.

However, **Tax Evasion** refers to any attempt to avoid payment of taxes by using illegal means. Some of the ways of tax evasion are:

- Providing false information;
- failure to record investments in books of account;
- claim of bogus expenditure;
- 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

Tax Planning under English Law

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.

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.

Tax Planning under Indian Law

In CIT vs. A. Raman & Co. 1 SCR 10, the Supreme Court followed the case 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 tax payer 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.

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 of 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 by 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

The Supreme Court emphasised that tax planning may be legitimate provided it is within the framework of law and colourable 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 AND DOCTRINE OF FORM AND SUBSTANCE

One of the reason of tax planning is the existence of the doctrine of form and substance. Is it possible to ignore the form of a transaction and determine the substance thereof?

In *Commissioner of Income tax vs. Motor and General Stores (P) Ltd. (1967) 66 ITR 692 (SC.)* 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.

Principles governing the form and substance:

(i) 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.

(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) It is well settled that when a transaction is entered 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, therefore, 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.

(iv) Where the terms of a transaction are contained 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 should be interpreted so as to accord with the real intention of the parties as appearing from the instrument.

(v) 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.

SUCCESSFUL TAX PLANNING : TESTS TO BE APPLIED

Successful tax planning must fulfil two outstanding tests i.e.,

(a) Conformity with the current law and

(b) Flexibility.

In order to satisfy the first test, the essential requirement is a **comprehensive knowledge** of the law, rules and regulations on the part of the tax planner. This knowledge of law extends not only to the provisions of the taxing statutes and the case law that has developed on those statutes, but also to other branches of law, both civil and personal, so that the tax planner's device does not get defeated by the universal principles of jurisprudence.

The second test of flexibility seeks to ensure that the success of the tax planning device is not nullified by statutory negation. Though the tax planner may be successful in seeking out a device which in his opinion is in conformity with law, the subsequent statutory negation may nullify his success. In order to counter this exigency, his tax plan must be flexible. Flexibility essentially means that the device provides for suitable changes in accepted forms.

SYSTEM AND METHOD OF TAX PLANNING

Tax-planning will either be

- Short-range tax-planning or
- Long-range tax-planning.

The short-range tax planning has limited objective and is done for immediate benefits. For eg An assessee whose high income in a particular year on account sale of capital asset like house property, as compared to the preceding year might plan to invest the same in notified bonds, bonds of National Highway Authority of India or Rural Electrification Corporation Limited to claim exemption u/s 54EC. This has a lock-in period of 3 years. Such a plan does not involve any permanent or long-term commitment and yet it results in substantial tax saving. This is an example of short-range tax planning.

The long- range tax planning, on the other hand, may not even confer immediate tax benefits. For e.g. in a case where an assessee transfers certain shares to his spouse, the income arising from the shares will be clubbed with the transferor's income. However, if the company subsequently issues bonus shares in respect of those shares the income arising from the bonus shares will not be clubbed with the transferor's income. Similarly, the income arising out of the investment of the income from the transferred assets will not also be clubbed with the transferor's income. Long range tax planning may be resorted to even for domestic or family reasons.

TAX PLANNING AND RETROSPECTIVE LEGISLATION

TAX PLANNING also has to deal with the specific problems arising from the retrospective application of tax rates and tax amendments.

The cardinal principle of construction is that a statute must always be interpreted prospectively unless the language of the statute makes it retrospective either expressly or by necessary implication. A retrospective operation is not to be given to a statute so as to impair vested rights or the legality of past transactions.

In India, the Government generally follows the principle that the changes in the rates of tax, as also the other amended provisions of tax laws, should ordinarily be made operative prospectively in relation to current incomes and not in relation to incomes of the past year. However, there are cases where the Government have introduced retrospective amendments in tax laws. The Supreme Court has upheld the validity of such retrospective laws.

Any retrospective legislation has two aspects. For pending assessments, the amended provision would be applied. The difficulty would arise in the case of completed assessments. The effect of a retrospective legislative amendment is that the provisions as amended, shall, for all legal purposes be deemed to have been included in the statute from the date on which the amendment came into force. All orders relating to periods subsequent to the date of retrospective amendment must be in consonance with the specific and clear provisions, as amended retrospectively.

TAX PLANNING AND ADMINISTRATIVE LEGISLATION

It is a common feature of enactment to lay down in the section of the Act, the principles and the policy of the Legislature leaving out details to be filled in or worked out by rules or regulations made either by the Government or by some other authority as may be empowered in the legislation.

The following principles emerging from various rulings are relevant in this context.

1. The rules cannot be made which are contrary to the object of the Act
2. A rule cannot have a condition ,which is not sanctioned/consistent with the Act.
3. No rule/Regulation can be contrary to the rules of natural justice.
4. A rule cannot over-ride the subject-matter relevant to the particular provision in the Act.
5. A rule cannot reduce, negate or take away the right, privilege, advantage or benefit granted by the section or the enactment relevant to it.
6. A rule cannot seek to impose a tax which the Legislature has not thought it fit or expedient to impose.
7. Both a rule and a provision of law are equally bound to respect the constitutional protection and fundamental right of the citizen contained in Article 14 of the Constitution.
8. A rule has to strictly confine itself to the subject-matter for which the rule-making authority has been empowered by the enactment.
9. Merely because a rule is subsequently laid before the Parliament, it cannot be given the status of a law of Parliament.
10. As in the case of an enactment, if a rule classifies persons and objects into identifiable classes and such classification is relevant to the purpose of the enactment and for carrying out the provisions of the Act, it cannot be called in question.
11. A rule has no retrospective operation unless the Act to which it is relevant specifically provides for the making of rules having retrospective operation.

LEGAL EFFECT OF A CIRCULAR

The various judicial rulings which have considered the legal aspects of Circulars under the Income-tax Act, 1961 point out the following:

(i) *The instructions in favour of the assessee should be followed by the Department, irrespective of the question of their legality; but the instructions adverse to the assessee can be challenged by the assessee.*

(ii) *The instructions of the Board are binding on the Department but not on the assessee.*

(iii) *Instructions adverse to the assessee cannot be issued with retrospective effect, while instructions favourable to the assessee can be so issued.*

(iv) *Instruction withdrawn subsequently should be given effect to by the Assessing Officer for the assessment year for which they were in force even though they are withdrawn at the a time he makes the assessment.*

(v) *In the exercise of its power, the Board cannot impose a burden or put the assessee in a worse position but the Board can grant relief or relax the rigour of the law.*

(vi) *No instruction or circular can go against the provisions of the Act.*

(vii) *Circulars and instructions of the Board are envisaged only in regard to administrative aspects and cannot restrict the judicial power or the discretion of an officer -ALA Firm vs. CIT 102 ITR 622 (Madras), Sirpur Paper Mills Ltd. vs. CWT 77 ITR 6 (SC).*

(viii) *No such orders, instructions or directions shall be issued — (a) so as to require any income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner or (b) so as to interfere with the discretion of the Deputy Commissioner (Appeals) or the Commissioner (Appeals) in the exercise of his appellate functions.*

TAX PLANNING AND SYSTEM OF ADVANCE RULINGS

A ruling is a statement in writing of prescribed tax administering authority to a taxpayer, which interprets and applies the law and regulation to a specific set of facts and states a conclusion as to the tax consequences of that particular transaction. As the rulings are given in advance of the concerned transactions they are called advance rulings.

The advance rulings given are binding on the tax authorities and the applicant who had sought such ruling, with reference to the particular cases in respect of which they are given. A change in the facts can affect the basis of the rulings because the law often pivots on a date, an amount, type of tax payer and so on.

Likewise, a ruling issued with respect to one transaction may not be good to the same tax payer for a subsequent transaction even on what might appear to be identical facts.

Advance rulings are an excellent device for fostering and encouraging the self-assessment system and would contribute to good relations between the administration and tax paying public. From the tax payer’s point of view, these rulings are most desirable because they give more assurance of certainty prior to entering into a transaction and guarantee more uniformity in the application of the tax legislation. They are desirable for the administration also as they minimise the scope for controversy and litigation, reduce the time spent in answering question from tax payers and help to achieve a fair and co-ordinated tax administration.

TAX PLANNING AND INTERPRETATION

No tax can be imposed on the subject without words in the clearly showing an intention to lay a burden upon him. In other words, the subject cannot be taxed unless he comes within the letter of the law.

(a) **Natural Justice:** Tax laws are to be interpreted reasonably and as per with principles of natural justice. Where a literal construction would defeat the obvious intention of the legislation and produce a wholly unseasonable result, the court must achieve that obvious intention and produce a rational construction.

If the interpretation of a fiscal enactment is open to doubts, the construction most beneficial to the subject should be adopted, even if it results in his obtaining “a double advantage”. A provision for exemption of relief should be construed liberally and in favour of the assessee. Likewise, a provision for appeal should be liberally construed. In cases of doubt regarding the construction, assistance may be sought from previous judicial interpretation or from previous legislation or by adverting to the mischief intended to be suppressed. A subsequent enactment affords no useful guide to the interpretation of earlier law, unless it is on the same subject and the earlier law is ambiguous.

(b) **Definition clause and undefined words:** A definition or interpretation clause which extends the meaning of a word should not be construed as taking away its ordinary meaning. Further, such a clause should be so interpreted as not to destroy the basic concept or essential meaning of the expression defined, unless there are competing words to the contrary. Words used in the sections of the Act are presumed to have been used correctly and exactly as defined in the Act and it is for those who assert the contrary to show that there is something repugnant in the subject or context. Words which are not specifically defined must be taken in their legal sense or their dictionary meaning or their popular or commercial sense as distinct from their scientific or technical meaning unless a contrary intention appears.

(c) **Marginal Notes:** Marginal notes to the sections cannot control the construction of the statute but they may throw light on the intention of the legislature.

(d) **Legal fiction:** The word "deemed" may include the obvious, the uncertain and the impossible. A legal fiction has to be carried to its logical conclusion but only within the field of definite purpose for which the fiction is created. As far as possible, a legal fiction should not be so interpreted as to work injustice.

(d) **Provisos:** A proviso cannot be held to control the substantial enactment or to withdraw by mere implication any part of what the main provision has given. A proviso is not applicable unless the substantive clause is applicable to the facts of the case. The proper function of a proviso is to provide an exception to a case which would otherwise fall within the general language of the main enactment and its effect as confined to that case. However, a proviso may be read as an independent substantive enactment where the context warrants such construction. Whether a proviso is construed as restricting the main provision or as a substantive clause, it cannot be divorced from the provision to which it stands as a proviso. It must be construed harmoniously with the main enactment.

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

- The Supreme Court judgments are binding on all the courts, Tribunals and authorities.
- Not only the ratio decidendi, but also obiter dicta of the Supreme Court are binding on all the Courts.
- Decision of a larger Bench shall prevail, when there are two irreconcilable decisions of the Supreme Court on some point of law.
- 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.
- The Supreme Court judgments cannot be ignored by the lower courts though such judgments are per incuriam.
- 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 COURT

- 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.
- 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.

- A Division Bench of High Court is bound to follow a decision of the Full Bench of the same High Court.
- 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.
- 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.
- All the lower authorities, courts 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.
- 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

- 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.
- 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.
- 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.
- An order of a Full Bench of a Tribunal is binding on the ordinary Bench of the Tribunal.
- If an ordinary bench of a Tribunal does not agree with an order of another Bench of the Tribunal, and that order of the 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.
- The Tribunal orders are binding on the Commissioner (Appeals) falling within the territorial jurisdiction of the Tribunal passing the order in question.
- The Assessing Officer and the Commissioner, while acting under section 263, cannot refuse to follow the decision of 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.
- 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.
- 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.)

TAX PLANNING AND DIVERSION OF INCOME /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.

VARIOUS AVENUES OF TAX PLANNING

Tax Planning and Salary Income

The definition of salary is very wide and includes not only monetary salary but also benefits and perquisites in kind. The only deductions available in respect of salary income are the deduction for entertainment allowance and deduction for professional tax. Therefore, the scope for tax planning in respect of salary income is severely limited. However, the following are some ideas of tax planning in regard to salary income.

1. Salary structure: The employer should not pay a lumpsum amount as salary to employee because the entire amount of salary will become taxable without any exemption. It should divide the same and pay it as basic salary plus various allowances and perquisites.

For example, the employer could provide Children education allowance, hostel allowance, house rent allowance, transport allowance etc. The employee will get exemption from salary incomes.

2. Employee welfare scheme: There are several employees welfare schemes such as recognised provident fund, approved superannuation fund, gratuity fund. Payments received from such funds by the employees are totally exempt or exempt upto significant amounts.

For example, the entire provident fund received by the employee from recognised provident fund is exempt. The employer should form such welfare schemes for the benefit of the employees. Such amount contributed by the employer towards the above funds are deductible from business Income.

However, the restrictive provisions of section 40A(9), disallows any contribution made to any non statutory welfare funds.

In this connection, it may be noted that section 10(23AAA) exempts any income of a staff welfare fund subject to the satisfaction of certain conditions.

(3) Insurance policies: Any health insurance premium payable by employer on health of an employee will not be treated as perquisite in the hands of the employee. Further, payments received from the employer in respect of keyman insurance policies constitute income in the hands of the employees. However, the payment of life insurance premium by the employer on behalf of the employee will be treated as a perquisite in hands of employee.

(4) Dearness Allowance and Dearness Pay: The employer should ensure that dearness allowance and dearness pay should form part of "salary". This is because certain items like gratuity, commuted pension, leave salary,VRS and the employer's contribution to the recognised provident fund etc. are calculated on the basis of salary. Therefore, if dearness allowance, dearness pay etc. are included in salary, the above benefits will also increase leading to higher exemption in the hands of the employee.

(5) Commission : The Supreme Court, in **Gestetner Duplicators Pvt. Ltd. v. CIT 117 ITR 1**, has held that if, under the terms of employment, commission is payable at a fixed percentage of turnover achieved by an employee such commission should be taken into account for calculating "salary" for the purpose of gratuity etc. The employer will be well advised to provide for such commission.

(6) Leave travel facility : The employer should provide leave travel facility to all employees . Under section

10(5) of the Income-tax Act, 1961, exemption is provided to employee from LTC twice in a block of 4 years .Such exemption is available for the employee, spouse, children (to a maximum of 2 children born on or after 1/10/98), dependent parents, dependent brothers and dependent sisters.

(7) RFA/HRA: An employee should analyse the tax incidence of a RFA and HRA whenever he is given an option, in order to choose the one which is more beneficial to him. The perquisite of RFA is taxed as per Rule 3 of the Income-tax Rules, 1962 and HRA is exempt as per limits u/s 10(13A) read with Rule 2A. The employee should therefore work out his tax liability and net cash flow under both the options and then, decide on whether to receive HRA or choose RFA.

(8) Medical Allowance: The employer should avoid paying fixed medical allowance. This is **100%** taxable. Whereas, he can also provide free medical facilities in his own hospital/Government hospital which is not taxable.

(9) Pension: Uncommuted pension (regular pension) is fully taxable. Therefore, the employees should get their pension commuted. Commuted pension (lumpsum pension) is fully exempt from tax in the case of government employees(Central and state) and partly exempt from tax in the case of non-government employees.

(10) Provident fund: Amount received from Recognised provident fund is exempt u/s 10(12) is received after 5 years of service. Where an employee, who resigns before completing five years service should ensure that he joins a firm which maintains a recognised provident fund. The accumulated balance of the provident fund with the previous employer will be exempt from tax provided the same is transferred to the new employer who also maintains a recognised provident fund.

(11) Retirement benefit : Incidence of tax on retirement benefits like gratuity, commuted pension, accumulated balance of unrecognized provident fund is lower if they are paid in the beginning of the financial year. The employer and the employees should mutually plan their affairs in such a way that retirement takes place in the beginning of a financial year.

(12) Pension by non resident : Pension received in India by a non-resident assessee from abroad is taxable in India. If, however, such pension is first received by or on behalf of the employee in a foreign country and later on remitted to India, it will be exempt from tax.

(13) Accidents Insurance : In respect of accident insurance policies, the decision of the Supreme Court in *CIT v. L.W.Russel (1964) 53 ITR 91* points out that the term perquisite applied to only such sums in regard to which there was an obligation on the part of the employer to pay and a vested right on the part of the employee. If the employee has no vested interest in the policy, it cannot be considered as a perquisite. In view of this position, in cases where an employer takes out accident insurance policy covering all workmen and staff members and pays insurance premium and whenever any worker/staff member meets with an accident and the amount of claim is received from the insurance company and the same is paid away by the employer to the said worker or his family members, the premium paid by the employer in respect of group accident policies could not be considered as a perquisite, under section 17 to be added in the salary income of any employee [*CIT v. Lala Shri Dhar (1972) 84 ITR 192]*. The amount received from insurance company on accident or death by employee or his dependents will not also be in the nature of income but a capital receipt and therefore the same will not be taxable.

(14) Exempt perquisite: The following are the perquisites which are exempt from tax–

- Free meals in office upto ₹50/meal
- Use of telephone/mobile phone by employee
- Use of computers and laptop by employee;
- Medical facility in employer's own hospital or a public hospital or Government or other approved hospital;

- Educational benefit in a school run by employer provided value of benefit does not exceed ₹ 1,000 per month per child.

Tax Planning Considerations in relation to Business

For a new business, the spheres in which the question of tax planning is relevant are as follows:

1. **Form of the organisation**
2. **Nature of the business**
3. **Financial Structure**
4. **Acquisition of plant and machinery and other fixed assets**
5. **Setting up and commencement of business**

1. FORM OF BUSINESS ORGANISATION: The choice of the appropriate form of business organisation 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 organisation after the commencement of the business, may attract liability to tax. A new business can be organised 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 organisation 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, remuneration paid to proprietor is not allowed as deduction from business profits of the sole proprietorship firm. Whereas remuneration paid by partnership firm/LLP to its working partner is allowed as deduction subject to sec 40(b) As a result, the taxable income from business would get reduced and correspondingly, the incidence of tax would also be reduced.

Under sole proprietorship, the entire income of a business unit gets assessed in the hands of the same person along with other income, while the entire loss and other allowances shall be available for set off in his hands against other income. This may have some advantage in the initial years, after which the possibility of converting it into company/firm may be considered; on such conversion, the questions of possible capital gains tax, etc., will have to be considered.

Hindu Undivided Family 'HUF': The HUF is treated as a separate entity under the Income Tax Act. 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.

Partnership and LLP: All firms and LLPs will be taxed at a flat rate of 30**%.** If the total income exceeds ₹ 1 crore, surcharge @ 12% is applicable. There will be no initial 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 is fully exempt under section 10(2A).

Also, partnership firms carrying on eligible business can declare income on presumptive basis as per the provisions of section 44AD@8% of gross receipts (6% in case gross receipts are received by an account payee cheque/bank draft/ use of ECS through bank account).

Partnership firms carrying on notified profession can declare income on presumptive basis@50% of gross receipts as per the provisions of section 44ADA.

Company: 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 u/s 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:

(1) The General tax rate of domestic company is 30% and if turnover is upto ₹ 400 crores in last previous year, then General tax rate is 25%.

(2) The general tax rate of foreign company is 40%.

(3) The surcharge on domestic company is 7% if Total Income exceeds 1 crore and 12% if Total Income exceeds 10 crores.

(4) The surcharge on foreign company is 2% if Total Income exceeds 1 crore and 5% if Total Income exceeds 10 crores.

(5) 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.

(6) 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.

Place of Effective Management (POEM)

- The concept of POEM was 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.
- 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. It will have to file its tax returns, audit reports etc. with Indian tax department.

Cooperative Society: A co-operative society is also 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, under section 80P has been withdrawn w.e.f. A.Y.2007-08 in respect of all co-operative banks, other than primary agricultural credit societies and primary co-operative agricultural and rural development banks (i.e. societies having its area of operation confined to a taluka 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.

From the above analysis of various forms of the organisation and their treatment for income-tax purposes, it may be appreciated that the provisions of the taxation laws have a considerable influence on the entrepreneurs in their choice of particular form of the organisation that they should establish.

2. NATURE OF 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 combination of both.

Deduction is available under section 10AA to newly established units in Special Economic Zones.

A taxpayer carrying on manufacturing or industrial activities would be in a position to avail of the various concessions such as Depreciation allowance u/s 32, Spectrum expenditure u/s 35ABA, Telecomm licence u/s 35ABB, Preliminary expenses u/s 35D and Mining expenditure u/s 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.

While deciding the nature of the business, the benefit of tax exemption or treatment available in respect of certain types of income such as agricultural concessional 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) FINANCIAL STRUCTURE: Choice in the matter of financing a new unit or business would be between capital and borrowings. New units being set up by existing units or companies would have the possibility of using retained profits. In the case of a company, the means of finance are as follows:

(i) Share capital.

(ii) Debentures.

(iii) Other borrowings

(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: 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 and 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 are out and out tax considerations which 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.

The assessee engaged in the specified business mentioned in section 35AD can avail the benefit of deduction of capital expenditure incurred wholly and exclusively of the purpose of such specified business. Capital expenditure incurred prior to commencement of business shall be allowed as deduction during the previous year in which the assessee commences operation of the specified business if, such expenditure incurred is capitalized in the books of accounts of the assessee on the date of commencement of its operation. However, such deduction is not available in respect of capital expenditure incurred on acquisition of any land, goodwill or financial instrument.

(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 a gap 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 well settled position 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 plastics, the business is set up as soon as acquiring of raw material 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.

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 ten year or five year (as the case may be) period under section 35D.

(d) Such expenditure, if being of a capital nature and if not falling under any of the three categories noted above may be disallowed and there may not be relief either on account of depreciation or amortisation.

Tax Planning for Claiming Business Deduction

There are several matters which affect the assessee's ability to deduct various expenses for income-tax purposes. 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) Amount of allowability (disallowing provisions if any), and

(d) Carry-forward in future years..

Normally, deductions of expenditure is allowable in the year in which it is incurred or paid depending on the method of accounting followed, viz, mercantile or cash. In other words, the expenditure to be claimed as deduction should be claimed in the relevant year.

Where the assessee follows the cash system of accounting, the allowance in respect of expenses would be available only when the moneys in respect of them are actually paid by the assessee. Whereas in the case of mercantile system of accounting, if a business liability has definitely arisen in the accounting year, a deduction should be allowed.

Where accounts are kept on a mercantile basis, if an expenditure is claimed on the ground that it is legally deductible, it can be claimed in the year in which the liability for the expenditure is incurred even though the payment itself is made in a subsequent year. If an assessee following mercantile system fails to claim an expense in the year in which it accrues he loses the right to claim it as a deduction altogether. He cannot claim or make any attempt to reopen the accounts of the earlier year to which the expense relates.

The Supreme Court's decision in C.I.T. vs. Gemini Cashew Sales Corporation (1967), 651 T.R. 642 emphasizes the principle that if the liability to make the payment has arisen during the previous year, it must be appropriately regarded as the expenditure of that year and merely because the payment in respect of the expenditure is made in the subsequent year, the assessee would not be entitled to claim deduction in respect thereof in the subsequent year. As pointed out earlier, this is subject to the provisions of section 43B.

Normally, deduction can be claimed by the assessee only in respect of those expenses and losses which have been actually incurred by the assessee during the previous year, i.e. after the business is set up. However, there are some exceptions to this rule and a tax planner should be aware of the exceptions and make use of them in appropriate cases.

For example, expenditure incurred on scientific research before the commencement of the business — capital or revenue during the three years immediately preceding the commencement of the business and coming within the scope of the *Explanation* to sections 35(1)(i) and 35(1)(ii), capital expenditure incurred prior to commencement of specified business allowed as deduction in the year of commencement of business, in case capitalized under section 35AD, preliminary expenses incurred before commencement of the business and coming within the scope of section 35D, expenditure on prospecting for minerals coming within the scope of section 35E, are cases where the assessee could claim deduction in respect of the expenditure even though the expenditure was not incurred during the previous year.

Similarly, the expenditure in respect of which deduction is claimed by the assessee should not be in the nature of capital expenditure. This is again subject to the statutory exceptions contained in provisions like section 35 and 35AD. Again, subject to the statutory exceptions, the expenditure should be incurred wholly and exclusively for the purpose of the business.

Various other expenses incurred prior to the commencement of commercial operations may, in appropriate cases, be accumulated and capitalised by being spread over the cost of various assets constructed or acquired during the pre-production period. If this is done on a proper basis, the cost

of the various assets including the indirect expenses capitalised can be depreciated for tax purposes to the extent that the cost relates to assets which are themselves depreciable for income-tax purposes.

Under 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". 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.

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.

Interest on borrowed capital: An expenditure which is specifically provided for should be claimed under the relevant section rather under the general 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: An expenditure is regarded as being of a capital nature, if it results in the acquisition of an asset or of an advantage or benefit of an enduring nature.

The test with regard to the nature of the expenditure-capital or revenue - is to be applied with reference to its purpose rather than its effect. The test must be applied by reference to the assessee himself and not any other person.

For instance, a company must be obliged to construct pipelines for the purpose of its business but under conditions whereby the pipelines ultimately become the property of a municipal corporation rather than the company itself. In such a case, although the pipelines undoubtedly constitute tangible assets the expenditure may not be regarded as of a capital nature, since the assets do not belong to the company but to some other person. There are many judicial rulings to support this view. A leading case that maybe referred to in this context is *Lakshmiji Sugar Mills Co. P. Ltd. vs. CI T 82 ITR 376].*

If the purpose of the expenditure is to secure a commercial advantage, rather than acquisition of a capital asset, it is likely to be allowed as revenue expenditure even though the advantage may endure for an indefinite period. However, this rule is by no means inflexible or capable of universal application. Conversely, if the purpose of the expenditure is the acquisition of an advantage or benefit of an enduring nature the expenditure is liable to be treated as capital expenditure even if the period or durability of the asset acquired as the result of the expenditure is very short. For example, if a company making shoes acquires knives and lasts, whose life is only three years, the expenditure may nevertheless be regarded as capital expenditure.

In applying the various case laws on the subject of distinction between capital and revenue, it should be recognised that circumstances do change and the law normally keeps pace with such changing circumstances. The expenditure that was regarded as capital expenditure resulting in long- term benefit during the relatively *laissez faire* days of the 19th century may not perhaps, be regarded as capital expenditure in the context of the rapid technological changes which are the feature of industrial life today. The decision of the Supreme Court in *Shahzada Nund & Sons vs. CIT 108 ITR 358* also supports this view. A tax planner would do well to keep track of the various cases reported from time to time so as to keep himself informed of the trend of judicial thinking in this regard.

In this context, the requirements spelt out in the various income computation and disclosure standards have also to be kept in mind while considering the point in time of deductibility of expenditure.

Expenditure specifically allowed: The Income-tax Act, 1961 specifically allows many types of expenditure such as depreciation, expenditure on scientific research, expenditure on know-how, preliminary expenses, bad debts etc. The Act prescribes several conditions and restrictions for the allowance of such expenditure. The tax-planner should take care to see that all the prescribed conditions are complied with so that deductions may not be denied.

Other business expenses: As already explained earlier, section 37(1) deals with the various items of expenses which are otherwise not covered by the provisions of Section 30 to 36 of the Income-tax Act, 1961 and specifically provides that all expenses which are incurred wholly and exclusively (though not necessarily) for the purpose of the business or profession carried on by the assessee would be deductible in computing the assessee's business income. In order to qualify for deduction under this provision, the following important conditions will have to be fulfilled:

(i) The expenditure should have been incurred by the assessee in the ordinary course of his business or profession;

(ii) The expenditure should be of a revenue nature and should not be of capital nature;

(iii) The expenditure should not be of a personal nature;

(iv) The expenditure should not be covered by any other provisions of sections 30 to 36 for purposes of allowance and it should not also be covered by any of the provisions of disallowance contained in sections 40 to 44D; and

(v) The expenditure should not be one which is in the nature of an appropriation of income or diversion of profits by an overriding title. It should not also be one in respect of which deduction is permissible under Chapter VI-A of the Income-tax Act, 1961 from the gross total income of the assessee.

Commercial expediency: The concept of 'commercial expediency' helps a tax payer in insisting that a reasonable view is taken of his right to deduct normal expenditure. The trend in judicial thinking has also recognised this concept. This concept reflects the fact that it is virtually impossible for the legislation to list all possible deductions to which an assessee would be entitled in computing his taxable income and therefore the fact that a business has to be run by the assessee himself under normal commercial conditions must be recognised in determining the allowability of certain expenditure.

The test of commercial expendiency should be applied from the point of view of a normal prudent businessman, by reference to modern concepts of business responsibility and not by reference to the subjective standards of the revenue department.

A claim on the ground of commercial expediency is subject to the under-noted conditions and limitations:

(a) If the expenditure is covered by one of the express provisions in the Act, it must conform to the requirements stipulated therein.

(b) An expenditure which is expressly disallowed under the Act cannot be claimed on grounds of commercial expediency.

(c) An expenditure cannot be claimed on grounds of commercial expediency if it is improper or illegal. It may be commercially expedient to pay a bribe or incur a penalty but this does not mean that the bribe or penalty would be normally deductible for tax purposes.

There is also a distinction between a payment made for a violation or breach of law and payment made for a breach of contract. Courts have taken the view that where the payments are not in the nature of penalties for infraction of any law but made in pursuance of the exercise of an option given in a particular scheme and where the assessee opts for it out of commercial expediency and business consideration, it could be allowed as deduction. For instance, payments made to Export Promotion Council for shortfall in export performance and payment made to Cotton Mills Federation for non-import of allotted quota of requisite cotton, etc. were held to be allowable as payments falling in this category [*CIT vs. Manekia Harilal Spg & Mfg. Co. Ltd. (1991) 7 Taxman 395 (Guj), CIT vs. Raj Kumar Mills. Ltd. (1982) 135 ITR 812 (M.P.) CIT vs. Vasanth Mills Ltd. (1979) 120 ITR 311 (Mad.)]* and other cases.

TAX PLANNING AND MANAGEMENT/INVESTMENT DECISION

Though management/investment decisions are not based on the tax factor alone, yet it has become imperative to consider tax factors before adopting any course of action because the effect of this factor is not only significant but it may also differ from one alternative to another. To illustrate this point, tax implications that are relevant while taking some specific management decisions are explained below:

Make or buy decision: In making ‘make or buy’ decisions, the variable cost of making the product or part/component of product is compared with its purchase price in the market. The article is brought if the former is greater than the latter.

Alternatively, if the decision to make involves establishment of a separate industrial unit for this purpose, a decision may be taken on the basis of total cost rather than variable cost. In such an event, the assessee would also be in a position to get the tax benefits arising from allowances such as depreciation, tax holiday benefit and deduction in respect of profits from new industrial undertakings, wherever they are applicable.

There are many other costing and non-costing considerations which are kept in mind at the time of taking the decision, like capacity utilisation, supply position of the article to be bought, terms of purchase, etc. The basis of taking make or buy decision should be ‘saving after tax’. The net saving can be ascertained after deducting from gross savings, income-tax payable on the amount of saving. The long-term advantages arising out of a decision to make should also be given due weightage in arriving at a decision.

At the time of ascertaining variable cost of the product (for taking make or buy decision) all taxes such as excise duty, import duty, customs duty, octroi etc., payable in the process of manufacture should be taken into account and in determining purchase price of the product. All taxes to be borne by the purchaser such as sales tax, local taxes should be added for the purpose of comparison and cost of purchasing.

Own or lease: Another important area of decision making is whether to own or lease (or sale and lease back). There are advantages as well as disadvantages in leasing. Leasing avoids ownership and with it, the accompanying risks of obsolescence and terminal value losses. In leasing, immediate payment of capital costs is avoided but fixed rental obligation arises. There are many factors which are required to be considered before making 'own or lease' decision such as cost of asset to be owned, rent of the asset to be taken on lease, source of financing the asset, risk involved in the alternatives, impact of tax concessions such as depreciation, tax holiday benefit, etc.

Leasing can also provide important tax advantages. If the asset is taken on lease, the firm can deduct for income-tax purposes, the entire rental payment. If the rate of tax is 30%, then, the effective rent obligation is reduced to that extent. Another tax advantage of the lease is that the life of the lease can be shortened compared to the depreciable life otherwise allowed if the assessee purchased the asset. Thus, there is a delay in paying taxes and in effect an interest free loan by the Government to the extent of the delay in taxes. There is one more tax advantage arising out of lease which arises from the opportunity to depreciate otherwise non-depreciable assets. The principal asset of this type is land. The lease rental covers the cost of the land which thus becomes deductible. This arrangement may prove particularly attractive where the land value constitutes a high percentage of the total value of the real estate or where the building is already fully depreciated. Leasing is becoming popular in India.

Wherever possible or appropriate, the concept of sale and lease back can also be made use of as a tool for tax planning with its attendant advantages.

♦ ***Lease rent paid:*** As regards the consideration for the lease, there could be two types of receipts in the hands of the lessor-receipt on capital account termed 'premium' in respect of the transfer of rights and receipts on revenue account termed 'rent' for the right or liberty to use the property for a term of years.

  The lease rental paid is chargeable to revenue every year. The lease rental may be split into three components—the recovery of principal, cost, the interest chargeable and an element of profit. It is generally believed that the interest rate in-built into the rent would be more than the going market interest rate for term loans for purchase of equipment. Since the entire lease rental is chargeable to revenue the lessee could claim tax benefits on even the principal investment in the equipment. Tax advantage in such cases is reported to be more in a leasing transaction than in a similar loaning transaction.

♦ ***Retain or Replace Decision****:* One of the important decisions which involves alternative choice is whether or not to buy new capital equipment. Both have their own merits and demerits. Generally, replacement offers cost saving which results in increase in profit. However, replacement requires investment of large funds resulting in extra cost. The decision is based on the relative profitability and other financial and non-financial considerations. Tax considerations should also be taken into account in this context. Some of the important considerations from the tax angle to which attention will have to be paid relate to the allowance of depreciation, as also the allowance on account of expenditure on scientific research. The applicability of the provisions for allowances should be considered and their impact ascertained before any decision is taken.

TAX PLANNING FOR FOREIGN COLLABORATION

Sometimes, Indian entities enter into foreign collaboration agreements. The tax implications of these agreements both on the foreign party and on the Indian concern are required to be known in advance. The foreign collaborator wants to make sure about his tax liabilities in India and unless assured of involvement with a not too high amount of tax, the foreign party is not very eager to conclude an agreement with an Indian party.

In such a case, the foreign collaborator can seek advance ruling under the provisions of Chapter XIX-B of the Income-tax Act, 1961, for determination of tax implication of the transaction to be undertaken by the non-resident applicant. The Indian party must examine all the tax angles and devise a method which will saddle the foreign collaborator with the minimum amount of tax in India. The aim should be to arrange the affairs in such a way within the four corners of the law so as to attract the minimum amount of tax.

♦ **Double Taxation Avoidance Agreements**: For the determination of the taxability of foreign collaborators, the provisions of section 90 are very relevant. This provision empowers the Central Government to enter into double taxation avoidance agreement with foreign countries. In exercise of this power, the Government has entered into such agreements with a number of foreign countries.

Where there is an agreement between the Government of India and the Government of a foreign country, the tax liability of the foreign participant is determined in accordance with and subject to the provisions of the agreement and the Income-tax Act, 1961, to that extent, stands superseded by such agreement. In fact, *Circular No. 333 dated 2.4.1982*, issued by the CBDT clarifies that where a double taxation avoidance agreement provides for a particular mode of computation of income the same should be followed irrespective of the provision of the Income-tax Act, 1961. Where there is no specific provision in the agreement, it is the basic law, i.e., the Income-tax Act, 1961 which will govern the taxation of income.

Generally, the foreign party happens to be a non-resident for tax purposes. The status in which the chargeability to tax usually arises in the hands of the foreign party is either that of a company, or of an association of persons or of an individual. Body corporates incorporated outside India are treated as 'companies' for the purposes of section 2(17)(ii).

♦ **Advance Rulings:** In appropriate cases, the facility of getting Advance Rulings, envisaged by section 245N-245V could also be availed of.

♦ **Double taxation relief:** Taxpayers deriving income chargeable to tax both in India and in a foreign country by virtue of their business being carried on in more countries than one or otherwise, should avail of the benefit of double taxation relief granted under sections 90, 90A and 91 of the Income-tax Act, 1961 subject to GAAR provisions in Chapter X-A of the Act. In order to get the benefit of relief, before starting to carry on business operations in a foreign country, the assessee should be certain whether India has entered into a double taxation avoidance agreement with the foreign country and, if so, the extent to which and the manner in which the relief has to be availed of.

Taxpayers should prefer to derive income from those countries with which India has entered into agreement for granting relief from double taxation as compared to those countries with which no such agreement exists. Even in cases where the income is derived from a country with which India has not entered into double taxation avoidance agreement, the assessee should claim the unilateral relief available under section 91 by proving that he has paid tax in that country on the income which accrued or arose there during the previous year.

In such a case, he would be entitled to a deduction from the Indian-tax-payable by him, of a sum calculated on such doubly taxed income at the Indian rate of tax or at the rate of tax of the concerned country, whichever is the lower, or at the Indian rate of tax, if both the rates are equal. The claiming of this statutory relief would help to reduce the total incidence of tax on such doubly taxed income. However the arrangement's main purpose should not be to obtain a tax benefit, thus, not void of commercial substance and should not result in abuse/ misuse of the provisions of the Act.

Another aspect which will require consideration is the effect of double taxation avoidance agreements wherever they exist. To the extent specific provisions exist in such agreements, the corresponding provisions in the national law will not have application. Therefore, in understanding the tax liability in respect of technical tie -ups with foreign parties, attention will have to be paid to the relevant provisions of the double taxation avoidance agreements vis-à-vis the provisions of the Income-tax Act, 1961.

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.

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 Supreme Court, in *CIT vs. Shantilal P. Ltd. (1983) 145 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.

The assessee should exercise his right of set off of brought forward loss at the first available opportunity. The Madras High Court, in *Tyresoles (India) vs. CIT [1963] 49 ITR 15,* 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 not be entitled to claim the benefit of carry forward and set-off of losses, if shares carrying at least 51% of the voting power is not 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. A closely held company, eligible for deduction under section 80-IAC will not be entitled to claim the benefit of carry forward and set off of losses, if all the shares are not 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 and such loss should have been incurred during the seven years beginning from the date of incorporation of such company. 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: If an assessee is to get the benefit of carry forward under section 72 or 73 or 73A or 74 or 74A, he should file a return of loss within the period specified in section 139(1). Otherwise as per Section 80, their c/f will be restricted.

However, loss from house property under section 71B and unabsorbed depreciation u/s 32 can be carry forward even if sec 139(3) is not followed because their carried forward is not restricted by 139(3).

LESSON ROUNDUP

- Tax Planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods.
- Tax planning, in fact, is an honest and rightful approach to the attainment of maximum benefits of the taxation laws within their framework.
- Tax planning can be of following types: Short and long range tax planning, Permissive tax planning and purposive tax planning.
- Some of the important areas where planning can be attempted in an organised manner are as under:
  1. **At the time of setting up of new business entity:**
     a) Form of organisation/ownership pattern;
     b) Locational aspects;
     c) Nature of business.
  2. **For the business entities already in existence:**
     a) Tax planning in respect of corporate restructuring;
     b) Tax planning in respect of financial management;
     c) Tax planning in respect of employees remuneration;
     d) Tax planning in respect of specific managerial decisions;
     e) Tax planning in respect of Foreign collaborations
     f) Tax planning in the light of various Double Taxation Avoidance Agreements (DTAA)
- **The basic objectives of tax planning are:** (a) Reduction of tax liability; (b) Minimisation of litigation; (c) Productive Investment; (d) Healthy growth of economy; (e) Economic Stability.
- The test to be applied for Tax Planning
- Tax Planning and Retrospective / Administration Legislation
- Tax Planning and Interpretation
- The tax planner while planning his affairs or that of his clients must take into account not only the relevant legal provisions, but also the judicial pronouncements of Appellate Tribunals, High Courts and Supreme Court. He should also take into consideration all relevant rules, notifications, circulars etc.

TEST YOURSELF

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

1. Specify whether the following acts can be considered as an act of (i) Tax management; or (ii) Tax planning; or (iii) Tax evasion:

(a) X has paid premium of ₹72,000 for Life Insurance Policy so as to reduce Total Income.

(b) X has installed an air conditioner costing ₹60,000 at his residence but shows as it is fitted in a factory. This is with the objective to claim depreciation.

(c) Y Ltd maintains registers of tax deduction effected by it to enable timely compliance.

(d) Z ltd issues a credit note for ₹36,000 for brokerage payable to A, who is son of G, managing director of the company. The purpose is to reduce Z ltd. income and increase A's income from ₹18,000 to ₹54,000.

(e) A is a working partner in ABC Firm. In such capacity, he is entitled to a salary of ₹7,500 per month. He treats this as salary instead of business income.

(f) A is using a motor car for his personal purposes, but charges as business expenditure.

(g) X always pays advance tax on time

(h) Y sell his residential house and purchases another residential house to claim exemption u/s 54

(i) X had Fixed deposit interest amounting to ₹5,000 but did not disclose this amount in his Income Tax Return

(j) Y had Saving deposit interest amounting to ₹5,000, he disclosed this amount under other sources and claimed deduction u/s 80TTA

2. Test to be applied for Tax Planning – Explain?

3. Elaborate the types of Tax Planning.

4. Diversion of Income V/s Application of Income?

5. Various Avenues of Tax Planning – Discuss.

Answer

1. (a) Tax planning; (b) Tax evasion; (c) Tax management; (d) Tax evasion; (e) Tax evasion; (f) Tax evasion (g) Tax management; (h) Tax Planning ; (i) Tax Evasion ; (j) Tax Planning

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 11
International Taxation – An Overview

LESSON OUTLINE

- Double Taxation Avoidance Agreement
- Residency Issues
- Tax Heaven
- Controlled Foreign Corporation
- Permanent Establishment
- Business Connection
- General Anti Avoidance Rules
- Advance Ruling
- Transfer Pricing
- Case Studies
- LESSON ROUND UP
- TEST YOURSELF

LEARNING OBJECTIVES

After the liberalization of Indian economy and easing of restrictions on the entry of foreign entities, cross border business transactions have increased manifold. With the ratification of WTO by the Government of India, our economy has become robust and an atmosphere has sprung up where FII investments in India have increased tremendously. All these economic activities has ramifications for tax laws of the country. Issues like tax havens, transfer pricing, double taxation, WTO, Subpart F, etc. are required to be taken care of and have become part and parcel of international taxation regime.

At the end of the lesson, students will be able to understand:

- The need for double taxation relief
- The type of double taxation
- Comprehend the procedure for claiming deduction where there is no double taxation avoidance agreement between Indian and the other country where the income has been taxed and compute the amount of deduction
- The Residency Issues – Determining Residential Status in cases of Duel Residency
- Concept of Tax Heaven
- How to determine whether a state or a country is a tax heaven
- Concept of Controlled Foreign Corporation 'CFC'
- The concept of Permanent Establishment 'PE' and Business Connection 'BC' under double taxation avoidance agreements and its relevance
- What are impermissible avoidance agreements and its consequences?
- Appreciate the need for incorporation of Transfer Pricing provisions in the Income Tax Act, 1961
- Comprehend the meaning and Significance of Arm's Length Price, 'associated enterprise' 'international transaction' specified domestic transaction'
- Comprehend the meaning and scope of the term 'Advance Ruling' and the need for obtaining Advance Ruling
- Know the circumstances when an advance rulings can be declared void

DOUBLE TAXATION AVOIDANCE AGREEMENT

Generally, Income is taxable on two basis viz.

- Source of Income Basis and
- Residential Status Basis,

which results into double taxation of same income of the person.

Firstly, such income is taxed in the country in which such income is generated and again, the same income may be taxed on the basis of residential status of the person in another country.

Example: Mr. X, an ordinarily resident in India, earned bank interest of Rs. 1,00,000 on his money deposited into a bank located in US. In that case, such income is taxable in US on source of income basis and again in India as he is a ordinarily resident in India.

In times when economies are going global and borders fading, double taxation is still one of the major obstacles to the development of inter-country economic relations. In order to prevent this hardship or to avoid double taxation, relief is provided to the tax-payer.

Such relief is provided by two ways:

- Bilateral Relief
- Unilateral Relief

BILATERAL RELIEF

In this, government of two countries enters into an agreement (known as 'treaties') to provide relief against double taxation of same income. The relief is granted on the basis of terms of such agreement. Generally, such agreement provides relief through following methods:

- Exemption Method: In this method, one country provides exemption to such type of income. Generally, residence country gave up its right and the country of source is then given exclusive right to tax such incomes.
- Credit Method: In this method resident remains liable in the country of residence on its global income, however as far the quantum of tax liabilities is concerned credit or deduction for tax paid in the source country is given by the residence country against its domestic tax as if the foreign tax were paid to the country of residence itself.

UNILATERAL RELIEF

The aforesaid method is depending on bilateral activity of both the countries. However, no country will have such an agreement with every country in the world. In order to avoid double taxation in such cases, country of residence itself may provide relief on unilateral basis. In India, relief for avoidance of double taxation is provided in both ways.

Provisions relating thereto are enumerated here-in-below:

AGREEMENT WITH FOREIGN COUNTRIES [SECTION 90 BILATERAL RELIEF]

The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India:

a. for the granting of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, 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, as the case may be, or

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, as the case may be, 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, as the case may be, and may make such provisions as may be necessary for implementing the agreement.

Notes:

- Where the Central Government has entered into an agreement with the Government of any country or specified territory outside India for granting 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. However, the provisions of Chapter X-A of the Act (i.e. GAAR) shall apply to the assessee even if such provisions are not beneficial to him.
- An assessee, not being a resident, to whom DTA applies, shall not be entitled to claim any relief under such agreement unless a certificate of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory. Further, the assessee shall also provide such other documents and information, as may be prescribed.
- Where any term used in an agreement entered into u/s 90 is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.
- Further, any term used but not defined in the Act or in the agreement shall, unless the context other wise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.
- Where any term is used in any agreement and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.
- 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.
- **"Specified territory"** means any area outside India which may be notified as such by the Central Government.
- If no tax liability is imposed under this Act, the question of relief does not arise [**UOI vs Azadi Bachao Andolan (2003) (SC)**]
- Relief cannot be granted unless the income which has been taxed in one of the contracting countries has also suffered tax in the other contracting country. Proof has to be provided of the income having suffered double taxation.

- Sections 4 and 5 of the Income-tax Act provide for taxation of global income of an assessee but this is subject to the provisions of an agreement entered into between the Central Government and the Government of a foreign country for avoidance of double taxation. In case of any conflict between the provisions of the agreement and the Act, the provisions of the agreement would prevail over the Act in view of the provisions of section 90(2) [**CIT v Kulandagan Chettiar (P V A L) (2004) (SC)]** If any matter or income is not covered by the agreement, the Income- tax Act shall be applicable.
- In case of a remittance to a country with which a Double Taxation Avoidance Agreement is in force, the tax should be deducted at the rate provided in the Finance Act of the relevant year or at the rate provided in the Double Taxation Avoidance Agreement, whichever is more beneficial to the assessee.

ILLUSTRATION 1: Mr. Ramesh, a resident Indian, has derived the following incomes for the previous year relevant to the A.Y. 2021-22:

a. Income from profession in India Rs 2,44,000

b. Income from profession in country A (Tax paid in foreign country @ 5%) Rs 4,50,000

Compute Indian tax liability of the assessee assuming that as per treaty between India and Country A, Rs 4,50,000 is taxable in India. However foreign tax can be set off against Indian tax liability

Solution: Computation of total income and tax liability of Mr. Ramesh for the A.Y. 2021-22

Particulars	**Amount**
Income from profession in India	2,44,000
Income from profession in Country A	4,50,000
Gross Total Income	6,94,000
Less: Deduction u/s VIA	Nil
Total income	6,94,000
Tax on above	51,300
Add: Health & Education cess	2,052
Tax and cess payable	53,352
Less: Relief u/s 90 [Rs 4,50,000 * 5%]	22,500
Tax payable in India (Rounded off u/s 288B)	30,850

ILLUSTRATION 2*:* Shri Anuj, an ordinarily resident in India, provides following details of his income for the previous year relevant to the A.Y. 2021-22 –

Income from India	Rs 3,40,000
Income from Country Z	Rs 2,00,000
Investment in PPF	Rs 10,000

India has avoidance of double taxation agreement with Country Z. According to said agreement, income is taxable in the country in which it is earned and not in other country. However, in the other country such income can be included for the purpose of country Z @ 20%. Compute Indian tax payable.

Solution: Computation of total income and tax liability of Shri Anuj for the A.Y. 2021-22

Particulars	**Amount**
Income from India	3,40,000
Income from Country Z	2,00,000
Gross Total Income	5,40,000
Less: Deduction u/s 80C [Investment in PPF]	10,000
Total income	**5,30,000**
Tax on above	18,500
Add: Health & Education cess	740
Tax and cess payable	19,240
Less: Relief u/s 90 [Rs 2,00,000 × 3.63%]	7,260
Tax payable in India (Rounded off u/s 288B)	**11,980**

[Average rate of Indian tax = Rs 19,240 / Rs 5,30,000 × 100 = 3.63%]

Illustration3: 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.

Answer:

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)].

ADOPTION BY CENTRAL GOVERNMENT OF AGREEMENTS BETWEEN SPECIFIED ASSOCIATIONS FOR DOUBLE TAXATION RELIEF [SECTION 90A]

Any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make such provisions as may be necessary for adopting and implementing such agreement –

a) for granting of relief in respect of –

  (i) income on which have been paid both income-tax under this Act and income-tax in any specified territory outside India; or

  (ii) income-tax chargeable under this Act and under the corresponding law in force in that specified territory outside India 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 specified territory outside India, or

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 specified territory outside India, 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 specified territory outside India.

Notes

- Specified association 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 for the purposes of this section.
- An assessee, not being a resident, to whom DTA applies, shall not be entitled to claim any relief under such agreement unless a certificate of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory. Further, the assessee shall also provide such other documents and information, as may be prescribed.
- Specified territory means any area outside India which may be notified as such by the Central Government for the purposes of this section.
- Where any term used in an agreement entered into is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.
- Where any term is used in any agreement and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.
- Where a specified association in India has entered into an agreement with a specified association of any specified territory outside India and such agreement has been notified, for granting relief of tax, or as the case may be, 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. However, the provisions of Chapter X-A of the Act (i.e., GAAR) shall apply to the assessee even if such provisions are not beneficial to him.
- The DTAAs under section 90A are intended to provide relief to the taxpayer, who is resident of one of the contracting country to the agreement. Such tax payer 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 country also resorted to claiming the benefits under the agreement entered into by the Indian Government with the Government of the other country. In effect, third party residents claimed the unintended treaty benefits.
- Therefore, section 90A(4) provides that the non-resident to whom the agreement referred to in section 90A(1) applies, shall be allowed to claim the relief under such agreement 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.
- Therefore, a certificate issued by the Government of a foreign country would constitute proof of tax residency, without any further conditions regarding furnishing of “prescribed particulars” therein. In addition to such certificate issued by the foreign Government, section 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 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.

Illustration 4: 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.

Answer : Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee. This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

However, as per section 90(4), the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide the following information in Form No. 10F:

(i) Status (individual, company, firm etc.) of the assessee;

(ii) PAN of the assessee, if allotted;

(iii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iv) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the assessee claims to be a resident;

(v) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(vi) Address of the assessee in the country or specified territory outside India, during 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.

COUNTRIES WITH WHICH NO AGREEMENT EXISTS [SECTION 91 UNILATERAL RELIEF]

If any person who is resident in India in any previous year proves that:

a) The income has accrued or arose during the previous year outside India (and which is not deemed to accrue or arise in India),

b) He has paid in any country income-tax on such income, by deduction or otherwise, under the law in force in that country

c) India does not have any agreement u/s 90 for the relief or avoidance of double taxation with that country, then he shall be entitled to the deduction from the Indian income-tax payable by him

   (i) of a sum calculated on such doubly taxed income at the average of Indian rate of tax or

   (ii) of a sum calculated on such doubly taxed income at the average rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

Notes

a) The expression 'such doubly taxed income' really purports to indicate that it is only that portion of the income on which tax has been imposed and been paid by the assessee that is eligible for the double tax relief. Thus, where the foreign income which suffered tax in the foreign country was Rs 88,535, and the income actually taxed in India after allowances and set off of losses (or deduction under chapter VIA) was Rs 63,141, relief admissible would be calculated on Rs 63,141 **[CIT v. O.VR.SV.VR. Arunachalam Chettiar]**

b) Relief u/s 91 is to be calculated on income country-wise and not on basis of aggregation or amalgamation of income of all foreign countries **[CIT v. Bombay Burmah Trading Corpn. Ltd. (2003)]**

c) No benefit is available on income which is deemed to accrue or arise in India, even though such income is doubly taxed.

Illustration 5: Mr. Saha, a resident Indian, has derived the following incomes for the previous year relevant to the A.Y. 2021-22:

a. Income from profession Rs 3,74,000

b. Royalty on books from foreign country Y (Rs 3,00,000 is eligible for deduction u/s 80QQB) (Tax paid in foreign country @ 20%) Rs 5,00,000.

Compute Indian tax liability of the assessee assuming that India does not have any agreement with country Y assuming Mr. Saha has not opted for Section 115BAC of the Income Tax Act, 1961.

Solution: Computation of total income and tax liability of Mr. Saha for the A.Y. 2021-22

Particulars	**Amount**
Income from profession	3,74,000

Royalty earned in country Y	5,00,000
Gross Total Income	8,74,000
Less: Deduction u/s 80QQB	3,00,000
Total income	5,74,000
Tax on above	27,300
Add: Health & Education cess	1,092
Tax and cess payable	28,392
Average rate of tax [Rs 28,392 / Rs 5,74,000 × 100] 4.95%	
Rate of tax in country Y 20%	
Relief u/s 91 [4.95% of Rs 2,00,000]	9,900
Tax payable (Rounded off u/s 288B)	**18490**

Note: Indian average tax rate: 4.95% Foreign average tax rate: 20.00% Relief u/s 91 is available at lower of aforesaid rate. i.e. 4.95%.

Illustration 6: Ruchira, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well-known dramatist deriving income of Rs. 1,10,000 from theatrical works played abroad. Tax of Rs. 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 Rs. 6,10,000. In view of tax planning, she has deposited Rs. 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC Rs. 32,000. She also contributed Rs. 28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of Rs. 26,000 to insure the health of her father, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Ruchira for the Assessment year 2021-22.

(Assuming Ms. Ruchira has not opted for Section 115BAC of the Income Tax Act, 1961)

Solution:

Computation of tax liability of Ruchira for the A.Y. 2021-22

Particulars	**Rs.**	**Rs.**
Indian Income		6,10,000
Foreign Income		1,10,000
Gross Total Income		**7,20,000**
Less: Deduction under section 80C		
Deposit in PPF	150000	
Contribution to approved Pension Fund of LIC (Section 80CCC)	32000	
Total	182000	
The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to Rs. 1,50,000	150000	

Contribution to Central Government Health Scheme Rs. 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 Rs. 50,000 (See Note 1)	28000	
Medical insurance premium of Rs. 26,000 paid for father aged 84 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of Rs. 50,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of Rs. 25,000.	25000	203000
Total Income		5,17,000
Tax on Total Income		
Income-tax (See Note below)		13,400
Add: Health and Education Cess @4%		536
Total Tax		13,936
Average rate of tax in India (i.e. Rs. 13,936/ Rs. 5,17,000 × 100)		
Average rate of tax in foreign country (i.e. Rs. 11,000/ Rs. 1,10,000 ×100)		
Deduction under section 91 on Rs. 1,10,000 @ 2.696% (lower of average Indian-tax rate or average foreign tax rate)		(2,966)
Tax payable in India (Rs. 13,936 – Rs. 2,966)		10,970

Notes:

1. Section 80D allows a higher deduction of up to Rs. 50,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, Ruchira will be allowed deduction of Rs. 28,000 under section 80D, since she is a resident Indian of the age of 60 years.

2. The basic exemption limit for senior citizens is Rs. 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Ruchira is eligible for the higher basic exemption limit of Rs. 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, Ruchira is eligible for deduction u/s 91.

Illustration 7: The following are the particulars of income earned by Miss Rinki, a resident Indian aged 25, for the assessment year 2021-22:

Particulars	**(Rs. In lacs)**
Income from playing snooker matches in country L	12.00
Tax paid in country L	1.80
Income from playing snooker tournaments in India	19.20
Life Insurance Premium paid	1.10
Medical Insurance Premium paid for her father aged 62 years (paid through credit card)	0.54

Compute her total income and tax liability for the assessment year 2021-22. There is no Double Taxation Avoidance Agreement between India and country L. [Assuming Assessee has not opted for Section 115BAC of the Income Tax Act, 1961]

Solution:

Computation of total income and tax liability of Ms. Rinki for the A.Y. 2021-22

Particulars	**Rs.**	**Rs.**
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 Rs.1,10,000 paid during the previous year deduction, is within the overall limit of Rs. 1.5 lakh. Hence, fully allowable as deduction	1,10,000	
Deduction under section 80D		
Medical insurance premium of Rs. 54,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of Rs. 50,000 (assuming that her father is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.	50,000	(1,60,000)
Total Income		29,60,000
Tax on Total Income		
Income-tax		7,00,500
Add: Health and education cess @4%		28,020
Total tax including cess		7,28,520

Average rate of tax in India (i.e. Rs. 7,28,520/Rs. 29,60,000 × 100)	24.61%	
Average rate of tax in foreign country (i.e. Rs. 1,80,000/ Rs.12,00,000 ×100)	15.00%	
Deduction under section 91 on Rs. 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)		(1,80,000)
Tax payable in India (Rs. 7,28,520 – Rs. 1,80,000)		5,48,520

Note: Miss Rinki 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.

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.

RESIDENCY ISSUE

In India, section 6 of the Income-tax Act provides for the definition of residential status of different categories of persons. Similarly, every Government will have its own legislation providing for its own definition of residential status. There can be very wide differences amongst different definitions. For example, consider an individual. Section 6 of the Indian Income-tax Act, provides for physical stay of the individual. If the individual is physically present in India for the specified number of days, then he is an Indian resident. If he is present less than the specified number of days, then he is a non-resident of India.

However, the US Internal Revenue Code (IRC) provides as under: Every citizen of USA is tax resident of USA. Even a Green Card holder is a tax resident of USA. This would be true even if the assessee has left USA for a job/ business abroad for many years.

The issue relevant here is that different countries have different definitions of residential status. This has several consequences. The best solution adopted in the treaties is: not to define residential status in the treaty. The treaties refer to the domestic legislation. In other words, the residential status will be determined by the domestic Income-tax Act.

In case of cross border income, the issue arises as to under which jurisdiction the income would be taxed. In international taxation jurisdiction are referred to as Connecting Factors or Nexus. It's an internationally accepted principle to tax the global income of assessee qualifying as resident of that particular country. Further it is also accepted that if the income is sourced in a country, it has a right to tax that income. India also follows the same principles.

The Organization of Economic and Co-operation Development (OECD) Model Convention and the UN Model Convention are identical and provide for a definition of "resident of a Contracting State" as follows:

For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political sub-division or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

Where by reason of the provisions of aforesaid paragraph an individual is a resident of both Contracting States, then his status shall be determined as follows:

a. he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

b. if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

c. if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

d. if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement. Where by reason of the aforesaid provisions, a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

1. Dual Residence - Individuals: Article 4(2)

Same individual may be treated as resident of both the countries being parties to a treaty. For example, Mr. A is a citizen of UK. He has a house, a bank account and other connections with UK. However, he has taken up employment in India. For last few years, as well as during the current previous year, he is residing in India. Hence, under section 6(1) he will be treated as a resident of India. However, under the UK Income-tax Act, he will be treated as a resident of UK. Hence the same person will be treated as resident of two countries. This is called dual residence.

India and UK both will want to tax the global income of Mr. A. Let us say, India and UK both have the highest tax rate of 30%. Then Mr. A will pay 60% income-tax. To avoid such situation, article 4 (2) provides for Tie-Breaking provisions. Article 4 (2) considers several probable tests which determine the country in which the tax payer is resident. Each test is to be considered in the serial order in which it is listed under article 4 (2).

Permanent Home:

Consider a situation where Mr. A has a permanent home available to him in any one of the countries and does not have a permanent home in the other country. He will be considered to be a resident of the country in which he has the permanent home. It may be noted that it is not necessary that the assessee owns a home. The only condition applicable is that the assessee has a home available to him. It may be a rental home. Or it may be a home owned or rented by a family member. As long as the home is available to Mr. A, he will be considered as resident of the country in which the home is available.

Personal & Economic Relations:

Another probable situation: Mr. A has permanent home available to him in both the countries or in no country. Then it will not be possible to determine his residential status by the permanent home test. Hence the treaty provides that he will be treated as resident of that country with which he has closer personal and economic relations.

Thus for example, Mr. A is employed by British company, his family continues to stay in Britain and he is only deputed to an Indian Group company, then Mr. A may claim that his personal and economic relations with Britain are closer than his personal and economic relations with India. In such a case, he will be treated as resident of Britain.

The test: Personal & Economic Relations is also referred to as Centre of Vital Interests.

Habitual Abode:

Some people may have their commercial interest as well as family spread out in both countries. For example, Mr. A and his wife may stay in India. However, his parents and children continue to stay in UK. Mr. A has substantial savings, and investments and income in both the countries. It is not very easy to determine whether the centre of his vital interests lies in India or in UK. In such a situation, one has to find out the state in which the assessee has his habitual abode. Now the term habitual abode is different from the term permanent home. There may be some people who do not have a permanent home but do have a habitual abode in one of the countries. Habitual abode refers to that country where the tax payer stays for a comparatively longer time.

Nationality:

Again there can be some people who have a habitual abode either in both the states or in none of the states. Here one may consider the concept of permanent travellers. There are some people who have their business and or investments in several countries. They can arrange their affairs so that they are not physically present in any single country for a period of 6 months. These people either may not have house in any country; nor have habitual abode in any country; or may be having homes available to them in several countries. Since they are permanent travelers, they may not be held to be resident of any one country. In such cases, they avoid COR taxes in all the countries. Of course they will be liable to COS taxes in the countries in which they earn income. If they are actually non-residents of all the countries, they will not get treaty benefit in any country.

However, in cases like UK, Canada, USA, etc. even if a person is not present for a long period in the country, he may be held to be tax resident of that country. And he may become resident of two countries. In such cases, for the purposes of tie-breaking under Article 4(2)(c) one has to examine his nationality. He will be considered to be a resident of that country of which he is a national.

Mutual Agreement:

There may be individuals who are not nationals of any of the Treaty countries or who are nationals of both countries. India does not permit a person to be citizen of two countries. In other words, if a person wants Indian citizenship, he cannot be citizen of any other country. However, there are some countries which permit dual citizenship.

In such cases it becomes impossible to determine the residence by any criteria listed in article 4 (2). Then for the purposes of tie-breaking, he will have to apply to the competent authority. The competent authorities of both the countries will mutually discuss and decide the residence of the assessee.

2. Dual Residence Companies: Article 4(3)

Just as an individual can be resident of two or more countries, a company or other non-individual entity can also be resident of two or more countries. In such cases, determining the residential status for the purposes of treaty becomes difficult. OECD Model provides a criterion for the purposes of tie breaking. The country in which its Place of Effective Management is situated shall be considered to be the Country of Residence.

Place of Effective Management ignores incorporation, location of registered office and all formal nomenclature. The country from which the management of the Company is effectively carried out, is considered to be the Country of Residence.

TAX HAVENS

Most effective way to attract foreign investment, many sovereign states and countries use tax and non-tax incentives. Such countries or state as the case may be, offer the foreign investor an environment with either no taxation or only nominal taxation which is generally equipped with a perquisites in which regulatory or administrative constraints are for name sake. The laws made for these investors are usually not subject to information exchange.

These countries and states are known as tax havens. In simple words, if any country or states mend their tax and allied laws to gain the confidence of foreigners could be considered a tax haven. The utmost feature of a haven is that its mended laws and other activities can be used to evade or avoid the tax of other jurisdictions.

Mauritius is accused of being a tax haven, the island has a corporation tax of 15%, but tax credits for global business companies mean an effective rate of 3%. There is no capital gains tax and no withholding tax on dividends.

Seychelles, where there is absolutely no tax on income or profits for international companies and as well as no capital gains tax, and the government does not tax interest payments from abroad.

Such tax systems are one of the potent tool which allow companies to speck themselves and register 'shell companies', companies only in name with no substantial operations or no operations at all in the tax haven. So, what does make a country a tax haven is if it creates legal loopholes to allow organizations to register their shell companies without due diligence. The countries in which real economic activities take place are unable to collect taxes corresponding with the economic activity and failed to have effective fiscal control.

Cayman Islands for the size and secrecy of its offshore financial activities.

The Tax Justice Network estimates that there is between $21 trillion and $32 trillion of private financial wealth parked in what it calls "secrecy jurisdictions" around the world. The U.S. has been steadily increasing its market share for offshore financial services, and now claims about 22 percent of the global market.

According to the group, "The U.S. provides a wide array of secrecy and tax-free facilities for non-residents, both at a Federal level and at the level of individual states. Many of the main Federal-level facilities were originally crafted with official tolerance or approval, in some cases to help with the U.S. balance of payments difficulties during the Vietnam War; however some facilities – such as tolerance by states like Delaware or Nevada of highly secretive anonymous shell companies – are more the fruit of a race to the bottom between individual states on standards of disclosure and transparency."

Here are the top 15 countries in the financial secrecy Index for 2018:

1. Switzerland
2. USA
3. Cayman Islands
4. Hong Kong
5. Singapore
6. Luxembourg
7. Germany
8. Taiwan
9. United Arab Emirates (Dubai)
10. Guernsey
11. Lebanon
12. Panama
13. Japan
14. Netherlands

15. Thailand

Four vital contributors are used to determine whether a state or a country is a tax haven:

1. **Taxes are absent or nominal tax rate**: Tax havens impose nil or only nominal taxes (generally or in special circumstances)and offer themselves, or are perceived to offer themselves, as a place to be used by non-residents to escape high taxes in their country of residence.
2. **Least transparency:** Transparency ensures that there is an open and consistent application of tax laws among similarly situated taxpayers and that information needed by tax authorities to determine a taxpayer's correct tax liability is available (e.g., accounting records and underlying documentation). A lack of transparency in the operation of the legislative, legal or administrative provisions is another factor used to identify tax havens. The OECD is concerned that laws should be applied openly and consistently, and that information needed by foreign tax authorities to determine a taxpayer's situation is available. Lack of transparency in one country can make it difficult, if not impossible, for other tax authorities to apply their laws effectively. 'Secret rulings', negotiated tax rates, or other practices that fail to apply the law openly and consistently are examples of a lack of transparency. Limited regulatory supervision or a government's lack of legal access to financial records are contributing factors.
3. **Lack of effective exchange of tax information with foreign tax authorities**: Whether there are laws or administrative practices that prevent the effective exchange of information for tax purposes with other governments on taxpayers benefiting from the no or nominal taxation. Tax havens typically have laws or administrative practices under which businesses and individuals can benefit from strict rules and other protections against scrutiny by foreign tax authorities. This prevents the transmittance of information about taxpayers who are benefiting from the low tax jurisdiction.
4. **No requirement for a substantive local presence of the entity:** The absence of a requirement that the activity be substantial is important because it suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. It may also indicate that a country does not provide a legal or commercial environment or offer any economic advantages that would attract substantive business activities in the absence of the tax minimising opportunities it provides. The no substantial activities criterion was included in the 1998 Report as a criterion for identifying tax havens because the lack of such activities suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. In 2001, the OECD's Committee on Fiscal Affairs agreed that this criterion would not be used to determine whether a tax haven was cooperative or un-cooperative.

With regard to exchange of information in tax matters, the OECD encourages countries to adopt information exchange on an "upon request" basis. Exchange of information upon request describes a situation where a competent authority of one country asks the competent authority of another country for specific information in connection with a specific tax inquiry, generally under the authority of a bilateral exchange arrangement between the two countries. An essential element of exchange of information is the implementation of appropriate safeguards to ensure adequate protection of taxpayers' rights and the confidentiality of their tax affairs.

Methodology

The methods followed in doing business through tax heavens, broadly, are as under:

Personal residency : Wealthy individuals from high-tax jurisdictions have sought to relocate themselves in low-tax jurisdictions. In most countries in the world, residence is the primary basis of taxation. In some cases the low-tax jurisdictions levy no, or only very low, income tax, capital gain tax and inheritance tax. Individuals who are unable to return to a higher-tax country in which they used to reside for more than a few days a year are sometimes referred to as tax exiles.

Asset holding : Asset holding involves utilizing a trust or a company, or a trust owning a company. The company or trust will be formed in one tax haven, and will usually be administered and resident in another. The function is to hold assets, which may consist of a portfolio of investments under management, trading companies or groups, physical assets such as real estate or valuable chattels. The essence of such arrangements is that by changing the ownership of the assets into an entity which is not resident in the high-tax jurisdiction, they cease to be taxable in that jurisdiction. Often the mechanism is employed to avoid inheritance tax.

Trading and other business activity : Many businesses which do not require a specific geographical location or extensive labour are set up in tax havens, to minimize tax exposure. Perhaps the best illustration of this is the number of reinsurance companies which have migrated to Bermuda over the years. Other examples include internet based services and group finance companies.

Financial intermediaries : Much of the economic activity in tax havens today consists of professional financial services such as mutual funds, banking, life insurance and pensions. Generally the funds are deposited with the intermediary in the low-tax jurisdiction, and the intermediary then on-lends or invests the money (often back into a high-tax jurisdiction). Although such systems do not normally avoid tax in the principal customer's jurisdiction, it enables financial service providers to provide multi-jurisdictional products without adding an additional layer of taxation. This has proved particularly successful in the area of offshore funds.

Counteracting harmful tax practices : OECD has issued a report on Harmful Tax Competition and has made 19 specific recommendations, some of them are as follows:

a. Adopt Controlled Foreign Corporations (CFC) or equivalent rules

b. Consider foreign information reporting rules

c. Enter into Tax Information Exchange Agreement (TIEA)

d. Application of provision of withholding tax while making payment to offshore recipients

e. Curbing ' treaty shopping nations' of existing treaties with tax heaven

f. Mutual assistance of tax authorities in the recovery of cross boarder tax claims

g. More international co-operation by establishing Forum to avoid Harmful Tax Practices

h. Other measures

   - Adopt foreign investment fund or equivalent rules
   - Considering restrictions on participation exemption and other systems of exempting foreign income in the context of harmful tax competition
   - Formulation and adoption of transfer pricing rules
   - Providing access to banking information for tax purposes
   - Considering co-ordinated enforcement regimes (joint audits; co-ordinated training programmes, etc.)
   - Guidelines to develop and actively promote Principles of Good Tax Administration

CONTROLLED FINANCIAL CORPORATION (CFC)

ABC LTD on an average pay enormous amount of tax to US authorities (US taken in case study is purposively because in India such provision are not applicable, they are just a part of direct tax code as proposed by Kelkar committee) every year. Assume tax rate is very high. Country invites FDI and provided for tax exemption to foreign companies. The proposal seems to be interesting to ABC ltd and they want to open a 100% subsidiary over there and have intentions to shift about 70% business to that country by which they manage to lesser their tax burden substantially. But on the other hand US revenue department will lose huge revenue. So following question arises :

- Such act of ABC ltd legitimate?
- Can US stop shifting its business to different country?
- Is there any solution to this problem

To answer all the above questions one need to understand the concept CFC which are as follows :

One of the of Tax deferral or avoidance is transfer of passive or investment income (such as interest, dividend and capital gains) by establishing an entity in a low tax country or tax havens.

The system of tax deferrals can be initiated by establishing an entity in a low tax jurisdiction. Such entity as it is controlled by parent company is called a “Controlled Foreign Corporation” in the home country of parent company. E.g., a 100% subsidiary of an Indian company in China is a CFC in India.

There are two ways to defer/avoid the tax:

1. Shift the management base to that country and enjoy tax benefits as additional cash inflows.
2. Dividend and interest income not to be distributed to the stake holders of CFC for a long time.

This manipulative deferral of taxes through these kinds of practices has been considered as an injurious to revenue collection targets in various countries specially the developed economies. Many countries have adopted measures aimed at preventing this manipulative deferral of passive or investment income through CFC’s. USA was first to introduce the CFC rules followed by Germany, Canada, Japan, France, UK, New Zealand, Sweden, Australia, Norway, Finland, Spain, Indonesia, Portugal, Denmark, Korea, Hungry, Mexico, South Africa, Argentina, Venezuela, Italy, Israel, Egypt, Estonia, Turkey, Iceland, Brazil, China and Lithuania While the rules applicable to CFCs and the attributes of a CFC differ from country to country, the concept of CFC regimes in general is that they eliminate the deferral of income earned by a CFC and tax residents currently on their proportionate share of a CFC’s income.

The CFC rules are one of the tool to curb the practice of artificial deferral of income.

Under CFC rules any undistributed income of a CFC is deemed to be distributed to the parent company / shareholders, thus taxed in their hand in the home country tax jurisdiction. Thus, Controlled foreign company (CFC) regimes are used in many countries as a means to prevent erosion of the domestic tax base and to discourage residents from shifting income to jurisdictions that do not impose tax or that impose tax at low rates. Typical conditions for the application of such regimes are that:

1. a domestic taxpayer “control” the CFC;
2. the CFC be located in a “low tax” jurisdiction or a jurisdiction that imposes a tax rate lower than the rate in the shareholder’s country, or alternatively that the CFC be located in a “black” or “grey” list jurisdiction (as opposed to favored “white” list jurisdictions); and
3. the CFC has earned the passive income like interest, dividend, capital gains, etc.;
4. the CFC has not distributed such income to the parent company for a long time. In case the above conditions are satisfied, the passive undistributed income of the CFC is deemed to be distributed to the shares holders and is taxed in the hands of such shareholders in the home country of such shareholder in proportion of their shareholdings.

According to definition given u/s 952 of the US Code by Legal Information Institute (Cornell University Law School), Sub Part F income, in general, means in the case of any controlled foreign corporation, the sum of:

(1) Insurance income (as defined u/s 953),

(2) The foreign base company income (as determined u/s 954),

(3) an amount equal to the product of: (A) the income of such corporation other than income which is attributable to earnings and profits of the foreign corporation included in the gross income of a United States person u/s 951 (other than by reason of this paragraph), multiplied by (B) the international boycott factor (as determined u/s 999),

(4) the sum of the amounts of any illegal bribes, kickbacks, or other payments (within the meaning of sec.162(c)) paid by or on behalf of the corporation during the taxable year of the corporation directly or indirectly to an official, employee, or agent in fact of a government, and

(5) The income of such corporation derived from any foreign country during any period during which sec. 901(j) applies to such foreign country.

The payments referred to in paragraph (4) are payments which would be unlawful under the Foreign Corrupt Practices Act of 1977 if the payer were a United States person. For purposes of paragraph (5), the income described therein shall be reduced, under regulations prescribed by the Secretary, so as to take into account deductions (including taxes) properly allocable to such income.

PERMANENT ESTABLISHMENT 'PE'

One of the important terms that occurs in all the Double Taxation Avoidance Agreements is the term 'Permanent Establishment' (PE) which has not been defined in the Income Tax Act.

However as per the Double Taxation Avoidance Agreements, PE includes, a wide variety of arrangements i.e. a place of management, a branch, an office, a factory, a workshop or a warehouse, a mine, a quarry, an oilfield etc. Imposition of tax on a foreign enterprise is done only if it has a PE in the contracting state.

Tax is computed by treating the PE as a distinct and independent enterprise. Generally, in Indian context, 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 "permanent establishment" shall also include:

a. a place of management;

b. a branch;

c. an office;

d. a factory;

e. a workshop;

f. a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;

g. a warehouse in relation to a person providing storage facilities for others;

h. a farm, plantation or other place where agricultural, pastoral, forestry or plantation activities are carried on;

i. premises used as a sales outlet or for receiving or soliciting orders;

j. an installation or structure, or plant or equipment, used for the exploration for or exploitation of natural resources;

k. a building site or construction, installation or assembly project, or supervisory activities in connection with such a site or project, where that site or project exists or those activities are carried on (whether separately or together with other sites, projects or activities) for more than specified months (generally 6 months).

Exclusion An enterprise shall not be deemed to have a permanent establishment merely by reason of:

- **a.** the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
- **b.** the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display ;
- **c.** the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- **d.** the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise; or
- **e.** the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise.

An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, a general commission agent or any other agent of an independent status, where that person is acting in the ordinary course of the person's business as such a broker or agent.

However, when the activities of such a broker or agent are carried on wholly or principally on behalf of that enterprise itself or on behalf of that enterprise and other enterprises controlling, or controlled by or subject to the same common control as, that enterprise, the person will not be considered a broker or agent of an independent status within the meaning of this paragraph.

Illustration 8: 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).

Solution: 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.

Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

BUSINESS CONNECTION 'BC'

The concept of permanent establishment ("PE") has gained considerable importance with the growing trend of globalization. The concept of a PE is important for several Articles of the Convention and the concept or its cognate, also appears in the domestic laws of some countries. For example, in India we have the concept of business connection (BC).

BC is the Indian equivalent of PE. It is much wider in connotation and has been very effectively used by the revenue authorities to tax the income of non-residents in India. Despite being referred to in the Income Tax Act, 1961 ("ITA"), the term was not defined till the Finance Act, 2003 inserted a somewhat cryptic explanation to Section 9 of the Indian Income Tax Act, 1961.

The government aims to toughen the existing 'Business Connection' (treaty equivalent of the term 'Permanent Establishment') regime by adopting the more stringent definition of Dependent Agent Permanent Establishment (DAPE)

India has been an active advocate of the initiative by Organisation for Economic Co-operation and Development and the G20 on the Base Erosion and Profit Shifting (BEPS) project. The outcome of the project, in the form of 15 action plans, addresses various issues of tax avoidance contemporaneous with the current digitalized business environment. The final report provided its recommendations pertaining to various domestic and tax treaty provisions. Considering the colossal number of such tax treaties, the Action Plan 15 recommended creation of a multilateral instrument (MLI) wherein one document containing all the amendments could be applicable to all the tax treaties. The MLI has had 78 countries and counting, to being a signatory to the convention, including India.

As a part of the Budget proposals, the government aims to toughen the existing 'Business Connection' (treaty equivalent of the term 'Permanent Establishment') regime by adopting the more stringent definition of Dependent Agent Permanent Establishment (DAPE) as has been provided by the OECD under BEPS Action Plan 7 and the MLI.

Since India is a signatory to the multilateral instrument, the DAPE provisions of India's tax treaties, as modified by MLI, shall become wider in scope than the current provisions contained in the Income-tax Act, 1961 (the Act), and as a result of this non-residents would have an option to choose the provisions of the Act that are beneficial to them.

By virtue of this proposed amendment, the definition of the DAPE as per the Act is being amended to be at par with the definition contained in the MLI.

The proposed amendment is in two parts:

Business Connection: As per existing provisions, in order to constitute a taxable presence (that is, a business connection) in India, inter alia, any person acting on behalf of the non-resident must have had an authority to conclude contracts on behalf of such non-resident. By merely taking away such authority, certain taxpayers would take the benefit of the loophole in the law and avoid payment of taxes in India.

Under the revised definition proposed in the Finance Bill 2018, an agent would include not only a person who habitually concludes contracts on behalf of the non-resident, but also a person who habitually plays a principal role leading to the conclusion of contracts.

Significant Economic Presence: As per BEPS Action Plan 1, OECD analysed three ways to tax digital transactions undertaken by the non-residents without having any physical presence in a country: (i) a new nexus in the form of a significant economic presence, (ii) withholding tax on certain types of digital transactions, and (iii) an equalization levy. OECD left it to individual countries to adopt any of these three measures in their domestic law as additional safeguards against BEPS.

India has already introduced the concept of equalisation levy as a separate code by Finance Act, 2016, in order to tax certain digital transactions.

However, it seems that the government is of the opinion that the equalization levy is not a one-stop solution and the memorandum to the Finance Bill, 2018 specifically addresses this issue of tax avoidance in a digital economy.

A non-resident enterprise interacts with customers in another country without having any physical presence in that country resulting in avoidance of taxation in the source country. Therefore, going a step further, the

Finance Bill, 2018, now proposes to tax digital transactions on the basis of 'significant economic presence' vis-à-vis 'physical presence' by making amendments to the definition of the term 'business connection' as provided under the Act.

A non-resident enterprise that generates significant revenues from in-country customers by targeting them through digital means and without any physical presence would be a substantial economic presence.

The proposed amendment would only make an impact if India is able to negotiate its treaties to include 'significant economic presence' in the definition of Permanent Establishment.

It appears that India is adopting a two-pronged approach to tax e-commerce trade to demand its share of taxes.

The Indian Income-tax Act provides for levy of income-tax on the income of foreign companies and non-residents, but only to the extent of their income sourced from India. Under section 5 of the Act, a foreign company or any other non-resident person is liable to tax on income which is received or is deemed to be received in India by or on behalf of such person, or income which accrues or arises or is deemed to accrue or arise to it in India. Income tax is payable by a taxpayer, regardless of whether he is a resident taxpayer, a non-resident taxpayer, or a non-resident Indian, on the total income computed by the Assessing Officer under the provisions of the Income Tax Act 1961. Section 9 thereafter specifies certain types of income that are deemed to accrue or arise in India in certain circumstances. These two sections embody the source rule of income taxation in the domestic law. No income of a non-resident can be taxed in India unless it falls within the four corners of section 5 read with section 9 of the Income-tax Act. Section 9(1) of the I.T. Act specifies that for the income to be taxed in India, it should deemed to accrue or arise in India.

And one among those incomes are income from "business connection" in India .The basic aim of this paper work is to look into the series of judicial pronouncements related to the term "business connection" and the changes which have been introduced therein after.

Section 9 of IT Act: Broadly speaking, business income of a foreign company or other non-resident person is chargeable to tax to the extent it accrues or arises through a business connection in India or from any asset or source of income located in India, and to the extent such income is attributable to the operations carried out in India. Certain income is deemed to accrue or arise in India under section 9 of the said act, even though it may actually accrue or arise outside India .Section 9 applies to all assesses irrespective of their residential status and place of business. Thus, only Indian income is liable to income tax in India in the case of a non-resident person. This means that a non-resident person is not liable to pay any income tax in India on his foreign income. Though an income may not actually accrue or arise in India, yet it may be deemed to accrue or arise in India.

Special Points: Following Explanation shall be inserted u/s 9 by the Finance Act, 2020, w.e.f. 1-4-2022:

For the removal of doubts, it is hereby declared that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean:

(a) transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India, as may be prescribed:

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not—

(i) the agreement for such transactions or activities is entered in India; or

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

Following Explanation shall also be inserted u/s 9 by the Finance Act, 2020, w.e.f. 1-4-2021 :

For the removal of doubts, it is hereby declared that the income attributable to the operations carried out in India, shall include income from—

(i) such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;

(ii) sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and

(iii) sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.

Thus, under Section 9, the following are the important types of income which are deemed to accrue or arise in India:

- Income through any business connection in India, or through 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.
- Salary income for service rendered in India; and
- Salary for the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment from the A.Y. 2000.Also the following incomes which are payable outside India are deemed to arise in India:-
    a. Dividend paid by an Indian company outside India.
    b. Interest payable on money borrowed and brought into India.
    c. Royalty and technical service fees payable in respect of any right/ technical services used for business / profession in India. However, royalty and fees for technical services is exempt, where such royalty / fees earned is in respect of computer software supplied by a Non-resident manufacturer along with the computer or computer based equipment under an approved scheme.

"Business Connection"- The term business connection has undergone lot of changes. The Hon'ble Courts have time and again interpreted the term "business connection" with reference to facts, circumstances and prevailing conditions. A business connection involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in India which contributes to the earning of these profits or gains. A business connection can arise between a non-resident and a resident if both of them carry on business and if the non-resident earns income through such a connection. A business connection involves a relation between business carried on by non-resident which yields profits or gains and some activity in India which contributes to the earning of these profits or gains.

A business connection can arise between a non-resident and a resident of both of then carry on business and if the non-resident earns income through such connections. It basically predicates an element of continuity between the business of the non-resident and the activity in India: a stray or isolated transaction is not normally regarded as business connection.

"BUSINESS CONNECTION" as defined in the Act [Section 9(1) Income Tax Act] And also in Circular No 23, Section(s) referred 9 of income tax. It includes a profession connection. It includes a person acting on behalf of a non-resident and who performs any one or more of the following –

Activity 1: He exercises in India an authority to conclude contracts on behalf of non-resident (it does not cover the activity of only the purchase of goods or merchandise for then on-resident)

Activity 2: 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

Activity 3: He habitually secures order in India (mainly or wholly) for the non-resident or for non-residents under the same management.

Where such a business is carried on in India through a person referred to in Activity one, two or three (mentioned above) only so much of income is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

Also according to the Circular No 23, income tax some illustrative instances of a non-resident having business connection in India, are given below:

(a) Maintaining a branch office in India for the purchase or sale of goods or transacting other business.

(b) Appointing an agent in India for the systematic and regular purchase of raw materials or other commodities, or for sale of the non-resident's goods, or for other business purposes.

(c) Erecting a factory in India where the raw produce purchased locally is worked into a form suitable for export abroad.

(d) Forming a local subsidiary company to sell the products of the non-resident parent company.

(e) Having financial association between a resident and a non-resident company.

Although the term business connection is nowhere defined in the act but the courts have given various judicial pronouncements which have been categorically classified below:

1) **There must be element of continuity as well as real and intimate connection -** The expression 'business connection' undoubtedly means something more than 'business'. A business connection involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in the taxable territories which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and the activity in the taxable territories. The expression 'business connection' postulates a real and intimate relation between trading activity carried on outside the taxable territories and trading activity within the territories, the relation between the two contributing to the earning of income by the non-resident in his trading activity.

In the case of CIT v. R.D. Aggarwal & Co., the contracts for the sale of goods took place outside the taxable territories, price was received by the non-residents outside the taxable territories, and delivery was also given outside the taxable territories. Therefore in the view of the court case such a relation w.r.t expression "business connection" must be real and intimate through or from which income must accrue or arise whether directly or indirectly to the non-resident was absent. The Supreme Court in the same case further observed that a business connection.....involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in the taxable territories which contributes directly or indirectly to the earning of those profits or gains. Business connection may take several forms: it may include carrying on a part of the main business or activity incidental to the main business of the non-resident through an agent, or it may merely be a relation between the business of the non-resident and the activity in the taxable territories, which facilitates or assists the carrying on of that business. In each case the question whether there is a business connection from or through which income, profits or gains arise or accrue to a non-resident must be determined upon the facts and circumstances of the case.

The expression “business” is defined in the Act as any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce or manufacture, but the Act contains no definition of the expression “business connection” and its precise connotation is vague and indefinite.

In CIT v. Fried Krupp Industries it was held that an isolated transaction between a non-resident and a resident in India without any course of dealings such as might fairly be described as business connection does not attract section 9. There is no question of continuing business relating when a person purchases machinery or other goods abroad or uses them in India and earns profit but where there is connection a continuity in business relationship between the person in India who helps to make the profits and the person outside India who receives and realizes the profit, such relationship constitute a business connection. In each of such case whether there is a business connection from or through which income arises or accrues must be determined upon the facts or circumstances of that case.

2**) ‘Business’ includes profession, vocation and callings -** The expression ‘business’ does not necessarily mean trade or manufacture only. It is being used as including within its scope profession, vocations and calling from a fairly long-time.

In the context in which the expression ‘business connection’ is used in section 9(1), there is no warrant for giving a restricted meaning to it excluding ‘professional’ connection, from its scope. The definition of the expression “business” given in the Act is an inclusive one. The expression “business connection”, however, is not defined in the Act It is no doubt true that there is specific reference to “business” in section 9(1) and there is no reference to “profession”.

“The phrase ‘business connection’ is different from, though doubtless not unrelated to, the word business of which there is a definition in the Act.”

The expression “business” does not necessarily mean trade or manufacture only. It is being used as including within its scope professions, vocations and callings from a fairly long time. The Shorter Oxford English Dictionary defines “business” as “stated occupation, profession or trade” and “a man of business” is defined as meaning “an attorney” also. In view of the above dictionary meaning of the word “business”, it cannot be said that the definition of business given in section 45 of the Partnership Act, 1890 (53 & 54 Vict. clause 39), was an extended definition intended for the purpose of that Act only. Section 45 of that Act says:

> “The expression ‘business’ includes every trade, occupation, or profession.”

Section 2(b) of the Indian Partnership Act, 1932, also defines “business” thus:” ‘Business’ includes every trade, occupation and profession.”

The observation of Rowlett J. in Christopher Barker & Sons v. IRC , “All professions are businesses, but all businesses are not professions ...” also supports the view that professions are generally regarded as businesses. The same learned judge in another case, IRC v. Marine Steam Turbine Co. Ltd. held:

> “The word ‘business’, however, is also used in another and a very different sense, as meaning an active occupation or profession continuously carried on and it is in this sense that the word is used in the Act with which we are here concerned.”

The word “business” is one of wide import and it means an activity carried on continuously and systematically by a person by the application of his labor or skill with a view to earning an income. The Courts are of the view that in the context in which the expression “business connection” is used in section 9(1) of the Act, there is no warrant for giving a restricted meaning to it excluding “professional connections” from its scope.

In the case of Barendra Prasad Ray v. ITO, the contention of the appellants was that a professional connection cannot amount to a business connection attracting section 9(1) of the Act. The Court held that the word “business” is one of wide import and it means an activity carried on continuously and systematically by a person by the application of his labour or skill with a view to earning an income. The judges were of the view that in the context in which the expression “business connection” is used in section 9(1) of the Act, there is no warrant for giving a restricted meaning to it excluding “professional connections” from its scope.

3) **Mere purchase abroad and use in India is not ‘continuing business’ -** The term ‘business connection’ postulates a continuity of business relationship between the foreigner and the Indian. There is no question of continuing business relation when a person purchase the machinery or other goods abroad and uses them in India and earns profit as it was held in CIT v. Fried Krupp Industries. In this case the court looked into the question whether principal to principal transaction amounts to any business connection.

The court observed that where a person purchased goods from a foreigner without anything more, and the purchased goods are utilized in commercial operations in India by the Indian, then the Indian merchant or company is earning his own or its own income. The foreigner in such a case has nothing to do with the Indian-assessee’s transaction in India, as by selling his machinery abroad, he had no further interest in the business in India. The term “business connection” postulates a continuity of business relationship between the foreigner and the Indian. The court held that there is no question of continuing business relation when a person purchases machinery or other goods abroad and uses them in India and earns profit and the part of the foreigner has been played wholly abroad, so that there is no connection as such with any business in India. The Supreme Court referred and approved the decision of the Bombay High Court in CIT v. Tata Chemicals Ltd., wherein it had been held that in order to rope in the income of a non-resident, under the deeming provision, it must be shown by the department that some of the operations were carried out in India in respect of which the income was sought, to be assessed. Therefore the court declared that in respect of principal to principal transaction there is no question of any business connection.

4) **Capital gains derived outside India is excluded -** If the words ‘business connection in India’ were wide enough to cover all transactions including transactions in capital assets, there was no reason for Parliament to specifically include income (a) through or from any property in India, (b) through or from any asset or source of income from India, and (c) through or from sale of a capital asset situate in India. From the very fact that the transfer of a capital asset situate in India has been brought within the purview of section 9 the intention of Parliament was not to bring within its purview any income derived out of sale or purchase of a capital asset effected outside India as it was held in the case of CIT v. Quantas Airways Ltd.

5) **If no operations are carried in India, deeming concept cannot apply:** In CIT v. Toshoku Ltd. the court observed that if no operations of business are carried out in the taxable territories, it follows that the income accruing or arising abroad through or from any business connection in India cannot be deemed to accrue or arise in India.

6) **Transactions must be systematic and well-defined**: It is not every business activity of a manufacturer that comes within the expression ‘operation’ to which the provisions of section 42(3) of the 1922 Act [corresponding to section 9 of the 1961 Act] are attracted. In the case of Anglo-French Textile Co. Ltd. v. CIT (No. 2) it was observed that activities which are not well defined or are of a casual or isolated character would not ordinarily fall within the ambit of this rule, in a case where all that may be known is that a few transactions of purchase of raw materials have taken place in British India, it could not ordinarily be said that the isolated acts were in their nature ‘operations’ within the meaning of that expression.

Therefore these were the changes introduced by the judiciary in the definition of tern “business connection”. Other then the above mentioned transactions, following transactions does not amount to business connections:-

a. In respect of business operations carried out both in India and overseas, transactions relating to overseas operations,

b. Transactions relating only to purchase of goods in India for purpose of export by the non-resident,

c. Transactions confined to the collection of news for transmission outside India in the business of news agency or publishing newspapers, magazines or journals, carried on by non-resident,

d. Operations confined to shooting of cinematography films by a non-resident foreign national.

Conclusion

The expression 'business connection' limits no precise definition. The import and connotation of this expression has been explained by the Supreme Court in their judgment in C.I.T. v. R.D. Aggarwal and Co. which still holds good. Although the question whether a non-resident has a 'business connection' in India from or through which income, profits or gains can be said to accrue or arise to him within the meaning of section 9 of the Income-tax Act, 1961, has to be determined on the facts of each case but its definitely has given some relief so as do away with the prevalent confusion regarding the term business connection. Generally confusion prevailed in a situation where few transactions of purchases of raw materials took place in India and the manufacture and sale of goods took place outside India, the profits arose from such sales were considered to have arisen out of a business connection in India which was a wrong practice .Later the case of CIT v. Fried Krupp Industries has made the concept even more clear by hinting at "continuity of business" which is essential so as to establish business connections. Therefore the term business connection has been rationalized with the help of the judicial interpretation and been successful to a larger extent in resolving various complications related to transaction and unlike few years back.

GENERAL ANTI AVOIDANCE RULE

An arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising therefrom may be determined subject to the provisions of this Chapter. 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.

Impermissible Avoidance Arrangement [Section 96]

1. An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit, and it—

(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

(c) lacks commercial substance or is deemed to lack commercial substance u/s 97, in whole or in part; or

(d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

2. An arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

Arrangement to Lack Commercial Substance [Section 97]

An arrangement shall be deemed to lack commercial substance, if—

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; or

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).

For the aforesaid purposes, 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.

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.

The following may be relevant but shall not be 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.

Consequences of Impermissible Avoidance Arrangement [Section 98]

If an arrangement is declared to be an impermissible avoidance arrangement, then, the consequences, in relation to tax, of the arrangement, including denial of tax benefit or a benefit under a tax treaty, shall be determined, in such manner as is deemed appropriate, in the circumstances of the case, including by way of but not limited to the following:

a. disregarding, combining or recharacterising 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;

e. reallocating amongst the parties to the arrangement:

(i) any accrual, or receipt, of a capital nature 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.

For this purposes:

(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 Person and Accommodating Party [Section 99]

For the purposes of this Chapter, 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) the 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.

Application of this Chapter [Section 100]

The provisions of this Chapter shall apply in addition to, or in lieu of, any other basis for determination of tax liability.

Framing of Guidelines [Section 101]

The provisions of this Chapter shall be applied in accordance with such guidelines and subject to such conditions, as may be prescribed. Following scheme has been framed:

Application of General Anti Avoidance Rule [Rule 10U]

The provisions of Chapter X-A (i.e. GAAR Provisions) shall not apply 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 Rs. 3 crore;

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 90A; 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;

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 01-4-2017 by such person.

The provisions shall apply to any arrangement, irrespective of the date on which it has been entered into, in respect of the tax benefit obtained from the arrangement on or after 01-04-2017.

Determination of consequences of impermissible avoidance arrangement [Rule 10UA]

For the purposes of section 98(1), 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.

Notice, Forms for reference under section 144BA [Rule 10UB]

1. For the purposes of section 144BA(1), the Assessing Officer shall, before making a reference to the Commissioner, issue a notice in writing to the assessee seeking objections, if any, to the applicability of provisions of Chapter X-A in his case.

2. The notice shall contain the following:

i. details of the arrangement to which the provisions of Chapter X-A are proposed to be applied;

ii. the tax benefit arising under the arrangement;

iii. the basis and reason for considering that the main purpose of the identified arrangement is to obtain tax benefit;

iv. the basis and the reasons why the arrangement satisfies the condition provided in section 96; and

v. the list of documents and evidence relied upon in respect of (iii) and (iv) above.

3. The reference by the Assessing Officer to the Commissioner u/s 144BA(1) shall be in Form No. 3CEG.

4. Where the Commissioner is satisfied that the provisions of Chapter X-A are not required to be invoked with reference to an arrangement after considering: i. the reference received from the Assessing Officer u/s 144BA(1); or ii. the reply of the assessee in response to the notice issued u/s 144BA(2), he shall issue directions to the Assessing Officer in Form No. 3CEH.

5. Before a reference is made by the Commissioner to the Approving Panel u/s 144BA(4), he shall record his satisfaction regarding the applicability of the provisions of Chapter X-A in Form No. 3CEI and enclose the same with the reference.

Time limits [Rule 10UC]

For the purposes of section 144BA:

i. No directions u/s 144BA(3) shall be issued by the Commissioner after the expiry of 1 month from the end of the month in which the date of compliance of the notice issued u/s 144BA(2) falls;

ii. No reference shall be made by the Commissioner to the Approving Panel u/s 144BA(4) after the expiry of 2 months from the end of the month in which the final submission of the assessee in response to the notice issued u/s 144BA(2) is received;

iii. The Commissioner shall issue directions to the Assessing Officer in Form No.3CEH:

a. in the case referred to in rule 10UB(4)(i), within a period of 1 month from the end of month in which the reference is received by him; and

b. in the case referred to in rule 10UB(4)(ii), within a period of 2 months from the end of month in which the final submission of the assessee in response to the notice issued u/s 144BA(2) is received by him.

Definitions [Section 102]

Meaning of various term used are as under:

1. "arrangement" 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;

2. "asset" includes property, or right, of any kind;

3. "benefit" includes a payment of any kind whether in tangible or intangible form;

4. "connected person" means 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 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;

5. "fund" includes— **(a)** any cash; **(b)** cash equivalents; and **(c)** any right, or obligation, to receive or pay, the cash or cash equivalent;

6. "party" includes a person or a permanent establishment which participates or takes part in an arrangement;

7. a person shall be deemed to have a substantial interest in the business, if,—

- **a.** in a case where the business is carried on by a company, such person is, at any time during the financial year, the beneficial owner of equity shares carrying twenty per cent or more, of the voting power; or

   b. in any other case, such person is, at any time during the financial year, beneficially entitled to twenty per cent or more, of the profits of such business;

8. "step" includes 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;

9. "tax benefit" includes,—

   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;

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. 2017-18 for manufacturing of chemicals. It claims 100% deduction of profits earned from that unit in F.Y. 2018-19 and subsequent years as per section 10AA. Is GAAR applicable in such a case?

Interpretation:

There is an arrangement of setting up of a unit in SEZ which results into 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 submitting to the conditions 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 2:

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 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 3

Facts:

In the above example 2, 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 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?

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 transfer pricing regulations that deny tax benefits. Hence, the Revenue would not invoke GAAR in such a case.

Example 4

Facts:

In the above example 3, 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. There has not been any shifting of equipment from unit B to unit A. 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 would not invoke GAAR in such a case.

Example 5

Facts:

An Indian company (Indco) has set up a holding company (Holdco) in a no tax jurisdiction outside India (say NTJ) which has set up further subsidiary companies (Subco A and Subco B) which pay dividends to Holdco. Such dividends are not repatriated to Indco. Can GAAR be invoked to look through Holdco to tax dividends in the hands of Indco?

Interpretation: Declaration / repatriation of dividend is a business choice of a company. India does not have anti-deferral provisions in the form of Controlled Foreign Company (CFC) rules in the Income Tax Act. Accordingly, GAAR would not be invoked in such a case.

Example 6

Facts:

In the above example 5, dividend is accumulated in Holdco for a number of years and subsequently, Holdco is merged into Indco through a cross–border merger. Can GAAR be invoked on the ground that the merger route has been adopted to avoid payment of tax on dividend in India?

Interpretation: It is true that if Holdco declares dividends to Indco before merger, then, such dividend would have been taxable in India. But the timing or sequencing of an activity is a business choice available to the taxpayer. Moreover, section 47 of the Act specifically exempts capital gains on cross border merger of a foreign company into an Indian company. Hence, GAAR cannot be invoked when taxpayer makes a choice about timing or sequencing of an activity to deny a tax benefit granted by the statute.

Example 7

Facts:

The merger of a loss-making company into 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 under GAAR?

Interpretation: As regards setting off of losses, the provisions relating to merger and amalgamation already contain specific anti- avoidance safeguards. Therefore, GAAR would not be invoked when SAAR is applicable.

Example 8

Facts:

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?

Interpretation: GAAR provisions, would not, prima facie, apply to a decision of leasing (as against purchase of an asset). However, if it is a case of circular leasing, i.e. the taxpayer leases out an asset and through various sub-leases, takes it back on lease, thus creating a tax benefit without any change in economic substance, Revenue would examine the matter for invoking GAAR provisions.

Example 9

Facts:

1. X Ltd. is a banking institution in LTJ (low tax jurisdiction);
2. There is a closely held company Subco in LTJ which is a wholly owned subsidiary of another closely held Indian company Indco;
3. Subco has reserves and, if it provides a loan to Indco, it may be treated as deemed dividend u/s 2(22)(e) of the Act.
4. Subco makes a term deposit with X Bank Ltd. and X Bank Ltd. bank based on this security provides a back to back loan to Indco.

Say, India-LTJ tax treaty provides that interest payment to a LTJ banking company is not taxable in India.

Can this be examined under GAAR?

Interpretation:

This is an arrangement whose main purpose is to bring money out of reserves in Subco to India without payment of due taxes. The tax benefit is saving of taxes on income to be received from Subco by way of dividend or deemed dividend. The arrangement disguises the source of funds by routing it through X Bank Ltd. X Bank Ltd. may also be treated as an accommodating party. Hence the arrangement shall be deemed to lack commercial substance.

Consequently, in the case of Indco, the loan amount would be treated as dividend income received from Subco to the extent reserves are available in Subco; and no expense by way of interest would be allowed.

In the case of X Bank Ltd, exemption from tax on interest under the DTAA may not be allowed as X Ltd is not a beneficial owner of the interest, provided the DTAA has anti-avoidance rule of beneficial ownership. If such anti-avoidance rule is absent in DTAA, then GAAR may be invoked to deny treaty benefit as arrangement will be perceived as an attempt to hide the source of funds of Subco.

Example 10

Facts:

Indco incorporates a Subco in a NTJ with equity of US$100. Subco has no reserves; it gives a loan of US$100 to Indco at the rate of 10% p.a. which is utilized for business purposes. Indco claims deduction of interest payable to Subco from the profit of business. There is no other activity in Subco. Can GAAR be invoked in such a case?

Interpretation:

The main purpose of the arrangement is to obtain interest deduction in the hands of Indco and thereby tax benefit. There is no commercial substance in establishing Subco since without it there is no effect on the business risk of Indco or any change in the cash flow (apart from the tax benefit). Moreover, it is a case of round tripping which means a case of deemed lack of commercial substance. Hence, it would be treated as an impermissible avoidance arrangement.

Consequently, in the case of Indco, interest payment would be disallowed by disregarding Subco. No corresponding relief would be allowed in the case of Subco by way of refund of taxes withheld, if any.

Example 11

Facts:

A large corporate group has created a service company to manage all its non core activities. The service company then charges each company for the services rendered on a cost plus basis. Can the mark up in the cost of services be questioned using GAAR.

Interpretation: There are specific anti avoidance provisions through transfer pricing regulations as regards transactions among related parties. GAAR will not be invoked in this case.

Example 12

Facts

1. Y Ltd. is a company incorporated in country C1. It is a non-resident in India.
2. Z Ltd. is a company resident in India.
3. A Ltd. is a company incorporated in country F1 and it is a 100% subsidiary of Y Ltd.
4. 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.
5. 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.
6. 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.
7. As per the joint venture agreement, 49% of X Ltd‘s equity is allotted to A Ltd. and 51% is allotted to Z Ltd..
8. 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. Can GAAR be invoked to deny the treaty benefit?

Interpretation The arrangement of routing investment through country F1 results into a tax benefit. Since there is no business purpose in incorporating company A Ltd. in country F1 which is a 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. 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 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, unless it is a case where Circular 789 relating Tax Residence Certificate in the case of Mauritius, or Limitation of Benefits clause in India-Singapore treaty is applicable, GAAR can be invoked.

Example 13

Facts*:*

A Ltd. is incorporated in country F1 as a wholly owned subsidiary of company Y Ltd. which is not a resident of F1 or of India. The India-F1 tax treaty provides for non-taxation of capital gains in India (the source country) and country F1 charges no capital gains tax in its domestic law. Some shares of X Ltd., an Indian company, are acquired by A Ltd in the year after date of coming into force of GAAR provisions. The entire funding for investment by A Ltd. in X Ltd. was done by Y Ltd. These shares are subsequently disposed of by A Ltd after 5 years. This results in capital gains which A Ltd. claims as not being taxable in India by virtue of the India-F1 tax treaty. A Ltd. has not made any other transaction during this period. Can GAAR be invoked?

Interpretation: This is an arrangement which has been created with the main purpose of avoiding capital gains tax in India by routing investments through a favourable jurisdiction. There is neither a commercial purpose nor commercial substance in terms of business risks or cash flow to Y Ltd in setting up A Ltd. It should be immaterial here whether A Ltd has office, employee etc in country F1. Both the purpose test and tainted element tests are satisfied for the purpose of invoking GAAR. Unless it is a case where Circular 789 relating Tax Residence Certificate in the case of Mauritius, or Limitation of Benefits clause in India-Singapore treaty is applicable, the Revenue may invoke GAAR and consequently deny treaty benefit.

Example 14

Facts:

The shares of V Ltd., an asset owning Indian company, was held by another Indian company X Ltd. X Ltd. was in turn held by two companies G Ltd. and H Ltd., incorporated in country F2, a NTJ. The India-F2 tax treaty provides for non- taxation of capital gains in the source country and country F2 charges no capital gains tax in its domestic law. X Ltd. was liquidated by consent and without any Court Decree. This resulted in transfer of the asset/shares from X Ltd., to G Ltd. and H Ltd. Subsequently, companies G Ltd and H Ltd sold the shares of V Ltd to A Ltd. which was incorporated in F2. The companies G Ltd and H Ltd claimed benefit of tax treaty and the resultant gains from the transaction are claimed to be not taxable. Can GAAR be invoked to deny treaty benefit?

Interpretation: The alternative courses available to taxpayer to achieve the same result (with or without the tax benefit) are:

ii. **Option 1** (as mentioned in facts): X Ltd. liquidated, G Ltd. and H Ltd. become shareholders of V Ltd.; A Ltd. acquires shares from G Ltd. and H Ltd.; and becomes shareholder of V Ltd.

iii. **Option 2:** A Ltd. acquires shares of X Ltd. from G Ltd. and H Ltd.; X Ltd. is liquidated; and A Ltd. becomes shareholder of V Ltd.

iv. **Option 3:** X Ltd. sells its entire shareholding in V Ltd. to A Ltd. and subsequently, X Ltd is liquidated.

In Options 1 & 2, there is no tax liability in India except the deemed dividend taxation to the extent reserves are available in X Ltd. This is because of the treaty between India and country F1. In option 3, tax liability arises to X Ltd., an Indian company, on sale of shares of V Ltd. Subsequently, when X Ltd. is liquidated, tax liability arises on account of deemed dividend to the extent reserves are available in X Ltd.

The taxpayer exercises the most tax efficient manner in disposal of its assets through proper sequencing of transactions. The Revenue cannot invoke GAAR as regards this arrangement.

TRANSFER PRICING

Transfer Pricing Regulations in India

The Indian Transfer Pricing regulations are based on arm's length principle. The regulations came into effect from 1 April, 2001. The regulations provide that any income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price (ALP). The concept of associated enterprises has been defined in detail in the regulations. The regulations do not provide any hierarchy of the Arm's Length Methods and support concept of "most appropriate method" which provide the most reliable measure of an arm's length result under a particular set of facts and circumstances. The regulation prescribes mandatory annual filing requirements as well as maintenance of contemporaneous documentation by the taxpayer in case international transactions between associated enterprises cross a threshold and contains stringent penalty implications in case of non– compliance. The primary onus of proving arm's length price of the transaction lies with the taxpayer. Indian transfer pricing administration prefer Indian comparables in most of the cases and also accept foreign comparables in cases where foreign associated enterprises is less or least complex entity and requisite information are available about tested party and comparables. In order to provide uniformity in application of transfer pricing law there is a specialized Directorate of transfer pricing to administer transfer pricing rule under supervision of Director General of Income tax (International Taxation). Transfer Pricing officers (TPO) are vested with powers of inspection, discovery, enforcing attendance, examining a person under oath, on–the–spot enquiry/verification and compelling the production of books of account and other relevant documents during the course of a transfer pricing audit. A dispute resolution panel (in short DRP) is available to taxpayer to resolve disputes relating to transfer pricing before disputes of final order by Assessing Officer, (which incorporates the order of TPO).

XYZ ltd., a giant electronic brand of japan selling goods all over the world. They set up a call center in Gurugram, Haryana, India. Total number of employees employed by the said company is above 1000 total set up cost came out to Rs.100 crores, which they bring in fully convertible foreign exchange currency. There annual expenses are about 85 crores per annum, which the call center business gets reimbursed from XYZ LTD. again all the money received by call center is in fully convertible foreign exchange. Moreover 'call center set up' comply all the related laws applicable with them. XYZ LTD believes in full transparency and don't want to encourage any culture which leads to law evasion or avoidance.

But despite of extreme precautions they got demand from Income Tax Office, and they charge, that the company is engaged in tax evasion and avoidance practices. There total expenditure on average basis ranges from 80crores to 90crores and same amount they got reimbursed from XYZ ltd.

So there profit and loss expenses are like this:

Total revenue (reimbursed money)	85 crores
Total expenditure (Actual)	85 crores
Net profit before tax	0
Tax on profit	0

The plea from the call center business is as follows:

1. There net profit before tax is zero and hence no tax liability
2. They are all law compliant and hence they cannot be charge as tax evader by the income tax authority.
3. They bring fully convertible exchange in India every year.
4. They are providing employment and training to more than thousand personnels in India,
5. They are the contributors in real sense to the Indian economy.
6. They are neither selling anything from this call center, nor they provide any after sales services, what they are just doing, is helping customers (buyers) or facilitating them on effective use of electronic equipment and hence they are not doing any business activity in India.

Now, you as a student of company secretary course, what is your call? To understand the legal provisions one has to go through the provisions of Income tax Act, 1961 regarding provisions of transfer pricing and business connection.

In the above case one can have soft corner for XYZ LTD. But from taxation point of view they are indulge in tax evasion practices .They are doing one of the business activity in India because such act is integral part of their business as it is one of the condition of sale, which is so called customer care services.

Instead of opening their call center in Japan or other developed countries, they are saving cost by this practice, because labour in japan or other developed country is much higher as compared to India.

So from Indian taxman point of view, if they would have engaged any person (enterprise) for this work, the price paid to such enterprise should be considered as revenue from operation and after deducting related expenses from this activity will be the profit which is chargeable to tax under these circumstances.

Hence the price assumed by Indian taxman on certain prescribed basis as given under sections from to this, is known as arm's length price.

Transfer price is the price charged in a transaction. The term 'transfer price' is used to describe the actual price charged between the associated enterprises in an international transaction.

Transfer pricing issues arise when entities of multinational corporations resident in different jurisdictions transfer property or provide services to one another. These entities do not deal at arm's length and, thus, transactions between these entities may not be subject to ordinary market forces. Where the transfer price is different from the price which would have been charged if the enterprises were not associated and the difference gives rise the tax advantage, the tax is calculated on the basis of arm's length price.

Transfer price is the price which is charge by one associated company to another. And that can be considered as measure of tax avoidance by tax authorities because by this one can manipulate profits of associated enterprise.

Article 9 of the OECD Model Tax Convention is dedicated to the Arms Length Principle (ALP). It says that the transfer prices set between the corporate entities should be in such a way as if they were two independent entities.

ALP is based on real markets and provides the MNE's and the governments **a single international standard** for the contracts that allows various different government entities to collect their share of tax.

A functionally separate entity approach as a working hypothesis underlying the application of the arm's length principle, is found in almost all tax treaties.

Multinational groups has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same group. Such multinationals carrying on business in India can be controlled by their holding companies (parent companies) and the profit of Indian business can be controlled by:

- manipulating the prices charged and paid in such intra-group transactions
- The allowance for any expense or interest arising from an international transaction or specified domestic transaction.
- Where in an international transaction or specified domestic transaction,
  - o two or more **associated enterprises**
    - ▪ enter into a mutual agreement or arrangement for the apportionment of, or any contribution to, any cost incurred
    - ▪ in connection with a benefit, service or facility provided to any such enterprises,

  the cost apportioned to (contributed by), any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility.

- The provisions (in any of aforesaid situation) shall not apply in a case where the computation of income or the determination of the allowance for any expense or interest or the determination of any cost or expense allocated or contributed has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction or specified domestic transaction was entered into.
- thereby, leading to erosion of tax revenues. In other words, the course of business between a resident person and an associated non- resident or not ordinarily resident person, is so arranged that the resident makes either no profit or less than the ordinary profit in that business. Such an arrangement would deprive that Indian revenue of the tax which would otherwise be payable by the resident. With a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in case of such multinational enterprise, new set of special provisions relating to avoidance of tax have been introduced under chapter X in the Income tax Act. These provisions relate to computation of income from international transaction having regard to arm's length price, meaning of associated enterprises, meaning of international transaction, determination of arm's length price, keeping and maintaining of information and documents by persons entering into international transaction, furnishing of a report from an accountant by persons entering into such transactions.

Illustration 9: What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions? Examine.

Solution:

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.

Arm's length price means

(i) a price which is applied or proposed to be applied in a transaction

(ii) between persons other than associated enterprises (i.e., unrelated person, resident or non-resident),

(iii) in uncontrolled conditions. **Taxpoint : There may be more than one arm's length price. Process** The process to arrive at the appropriate arm's length price typically involves the following processes or steps: **(a) Comparability analysis** The concept of establishing comparability is central to the application of the arm's length principle. An analysis under the arm's length principle involves information on associated enterprises involved in the controlled transactions, the transactions at issue between the associated enterprises, the functions performed and the information derived from independent enterprises engaged in comparable transactions (i.e., uncontrolled transactions). The objective of comparability analysis is always to seek the highest practicable degree of comparability, recognising that there will be unique transactions and cases where any applied method cannot be relied on. It is clear that the closest approximation of the arm's length price will be dependent on the availability and reliability of comparables. There are many factors determining the comparability of transactions for transfer pricing analysis:

(i) Characteristics of the property or services Property, tangible or intangible, as well as services, may have different characteristics which may lead to a difference in their values in the open market. Therefore, these differences must be accounted for and considered in any comparability analysis of controlled and uncontrolled transactions. Characteristics that may be important to consider are:

- In case of tangible property, the physical features, quality, reliability and availability of volume and supply;
- In the case of services, the nature and extent of such services; and
- In case of intangible property, the type and form of property, duration and degree of protection and anticipated benefits from use of property.

(ii) Functional analysis (Functions, Assets and Risks)

- ♦ In dealings between two independent enterprises, the compensation usually reflects the functions that each enterprise performs, taking into account assets used and risks assumed. Therefore, in determining whether controlled and uncontrolled transactions are comparable, a proper study of all specific characteristics of an international transaction or functional activity needs to be undertaken, including comparison of the functions performed, assets used and risks assumed by the parties. Such a comparison is based on a "functional analysis".
- ♦ A functional analysis seeks to identify and compare the economically significant activities and responsibilities undertaken by the independent and associated enterprises. An economically significant activity is considered to be any activity which materially affects the price charged in a transaction and the profits earned from that transaction.
- ♦ Functional analysis is thus a key element in a transfer pricing exercise. It is a starting point and lays down the foundation of the arm's length analysis. The purpose of functional analysis is to describe and analyse the operations of an enterprise and its associated enterprises.
- ♦ Functional analysis typically involves identification of 'functions performed', 'assets employed' and 'risks assumed' (therefore named a "FAR analysis") with respect to the international transactions of an enterprise. Functions that may need to be accounted for in determining the comparability of two transactions can include:

Research and development

- Product design and engineering;
- Manufacturing, production and process engineering;
- Product fabrication, extraction and assembly;
- Marketing and distribution functions, including inventory management and advertising activities;
- Transportation and warehousing; and

- Managerial, legal, accounting and finance, credit and collection, training and personnel management services.
- Outsourcing nature of work
- Business process management

♦ Risks that need to be considered while determining the degree of comparability between controlled and uncontrolled transactions include:
  - Financial risks including method of funding, funding of losses, foreign exchange risk
  - Product risk including design & development of product, after sales service, product liability risk, intellectual property risk, risks associated with R&D, obsolescence / upgrading of product
  - Market risks including fluctuations in prices and demand, business cycle risks, development of market including advertisement and product promotion
  - Credit and collection risks;
  - Entrepreneurial risk including risk of loss associated with capital investment
  - General business risks related to ownership of plant, property and equipment.

♦ Furthermore it is not only necessary to identify the risks but to identify who bears such risks. The allocation of risk is usually based on contractual terms between the parties; however these may not always reflect the reality of a transaction or a relationship, and an allocation of risk between controlled taxpayers after the outcome of such risk is known or reasonably knowable lacks economic substance.

♦ Consider an example where company S, situated in country A, is the wholly owned subsidiary of company P, situated in country B but a foreign manufacturer. The subsidiary company S acts as the distributor of goods manufactured by the parent company P and both parties execute an agreement that any product liability costs will be borne by the parent company P. However, in practice when product liability claims are raised, subsidiary company S always pays the resulting damages. In such a case the tax authorities will generally disregard the contractual arrangement and treat the risk as having been in reality assumed by subsidiary company S.

(iii) Contractual Terms

♦ The conduct of the contracting parties is a result of the terms of the contract between them and the contractual relationship thus warrants careful analysis when arriving at the transfer price. Other than a written contract, the terms of the transactions may be figured out from correspondence and communication between the parties involved. In case the terms of the arrangement between the two parties are not explicitly defined, then the terms have to be deduced from their economic relationship and conduct.

♦ One important point to note in this regard is that associated enterprises may not hold each other to the terms of the contract as they have common overarching interests, unlike independent enterprises, who are expected to hold each other to the terms of the contract. Thus, it is important to figure out whether the contractual terms between the associated enterprises are a “sham” (something that appears genuine, but when looked closer lacks reality, and is not valid under many legal systems) and/or have not been followed in reality.

♦ Also, explicit contractual terms of a transaction involving members of a MNE may provide evidence as to the form in which the responsibilities, risks and benefits have been assigned among those members. For example, the contractual terms might include the form of consideration charged or paid, sales and purchase volumes, the warranties provided, the rights to revisions and modifications, delivery terms, credit and payment terms etc. This material may also indicate the substance of a transaction, but will usually not be determinative on that point.

Illustration 10: 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?

Solution:

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 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.

Illustration 11:

I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2019-20. 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.

Solution:

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.

Illustration 12: Examine the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961

(i) Transfer pricing rules shall have no implication where income is computed on the basis of book profits.

(ii) Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee.

Solution:

(i) The statement is correct:

For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the statement of profit and loss prepared in accordance with the Companies Act can be increased/ decreased only by the additions and deductions specified in Explanation 1 below section 115JB(2).

No other adjustments can be made to arrive at the book profit for levy of MAT, except where:

(a) it is discovered that the statement of profit and loss is not drawn up in accordance with the relevant Schedule of the Companies Act

(b) incorrect accounting policies and/or accounting standards have been adopted for preparing such accounts; and

(c) the method and rate of depreciation adopted is not correct.

Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

(ii) The statement is not correct:

Section 92CA(4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm's length price of an international transaction, the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.

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. 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.

(2) Section 92CC enables the Board (with the approval of the Central Government), to enter into an APA with any person undertaking an international transaction.

(i) **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 arm's length price or specifying the manner in which arm's length price shall be determined, in relation to such international transaction.

(ii) **Manner of determination of Arm's Length Price in APA**: The manner for determination of arm's length price referred above may include methods referred to in section 92C(1) or any other method with necessary adjustments or variations.

(iii) **Non-applicability of section 92C or section 92CA**: In case an APA has been entered into in respect of any international transaction, the arm's length price in relation to that transaction 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 apply overriding the provisions of section 92C or section 92CA, which are normally applicable for determination of arm's length price.

(iv) **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.

(v) **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

  (b) the Principal Commissioner or Commissioner and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(vi) **Not binding of APA**: The APA shall not be binding if there is any change in law or facts having bearing on such APA.

(vii) **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.

(viii) **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.

    (a) 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.

    (b) 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.

(ix) 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.

(x) 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.

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) 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; 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 apply may enter into agreement may, if such person 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.

(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.

Note - 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.

(4) **Approval of Central Government**: The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.

(5) **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;

(b) the conditions, if any, other than provided in the Act or these rules. 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.

(6) **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.

(7) **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.

(8) **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 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.

(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.

(9) **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.

(10) 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)]

(11) The negotiation between the competent authority in India and the competent authority in the other country or countries, in case of bilateral or multilateral 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)]

Provision for Roll back in APA Scheme [Section 92CC]

(a) In order to reduce current pending as well as future litigation in respect of the transfer pricing matters, 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 a person during any period not exceeding four previous years preceding the first of the previous years for which the APA applies in respect of the international transaction to be undertaken.

The attribution of profits to the PE of a non-resident under clause (i) of sub-section (1) of section 9 of the Act in accordance with rule 10 of the Rules also results in avoidable disputes in a number of cases. In order to provide certainty, the attribution of income in case of a non-resident person to the PE is also required to be clearly covered under the provisions of the Safe Harbour Rules and the Advance Pricing Agreement. In view of the above an amendment has been made vide Finance Act, 2020 in section 92CB and section 92CC of the Act to cover determination of attribution to PE within the scope of Safe Harbour Rules and the Advance Pricing Agreement**. [Amendment vide Finance Act, 2020]**

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, 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 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"). 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 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 Rs. 5 lakh.

10RA	Procedure for giving effect to rollback provision of an Agreement	Rule 10RA has been inserted to provide 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 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.

Question 2

Rule 10MA(2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word "same". Further, it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies.

The word "materially" is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word "materially" will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.

Question 3

Rule 10MA(2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Question 4

Rule 10MA(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm's length price of the said international transaction for the said year *has been the subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement. Further, Rule 10 RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant.*

There is a need to clarify the phrase “Tribunal has passed an order disposing of such appeal” and on the mismatch, if any, between Rule 10MA(3) and Rule 10RA(4).

Answer

The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given.

There is no mismatch between Rule 10MA(3) and Rule 10RA(4).

Question 5

Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. It may be clarified whether the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is Rs. 100, the income as adjusted by the TPO is Rs. 120, and the application of the rollback provisions results in reducing the income to Rs. 90, then the rollback for that year would be determined in a manner that the declared income Rs. 100 would be treated as the final income for that year.

Question 6

Rule 10RA(7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer

The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled.

This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub-rules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

Question 7

If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities, if MAP has already been concluded for a rollback year?

Answer

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year, subject to fulfilment of specified conditions in Rules 10MA and 10RA. However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Question 8

Rule 10MA(1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA(4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Question 9

Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Question 10

Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer

The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

Question 11

For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer

The second proviso to Rule 10MA(5) provides for revision of APAs already concluded to include rollback provisions.

Question 12

For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

Answer

The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Question 13

In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Question 14

In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

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.

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. 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.

(ii) 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, proceed to assess or reassess or re-compute the total income of the relevant assessment year having regard to and in accordance with the APA.

However, with effect from 1.9.2019, Assessing Officer shall pass 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]

(iii) 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.

(iv) 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

(v) no notice has been issued under section 143(2) till the expiry of the limitation period provided under the said section.

ADVANCE RULING

XYZ LTD a German company (well renowned in providing technical know how world- wide) wants to enter into technical collaboration with Indian company. The technical know-how which will be provided to Indian company may come from various research centers from all over the world. The total turnover and income of XYZ LTD. is huge and business in Indian may be 2% to 3% of their total turnover.

XYZ LTD. is very cautious that the tax incidence in India should be restricted to Indian transactions only, so they want to be doubly sure of such thing.

The answer to this problem lies with authority for advance ruling which can clearly identify the tax incidence on such income in India and such rulings are binding on income tax authorities as well.

By having ruling in advance, both German company and tax authorities are equally sure about the tax incidence on such transaction, which will definitely settle things amicably between them.

Moreover in the following cases also the advance rulings have no parallel:

- Determination of Tax Liability in Advance.
- Prevent & Reducing Litigation.
- Attract Foreign Direct Investment.

To avoid needless dispute & litigation and facilitating better taxpayer relations, a scheme for giving advance rulings was introduced by the Finance Act, 1993.

Chapter XIX-B of the Income-tax Act, deals with advance rulings, came into force with effect from 1-6-1993.

Chapter XIX-B, consisting of section 245N to 245V, provides a scheme for giving advance rulings in respect of transactions involving non-residents and specified residents, with a view to avoid needless litigations and promoting better tax-payer relations.

This scheme, the authority of accord advance rulings has been entrusted to an self governing adjudicatory body. Adjudicatory body, is high powered headed by a retired judge of the Supreme Court has been set-up.

The authority has power to issue rulings, which are binding both on the Income- tax Department and the applicant who sought such ruling subject to certain exceptions. The process is quite normal, less costly (as compared to fees charged by professional), expeditious and authoritative (have binding effect).

Advance Ruling means written opinion or authoritative decision by an Authority empowered to render it with regard to the tax consequences of a transaction or proposed transaction or an assessment in regard thereto. It has been defined in section 245N(a) of the Income-tax Act, 1961 as amended from time-to-time.

Advance Ruling means formal ruling given in advance by authority in respect of tax incidence of a transaction or proposed transaction or an assessment in regard thereto.

ADVANCE RULING DEFINITIONS (SECTION 245N)

As per section 245N(a) of the Income-tax Act, 1961

Advance ruling means:

(i) A determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant; or

(ii) A determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident; or

(iia) A determination by the Authority in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant

In above cases, such determination shall include the determination of any question of law or of fact specified in the application.

(iii) A determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal and such determination or decision shall include the determination or decision of any question of law or of fact relating to such computation of total income specified in the application.

(iv) A determination or decision by the Authority whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not.

Applicant [Section 245N(b)]

Applicant means any person who is:

a) a non-resident referred to in sub-clause (*i*) of clause (*a*) above; or

b) a resident referred to in sub-clause (*ii*) of clause (*a*) above; or

c) a resident who has undertaken or propose to undertake one or more transactions of value of 100 crores or more in total [Notification No. 73, dated 28-11-2014]

d) a public sector company [Notification No. 725, dated 03-08-2000]

e) a resident or a non-resident referred to in sub-clause (*iv*) of clause (*a*) above

f) an applicant as defined in section 28E(c) of the Customs Act, 1962

g) an applicant as defined in section 23A(c) of the Central Excise Act, 1944

h) an applicant as defined in section 96A(b) of the Finance Act, 1994

- makes an application u/s 245Q(1).

Authority for Advance Rulings [Section 245-O]

- The Central Government shall constitute an Authority for giving advance rulings, to be known as "Authority for Advance Rulings".

  Provided that the Authority shall cease to act as an Authority for Advance Rulings for the purposes of Chapter V of the Customs Act, 1962 on and from the date of appointment of the Customs Authority for Advance Rulings under section 28EA of that Act.

  On and from the date of appointment of the Customs Authority for Advance Rulings referred to in the proviso to sub-section (1), the Authority shall act as an Appellate Authority, for the purpose of Chapter V of the Customs Act, 1962 :

  Provided that the Authority shall not admit any appeal against any ruling or order passed earlier by it in the capacity of the Authority for Advance Rulings in relation to any matter under Chapter V of the Customs Act, 1962 after the date of such appointment of the Customs Authority for Advance Rulings.

- The Authority shall consist of a Chairman and such number of Vice-chairmen, revenue Members and law Members as the Central Government may, by notification, appoint.

- A person shall be qualified for appointment as –

  a) Chairman, who has been a Judge of the Supreme Court or the Chief Justice of a High Court or for at least 7 years a Judge of a High Court;

  b) Vice-chairman, who has been Judge of a High Court;

  c) a revenue Member –

     i. from the Indian Revenue Service, who is (or is qualified to be), a Member of the Board; or

     ii. from the Indian Customs and Central Excise Service, who is (or is qualified to be), a Member of the Central Board of Excise and Customs, on the date of occurrence of vacancy

  d) a law Member from the Indian Legal Service, who is (or is qualified to be), an Additional Secretary to the Government of India on the date of occurrence of vacancy.

- The terms and conditions of service and the salaries and allowances payable to the Members shall be such as may be prescribed.

- The Central Government shall provide to the Authority with such officers and employees, as may be necessary, for the efficient discharge of the functions of the Authority under this Act.

- The powers and functions of the Authority may be discharged by its Benches as may be constituted by the Chairman from amongst the Members thereof.

- In the event of the occurrence of any vacancy in the office of the Chairman by reason of his death, resignation or otherwise, the senior-most Vice-chairman shall act as the Chairman until the date on which a new Chairman, appointed to fill such vacancy, enters upon his office.

- In case the Chairman is unable to discharge his functions owing to absence, illness or any other cause, the senior- most Vice-Chairman shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties
- A Bench shall consist of the Chairman or the Vice-chairman and one revenue Member and one law Member.

  Provided that where the Authority is dealing with an application seeking advance ruling in any matter relating to this Act, the revenue Member of the Bench shall be such Member who is member of IRS ***[inserted by finance Act, 2018]***
- The Authority shall be located in the National Capital Territory of Delhi and its Benches shall be located at such places as the Central Government may, by notification specify.
- "Member" means a Member of the Authority and includes the Chairman and Vice-chairman.
- "Vice-chairman" means the Vice-chairman of the Authority.

Vacancies etc., not to invalidate proceedings (Section 245P)

Although, the members of the Authority function as a body in disposing off the applications before them, but section 245P makes it clear that no proceeding before the Authority, or the pronouncement of advance ruling by the Authority, shall be questioned or shall be invalid on the ground merely of the existence of any vacancy or defect in the Constitution of the Authority

Application for Advance Ruling [Section 245Q]

An applicant desirous of obtaining an advance ruling may make an application stating the question on which the advance ruling is sought in quadruplicate in:

(a) in Form No. 34C in respect of a non-resident applicant;

(b) in Form No. 34D in respect of a resident applicant seeking advance ruling in relation to a transaction undertaken or proposed to be undertaken by him with a non-resident;

(c) in Form No. 34DA in respect of a resident applicant referred to in section 245N(b)(iia) falling within any such class or category of person as notified by the Central Government; and

(d) in Form No. 34E in respect of a notified resident referred to in section 245N(b)(iii)

(e) in Form No. 34EA in respect of a applicant referred to in section 245N(b)(iiia) and shall be verified in the manner indicated therein.

• The application shall be accompanied by a fee of

a. Rs 10,000 or

b. such fees as may be prescribed.

– whichever is higher

• An applicant may withdraw an application within 30 days from the date of the application.

• An application shall be presented by the applicant in person or by an authorised representative to the Secretary or any other officer notified in writing by the Secretary or sent by registered post addressed to the Secretary along with a fee (in the form of a Demand Draft drawn in favour of "Authority for Advance Rulings" payable at New Delhi).

• An application sent by registered post shall be deemed to have been made on the date on which it is received in the office of the Authority.

• If the applicant is not hitherto assessed in India, he shall indicate in Annexure I to the application:

(a) his head office in any other country,

(b) the place where his office and residence is located or is likely to be located in India and

(c) the name and address of his representative in India, if any, authorised to receive notices and papers and act on his behalf.

• The Secretary may send the application back to the applicant if it is defective in any manner for removing the defects within such time as he may allow. Such application shall be deemed to have been made on the date when it is represented after correction.

Procedure on Receipt of Application [Section 245R]

- On receipt of an application, the Authority shall cause a copy thereof to be forwarded to the Principal Commissioner or Commissioner and, if necessary, call upon him to furnish the relevant records. Where any records have been called for by the Authority, such records shall, as soon as possible, be returned to the Principal Commissioner or Commissioner.
- The Authority may, after examining the application and the records called for, by order, either allow or reject the application. However, where the question raised in the application –

  (i) is already pending before any income-tax authority or Appellate Tribunal [except in the case of a resident applicant falling in section 245N(b)(iii)] or any court;

  (ii) involves determination of fair market value of any property;

  (iii) relates to a transaction or issue which is designed prima facie for the avoidance of income-tax [except in the case of a resident applicant falling in section 245N(b)(iii)] - shall be rejected by the authority.
- The words 'already pending', should be interpreted to mean: 'already pending as on the date of the application' and not with reference to any future date [Monte Harris -vs.- CIT (AAR)].
- No application shall be rejected unless an opportunity has been given to the applicant of being heard. Further, where the application is rejected, reasons for such rejection shall be given in the order.
- A copy of every order (allowing or rejecting) shall be sent to the applicant and to the Principal Commissioner or Commissioner.
- Where an application is allowed, the Authority shall, after examining such further material as may be placed before it by the applicant or obtained by the Authority, pronounce its advance ruling on the question specified in the application.
- On a request received from the applicant, the Authority shall, before pronouncing its advance ruling, provide an opportunity to the applicant of being heard, either in person or through a duly authorised representative.
- The Authority shall pronounce its advance ruling in writing within 6 months of the receipt of application.
- A copy of the advance ruling pronounced by the authority, duly signed by the Members and certified in the prescribed manner shall be sent to the applicant and to the Principal Commissioner or Commissioner, as soon as may be, after such pronouncement.

Appellate Authority not to proceed in certain cases [Section 245RR]

No Income-tax Authority or the Appellate Tribunal shall proceed to decide any issue in respect to which an application has been made by an applicant, being a resident, u/s 245Q.

Applicability of Advance Ruling [Section 245S]

The advance ruling pronounced by the Authority u/s 245R shall be binding only:

(a) on the applicant who had sought it;

(b) in respect of the transaction in relation to which the ruling had been sought; and

(c) on the Principal Commissioner or Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction.

The advance ruling shall be binding as aforesaid unless there is a change in law or facts on the basis of which the advance ruling has been pronounced.

Advance ruling to be void in certain circumstances [Section 245T]

Where the Authority finds, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, that an advance ruling pronounced by it has been obtained by the applicant by fraud or misrepresentation of facts, it may, by order, declare such ruling to be void ab initio and thereupon all the provisions of this Act shall apply to the applicant as if such advance ruling had never been made.

A copy of such order shall be sent to the applicant and the Principal Commissioner or Commissioner.

Powers of the Authority [Section 245U]

The Authority shall, for the purpose of exercising its powers, have all the powers of a civil court under the Code of Civil Procedure, 1908 as are referred to in section 131 of this Act.

Power to regulate its own procedure [Section 245V]

The Authority shall, subject to the provisions of this Chapter, have power to regulate its own procedure in all matters arising out of the exercise of its powers under this Act.

LESSON ROUND UP

– **Tax Haven:** A Tax Haven is a place where there is no tax on income or it is taxed at low rate. Individuals or corporate entities move from jurisdiction of high rates of taxes to the region of low tax in order to lower their overall tax liability.

– **Factors for determining whether a country is tax haven or not are:** Nil or Nominal tax Rate, No Exchange of Information, Lack of Transparency, Limited Regulatory supervision.

– **Controlled foreign Corporation:** The OECD recommended for adoption of CFCs Rules for taxing those entities which defer the tax liability after moving to the tax haven country. A CFC is a legal entity that exists in one jurisdiction but is owned or controlled primarily by taxpayers of a different jurisdiction. The CFC rules may also be termed ‘anti-deferral rules’.

– Sub Part F means special category of foreign source unearned income that is currently taxed by the Internal Revenue Code, 1986 of US whether or not it is remitted to the U.S. It is basically U.S. financial term used for the U.S. based institutions.

– **Residency Issue :** Residence as defined in double taxation treaties is different from residence as defined for domestic tax purposes. The situation of double taxation will arise where the income gets taxed in two or more than two countries whether due to residency or source principle as the case may be. The problem of double taxation arises if the income of a person is taxed in one country on the basis of residence and on the basis of residency in another country or on the basis of both.

– **Permanent Establishment:** as per the Double Taxation Avoidance Agreements, PE includes, a wide variety of arrangements i.e. a place of management, a branch, an office, a factory, a workshop or a warehouse, a mine, a quarry, an oilfield etc. Imposition of tax on a foreign enterprise is done only if it has a PE in the contracting state.

– **Transfer Pricing Provisions in India:** The Finance Act, 2001 introduced law of transfer pricing in India through Sections 92 to 92F of the Income Tax Act, 1961 which guides computation of the transfer price and suggests detailed documentation procedures.

  Arm's length price means fair price of goods transferred or services rendered. In other words, the transfer price should represent the price which could be charged from an independent party in uncontrolled conditions. Arm's length price calculation is very important for a company.

  Associated Enterprises has been defined in Section 92A of the Act. It prescribes that "associated enterprise", in relation to another enterprise, means an enterprise –

  (a) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

  (b) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

  "International Transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

– **Specified Domestic transactions:** Finance Act, 2012 has made a very important change and it has extended the applicability of Transfer Pricing Provisions to specified domestic transaction w.e.f. 1st April, 2012.

– **Methods for determination of Arm's Length Price:** Section 92C of Income Tax Act defines the methods which are to be used in determination of Arm's Length prices for International Transaction and specified domestic transaction.

  (A) Comparable Uncontrolled Price Method (CUP)

  (B) Resale Price Method (RPM)

  (C) Cost Plus Method (CPM)

  (D) Profit Split Method (PSM)

  (E) Transactional Net Margin Method (TNMM)

  (F) Such other method as may be prescribed by the Board.

– **Advance Pricing Agreement:** As per Section 92CC of Income Tax Act, 1961, w.e.f. 1st July, 2012, the Central Board of Direct Taxes (Board), with the approval of the Central Government, may enter into an Advance Price Agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person. Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority(Board) on an appropriate transfer pricing methodology for fixing the arm's length price for a set of transactions over a fixed period of time in future.

TEST YOURSELF

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

ELABORATIVE QUESTIONS

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 Govt. of India override the domestic law?
2. Explain the term 'Permanent Establishment' and examine its significance when such transaction is governed by double taxation avoidance agreements?
3. Explain the Bilateral and Unilateral tax treaty?
4. In cases, wherein Individual is resident in both the contracting states, how the residential status would be determine?
5. Explain the term 'Tax Heaven". How to determine whether a state or a country is a tax heaven?
6. What is impermissible avoidance agreement u/s 96 of Income Tax Act, 1961 and its consequences?
7. What is Arm's Length Price with respect to Transfer Pricing Provisions?
8. Who can make an application for Advance Ruling u/s 245N?
9. What of Controlled Foreign Corporation?
10. Explain the objective of bringing into existence the provisions relating to transfer pricing in relation to International Transaction?
11. When can an advance ruling pronounced by the authority for advance Rulings be declared void? What is the consequence?

PRACTICAL QUESTIONS

1. Mr. Amit, ROR in India, is a singer deriving income of Rs. 750000 from performance in show outside India. Tax of Rs. 100000 was deducted at the source country. India does not have double taxation avoidance agreements with that country. His Indian Income is Rs. 30,00,000. Compute the tax liability of Mr. Amit during the FY 2020-21 in India assuming he has deposited Rs. 150000 in PPF and paid medical insurance premium Rs. 32000 of his parents aged 65 year. [Assuming Mr. Amit has not opted for Section 115BAC of the Income Tax Act, 1961]
2. Mr. M , a non resident, made an application to the authority for advance rulings on 2.7.2020 in relation to a transaction to be undertaken by him. On 31.08.2020, he decides to withdraw the said application. Can he withdraw the application on 31.08.2020?

Answer:

1. Rs. 8,18,840
2. Refer provisions of section 245Q(3) of the Income Tax Act, 1961

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

Lesson 12
Recent Case Laws

LESSON OUTLINE

- Latest Supreme Court and High Court Judgements
- LESSON ROUNDUP
- TEST YOURSELF

LEARNING OBJECTIVES

Tax is a Dynamic law and is always evolving. Law makers try to cover every situation while formulating the law. However, sometimes certain situations cannot be foreseen. This situation creates conflicts between the Assessee and the Department. Here the role of the courts comes into picture. It is therefore important to study the Judicial decisions as it helps to interpret the law in a better manner.

After reading this lesson, students will be able to understand:

- How are arguments put forward in the courts by both parties
- How the courts put reliance on past judicial decisions while formulating its opinion
- What are the questions of law involved in the cases discussed
- How does the courts pronounce its judgements

1. CIT VS. MAHINDRA AND MAHINDRA LTD (SUPREME COURT)

ISSUE INVOLVED :

Whether a Loan Waiver is treated as Business Income u/s Section 28 or Deemed Business Income u/s 41

Brief facts:-

(a) For the proper appreciation of the issue in the case at hand, we deem it apposite to mention the gist of the facts. The appellant herein is the Department of Income Tax (for brevity 'the Revenue), on the other hand, respondent herein is Mahindra & Mahindra Ltd. (for brevity 'the Respondent') – a company registered under the Companies Act, 1956.

(b) The Respondent, way back, decided to expand its jeep product line by including FC-150 and FC-170 models. For this purpose, on 18.06.1964, it entered into an agreement with Kaiser Jeep Corporation (for short 'the KJC') based in America wherein KJC agreed to sell the dies, welding equipments and die models to the assessee. The final price of the tooling and other equipments was agreed at $6,50,000/- including cost, insurance and freight (CIF). Meanwhile, the Respondent took all the requisite approvals from the concerned Government Departments. The said toolings and other equipments were supplied by the Kaiser Jeep Corporation through its subsidiary Kaiser Jeep International Corporation (KJIC).

(c) However, for the procurement of the said toolings and other equipments, the KJC agreed to provide loan to the Respondent at the rate of 6% interest repayable after 10 years in installments. For this purpose, the Respondent addressed a letter dated 07.06.1965 to the Reserve Bank of India (RBI) for the approval of the said loan agreement. The RBI and the concerned Ministry approved the said loan agreement.

(d) Later on, it was informed to the Respondent that the American Motor Corporation (AMC) had taken over the KJC and also agreed to waive the principal amount of loan advanced by the KJC to the Respondent and to cancel the promissory notes as and when they got matured. The same was communicated to the Respondent vide letter dated 17.02.1976.

(e) On 30.06.1976 the Respondent filed its return and shown Rs. 57,74,064/- as cessation of its liability towards the American Motor Corporation. After perusal of the return, the Income Tax Officer (ITO) concluded that with the waiver of the loan amount, the credit represented income and not a liability. Accordingly, the ITO, vide order dated 03.09.1979, held that the sum of Rs 57,74,064/- was taxable under Section 28 of the Income Tax Act, 1961 (for brevity 'the Income Tax Act').

(f) Being dissatisfied, the Respondent preferred an appeal before the Commissioner of Income Tax (Appeals) being No. CIT(A) V/CCIV/IT/261/79-80. After perusal of the matter, learned CIT (Appeals), vide order dated 23.03.1981, dismissed the appeal and upheld the order of the ITO with certain modifications.

(g) Being aggrieved, the Respondent as well as the Revenue preferred appeals being Nos. 2007 (Bomb.) of 1981 and 2132 of 1981 respectively before the Tribunal. The Tribunal, vide order dated 16.08.1982, set aside the order passed by learned CIT (Appeals) and decided the case in favour of the Respondent.

(h) Being aggrieved, the Revenue filed a Reference before the High Court at Bombay. In that Reference, three applications were filed, one by the assessee and rest two by the Revenue. Vide impugned common judgment and order dated 29.01.2003, the High Court confirmed certain findings of the Tribunal in favour of the Respondent.

(i) Hence, these instant appeals have been filed by the Revenue.

Heard learned senior counsel for parties and perused the factual matrix of the case.

Point(s) for consideration: The short point for consideration before this Court is whether in the present facts and circumstances of the case the sum of Rs. 57,74,064/- due by the Respondent to Kaiser Jeep Corporation which later on waived off by the lender constitute taxable income of the Respondent or not?

Revenue contentions: At the onset, learned senior counsel for the Revenue submitted that the Respondent had received the amount of Rs. 57,47,064/- from the American Motor Corporation as loan waiver, which it had initially borrowed from the Kaiser Jeep Corporation as loan in order to enable it to purchase dies, tools etc. for manufacture of jeeps. The waiver of loan was done by the American Motor Corporation, who took over the Kaiser Jeep Corporation, as a measure of compensation for certain losses including goodwill, the benefit of association, and also for sudden change to the American Motor Corporation as a share holder which was credited by the Respondent to its account but was claimed as exemption from taxation being capital receipt.

Before concluding, it was contended that since an amount is waived off, for which the Respondent is claiming exemption, Income Tax Actually amounts to income at the hands of the Respondent in the sense that an amount which ought to be paid by it is now not required to be paid. As a result, the case of the Revenue falls within the ambit of Section 28(iv) and, alternatively within Section 41 of the Income Tax Act. Hence, the decision of the High Court is liable to be set aside.

Conversely, learned senior counsel for the Respondent submitted that the Kaiser Jeep International Corporation (KJIC) supplied the toolings and the loan was given by the Kaiser Jeep Corporation (KJC), hence, these transactions were independent transactions. The only relationship, which survived after the supply of toolings, was that of a lender and borrower. The purchase of toolings was not a transaction for the purchase of goods on credit in the ordinary course of business nor could it be equated to unpaid purchase consideration to be liquidated over a period of time.

Further, it was also submitted that it is very clear that the amount of $650,000 provided by KJC was in fact a loan on which interest was being paid regularly from time to time. It is also pointed out that in the books of account of the Respondent, this loan has been shown in the Balance Sheet under the heading “Loans-unsecured”. Hence, it is submitted that the said sum could not be brought to tax as it represents the waiver of a loan liability which was on the capital amount and is not in the nature of income. Accordingly, the High Court rightly upheld the order of the Tribunal and, hence, these appeals deserve to be dismissed.

Discussion: The term “loan” generally refers to borrowing something, especially a sum of cash that is to be paid back along with the interest decided mutually by the parties. In other terms, the debtor is under a liability to pay back the principal amount along with the agreed rate of interest within a stipulated time.

It is a well-settled principle that creditor or his successor may exercise their “Right of Waiver” unilaterally to absolve the debtor from his liability to repay. After such exercise, the debtor is deemed to be absolved from the liability of repayment of loan subject to the conditions of waiver. The waiver may be a partly waiver i.e., waiver of part of the principal or interest repayable, or a complete waiver of both the loan as well as interest amounts. Hence, waiver of loan by the creditor results in the debtor having extra cash in his hand. It is receipt in the hands of the debtor/assessee. The short but cogent issue in the instant case arises whether waiver of loan by the creditor is taxable as a perquisite under Section 28 (iv) of the Income Tax Act or taxable as a remission of liability under Section 41 (1) of the Income Tax Act.

The first issue is the applicability of Section 28 (iv) of the Income Tax Act in the present case. Before moving further, we deem it apposite to reproduce the relevant provision herein below:-

> **“Profits and gains of business or profession [Section 28] -** The following income shall be chargeable to income-tax under the head “Profits and gains of business profession”,–
>
> (iv) the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession; ”

On a plain reading of Section 28 (iv) of the Income Tax Act, *prima facie,* it appears that for the applicability of the said provision, the income which can be taxed shall arise from the business or profession. Also, in order to invoke the provision of Section 28 (iv) of the Income Tax Act, the benefit which is received has to be in some other form rather than in the shape of money. In the present case, it is a matter of record that the amount of Rs. 57,74,064/- is having received as cash receipt due to the waiver of loan. Therefore, the very first condition of Section 28 (iv) of the Income Tax Act which says any benefit or perquisite arising from the business shall be in the form of benefit or perquisite other than in the shape of money, is not satisfied in the present case. Hence, in our view, in no circumstances, it can be said that the amount of Rs 57,74,064/- can be taxed under the provisions of Section 28 (iv) of the Income Tax Act.

Another important issue which arises is the applicability of the Section 41 (1) of the Income Tax Act. The said provision is re-produced as under:

> **"Profits chargeable to tax [Section 41] -** (1) Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (hereinafter referred to as the first-mentioned person) and subsequently during any previous year,-
>
> (a) the first-mentioned person has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not; or"

On a perusal of the said provision, it is evident that it is a *sine qua non* that there should be an allowance or deduction claimed by the assessee in any assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee. Then, subsequently, during any previous year, if the creditor remits or waives any such liability, then the assessee is liable to pay tax under Section 41 of the Income Tax Act. The objective behind this Section is simple. It is made to ensure that the assessee does not get away with a double benefit once by way of deduction and another by not being taxed on the benefit received by him in the later year with reference to deduction allowed earlier in case of remission of such liability.

It is undisputed fact that the Respondent had been paying interest at 6 % per annum to the KJC as per the contract but the assessee never claimed deduction for payment of interest under Section 36 (1) (iii) of the Income Tax Act. In the case at hand, learned CIT (A) relied upon Section 41 (1) of the Income Tax Act and held that the Respondent had received amortization benefit. Amortization is an accounting term that refers to the process of allocating the cost of an asset over a period of time, hence, it is nothing else than depreciation. Depreciation is a reduction in the value of an asset over time, in particular, to wear and tear. Therefore, the deduction claimed by the Respondent in previous assessment years was due to the deprecation of the machine and not on the interest paid by it.

Moreover, the purchase effected from the Kaiser Jeep Corporation is in respect of plant, machinery and tooling equipments which are capital assets of the Respondent. It is important to note that the said purchase amount had not been debited to the trading account or to the profit or loss account in any of the assessment years. Here, we deem it proper to mention that there is difference between 'trading liability' and 'other liability'. Section 41 (1) of the Income Tax Act particularly deals with the remission of trading liability. Whereas in the instant case, waiver of loan amounts to cessation of liability other than trading liability. Hence, we find no force in the argument of the Revenue that the case of the Respondent would fall under Section 41 (1) of the Income Tax Act. In view of above discussion, we are of the considered view that these appeals are devoid of merits and deserve to be dismissed.

CONCLUSION :

Loan waiver would not be taxable as

(a) Business Income u/s 28(iv) of the Income Tax Act as receipts should be in the nature of cash or money.

(b) Deemed Business Income u/s 41(1) of the Income Tax Act as it does not apply since waiver of loan does not amount to cessation of trading liability because no deduction was claimed under business in any previous year.

2. ACIT VS. BHARAT V. PATEL (SUPREME COURT)

ISSUE INVOLVED :

Whether amount received by an employee from redemption of Stock Appreciation Rights (SARs) can be assessed as "perquisite" u/s 17(2)(iii) or as "profits of business" u/s 28(iv) or as "capital gains" (despite no "cost of acquisition") u/s 45

FACTS OF THE CASE

At the outset, learned counsel for the Revenue contended that the High Court erred in law while upholding that the amount received on redemption of Stock Appreciation Rights (SARs) is to be treated as capital gains and not perquisite under section 17(2)(iii) of the Income Tax Act. However, the same is not taxable under the category of capital gains since no consideration had passed from the Respondent.

In support of his argument, learned counsel placed reliance on Sumit Bhattacharya vs. ACIT Circle 16(1), Mumbai [2008] 112 ITD 1 (MUM.) (SB) and contended that the Respondent, having received an amount on redemption of Stock Appreciation Rights (SARs) as an employee of the company and there was an employer employee relationship subsisting at the relevant point of time, therefore, the amount received on redemption of Share Appreciation Rights must be treated as taxable income under the head income from "Salaries". Learned counsel finally contended that the impugned decision of the High Court deserves to be set aside

Per contra, learned senior counsel appearing for the Respondent submitted that the amount received by the Respondent from redemption of Stock Appreciation Rights (SARs) can be treated only as capital gains and cannot be treated as perquisite under Section 17(2)(iii) of the Income Tax Act or under Section 28 (iv) of the Income Tax Act. However, it was pointed out that the said capital gains cannot be said to arose to the Respondent since there was no consideration paid as the cost of acquisition by the Respondent. It was also submitted that such amount received on account of redemption of Stock Appreciation Rights could have been taxed if at all under the provisions of Clause (iiia) of Section 17(2) of the Income Tax Act. Finally, it was also submitted that the question of law sought to be raised by the Revenue is no more res integra as settled by this Court in the case of Commissioner of Income Tax vs. Infosys Technologies Ltd., [2008] 297 ITR 167 (SC). Hence, these appeals deserve to be dismissed at the threshold.

Discussion:

Before examining the case at hand, it is pertinent to have an understanding of the words "Perquisite" and "Capital Gains". The word "Perquisite" in common parlance may be defined as any perk or benefit attached to an employee or position besides salary or remuneration. Broadly speaking, these are usually noncash benefits given by an employer to an employee in addition to entitled salary or remuneration. It may be said that these benefits are generally provided by the employers in order to retain the talented employees in the organization. There are various instances of perquisite such as concessional rent accommodation provided by the employer, any sum paid by an employer in respect of an obligation which was actually payable by the employee etc. Section 17(2) of the Income Tax Act was enacted by the legislature to give the broad view of term perquisite.

On the other hand, the word ‘Capital Gains’ means a profit from the sale of property or an investment. It may be short term or long term depending upon the facts and circumstances of each case. This gain or profit is charged to tax in the year in which transfer of the capital assets takes place. In the instant case, the fundamental question which arises for consideration before this Court is with regard to the taxability of the amount received by the Respondent on redemption of Stock Appreciation Rights (SARs.)

It is a matter of record that the Respondent was employed as the Chairman cum Managing Director of the (P&G) India Ltd. at the relevant time and the said company is the subsidiary of (P&G) USA through Richardson Vicks Inc. USA and that (P&G) USA owned controlling equity. It is an undisputed fact that the Respondent was working as a salaried employee. The (P&G) USA was the company who had issued the Stock Appreciation Rights (SARs.) to the Respondent without any consideration from 1991 to 1996. The said SARs were redeemed on 15.10.1997 and in lieu of that the Respondent received an amount of Rs 6,80,40,724/from (P&G) USA. However, when the Respondent filed his return, he claimed this amount as an exemption from the ambit of Income Tax. The issue involved in this appeal is in respect of Rs 6,80,40,724/made on account of amount received on redemption of Stock Appreciation Rights.

The Tribunal was of the view that the stock options are capital assets and such assets in the instant case acquired for consideration, hence, gain arising therefrom is liable to capital gain tax. However, the stand of the Revenue before the Tribunal was that the amount in question is taxable as perquisite under Section 17(2)(iii) of the Income Tax Act or in alternatively under Section 28(iv) of the Income Tax Act instead of capital gains. The High Court also upheld the view of the Tribunal but the High Court disagreed that such capital gains arose to the Respondent on redemption of Stock Appreciation Rights since there was no cost of acquisition involved from the side of the Respondent. The meaning of the word perquisite for the instant case is given under Section 17(2) of the Income Tax Act. The Revenue alternatively contended that the case of the Respondent should come under the ambit of Section 28(iv) of the Income Tax Act.

It is apposite to note here that, particularly, in order to bring the perquisite transferred by the employer to the employees within the ambit of tax, legislature brought an amendment under Section 17 of the Income Tax Act by inserting Clause (iiia) in Section 17(2) of the Income Tax Act through the Finance Act, 1999 (27 of 1999) with effect from 01.04.2000, which was later on omitted by the Finance Act, 2000. The said Clause (iiia) as it was then is reproduced herein below:

“(iiia) the value of any specified security allotted or transferred, directly or indirectly, by any person free of cost or at concessional rate, to an individual who is or has been in employment of that person:

Provided that in a case where allotment or transfer of specified securities is made in pursuance of an option exercised by an individual, the value of the specified securities shall be taxable in the previous year in which such option is exercised by such individual.

Explanation: For the purposes of this clause,(a) “cost’ means the amount actually paid for acquiring specified securities and where no money has been paid, the cost shall be taken as nil; (b) “specified securities” means the securities as defined in clause(h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and includes employees’ stock option and sweet equity shares; (c) “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 knowhow or making available rights in the nature of intellectual property rights or value additions, by whatever name called; and (d) “value” means the difference between the fair market value and the cost for acquiring specified securities;”

The intention behind the said amendment brought by the legislature was to bring the benefits transferred by the employer to the employees as in the instant case, within the ambit of the Income Tax Act, 1961. It was the first time when the legislature specified the meaning of the cost for acquiring specific securities. Only by this amendment, legislature determined what would constitute the specific securities. By this amendment, legislature clearly covered the direct or indirect transfer of specified securities from the employer to the employees during or after the employment. On a perusal of the said clause, it is evident that the case of the Respondent falls under such clause. However, since the transaction in the instant case pertains to prior to 01.04.2000, hence, such transaction cannot be covered under the said clause in the absence of an express provision of retrospective effect. We also do not find any force in the argument of the Revenue that the case of the Respondent would fall under the ambit of Section 17(2) (iii) of the Income Tax Act instead of Section 17(2) (iiia) of the Income Tax Act. It is a fundamental principle of law that a receipt under the Income Tax Act must be made taxable before it can be treated as income. Courts cannot construe the law in such a way that brings an individual within the ambit of Income Tax Act to pay tax who otherwise is not liable to pay. In the absence of any such specific provision, if an individual is subjected to pay tax, it would amount to the violation of his Constitutional Right.

The Revenue also contended before the High Court that the amendment brought in by Section 17(2) of the Income Tax Act was clarificatory, hence, retrospective in nature. However, the High Court rejected the stand of the Revenue. The High Court, in its impugned judgment, on the point of the applicability of clause has held as under:

In the case of Commissioner of Income Tax, Bangalore vs B.C. Srinivasa Setty [(1981) 128 ITR 294 (SC)] this Court held that the charging section and computation provision under the 1961 Act constituted an integrated code. The mechanism introduced for the first time under the Finance Act, 1999 by which cost was explained in the manner stated above was not there prior to 1.4.2000. The new mechanism stood introduced w.e.f. 1.4.2000 only. With the above definition of the word cost introduced vide clause (iiia), the value of option became ascertainable. There is nothing in the Memorandum to the Finance Act, 1999 to say that this new mechanism would operate retrospectively. Further, a mechanism which explains cost in the manner indicated above cannot be read retrospectively unless the Legislature expressly says so. It was not capable of being implemented retrospectively. Till 1.4.2000, in the absence of the definition of the word cost value of the option was not ascertainable. In our view, clause (iiia) is not clarificatory. Moreover, the meaning of the words specified securities in section (iiia) was defined or explained for the first time vide Finance Act , 1999 w.e.f. 1.4.2000. Morevover, the words allotted or transferred in clause (iiia) made things clear only after 1.4.2000. Lastly, it may be pointed out that even clause (iiia) has been subsequently deleted w.e.f. 1.4.2001. For the aforestated reasons, we are of the view the clause (iiia) cannot be read as retrospective."

Circular No. 710 dated 24.07.1995 which was issued by the CBDT deals with the taxability of shares issued at less than the market price. For ready reference, Circular No. 710 issued by the CBDT is reproduced herein below:

"Taxability of the perquisite on shares issued to employees at less than market price:

1. Chief Commissioners and corporate assessees have been seeking clarification regarding taxability of the perquisite on shares issued to the employees at less than market price.
2. The matter has been considered by the Board. The benefit does amount to a perquisite within the meaning of clause (iii) of subsection (2) of Section 17 of the IncomeTax Act, 1961. The various situations in this regard have to be dealt with as under:
   (i) where the shares held by the Government have been transferred to the employee, there will be no perquisite because the employer employee relationship does not exist between Government and the employee (transferor and the transferee);
   (ii) where the company offers shares to the employees at the same price as have been offered to the other shareholders or the general public, there will be no perquisite;
   (iii) where the employer has offered the shares to its employees at a price lower than the one at which the shares have been offered to the other shareholders/public, the difference between the two prices will be taxed as perquisite;
   (iv) where the shares have been offered only to the employees, the value of perqusite will be the

> difference between the market price of the shares on the date of acceptance of the offer by the employee and the price at which the shares have been offered."

On a perusal of the above, prima facie, it appears that such Circular dealt with the cases where the employer issued shares to the employees at less than the market price. In the instant case, the Respondent was allotted Stock Appreciation Rights (SARs.) by the (P&G) USA which is different from the allotment of shares. Hence, in our opinion such Circular has no applicability on the instant case. Moreover, a Circular cannot be used to introduce a new tax provision in a Statute which was otherwise absent.

Alternatively, the Revenue also contended that the case of the Respondent shall come within the ambit of the Section 28(iv) of the Income Tax Act. At this juncture, we deem it appropriate, for the sake of convenience, to refer Section 28(iv) of the Income Tax Act which is reproduced herein below:

> "Section 28. Profits and gains of business or profession. The following income shall be chargeable to income tax under the head "Profits and gains of business or profession"(iv) the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession."

On a first look of the said provision, it is apparent that such benefit or perquisite shall have arisen from the business activities or profession whereas in the instant case there is nothing as such. The applicability of Section 28(iv) is confined only to the case where there is any business or profession related transaction involved. Hence, the instant case cannot be covered under Section 28(iv) of the Income Tax Act for the purpose of tax liability.

CONCLUSION:

Amount received on account of Stock Appreciation Rights(SAR) would be taxable as perquisite under head salary and not under Capital Gain or Business Income

3. CIT VS. SHREE RAMA MULTI TECH LTD (SUPREME COURT)

ISSUE INVOLVED :

Whether Interest accrued on account of deposit of share application money is not taxable income.

Can Such interest, which is inextricably linked with the requirement to raise share capital and is thus adjustable towards the expenditures involved for the share issue.

The common rationale that is followed in Bokaro Steel Ltd (1999) 236 ITR 315 (SC) and Karnal Cooperative Sugar Mills Ltd. (2000) 243 ITR 2 (SC) is that if there is any surplus money which is lying idle and it has been deposited in the bank for the purpose of earning interest then it is liable to be taxed as income from other sources but if the income accrued is merely incidental and not the prime purpose of doing the act in question which resulted into accrual of some additional income then the income is not liable to be assessed and is eligible to be claimed as deduction. Putting the above rationale in terms of the present case, if the share application money that is received is deposited in the bank in light of the statutory mandatory requirement then the accrued interest is not liable to be taxed and is eligible for deduction against the public issue expenses.

Learned counsel appearing on behalf of the Appellant contended that the impugned final order passed by the High Court is against law and facts of the present case. He further contended that the High Court grossly erred in relying on its earlier order dated 26.07.2011 passed in Tax Appeal No. 315 of 2010 titled Assistant Commissioner of Income Tax vs. Panama Petrochem Ltd. and not appreciating the fact that the Department could not file a petition for special leave before this Court due to low tax effect being Rs. 9,81,541/wherein it was held that the interest income occurred by keeping the amount of share application money in a bank account is liable to be set-off against the public issue expenses.

Learned counsel for the appellant finally contended that the law is well settled that the interest income is always regarded as of revenue nature unless it is received by way of damages or compensation. The present case is not related either to damages or compensation and the High Court erred in arriving on such a conclusion which is not in accordance with law and is liable to be aside.

Discussion:

The Respondent company had come out with initial public issue during the year under consideration and the amount of share application money received was deposited with the banks on which interest of Rs. 1,71,30,202/ was earned which was shown in the return of income originally filed as income from other sources which was also referred to in Col. 13(d) of the Tax Audit report filed under Section 44AB of the Income Tax Act.

Even though initially the income from the interest was shown as income from other sources in the return of income, however, the Respondent had raised an additional ground before the Tribunal to allow the set off of such interest against the public issue expenses. The issue was examined by the Tribunal and was set aside for fresh adjudication by the Assessing Officer. During the course of fresh proceedings, an opportunity was given to the Respondent to file the details of interest on share application money. The Respondent stated that the details of interest income on share application money was already furnished at Annexure No. 7 of their letter dated 11.03.2003 at the time of original assessment.

The verification of the said Annexure reveals that the Respondent had earned the interest income on FDRs placed with the bank, however, the period for which such FDRs were placed and the specific period of the interest earned was not found to have been mentioned. Under the circumstances, it was not possible to identify as to what portion of interest earned on FDRs was relating to the period prior to the allotment of shares or after the allotment of shares. Keeping in view the specific guidelines of the Tribunal in this regard and in the absence of specific working of interest for pre allotment and post allotment, the claim of the Respondent was not allowed and added to the total income under the head income from the other sources as was declared in the original return of income filed by the Respondent.

Coming back to the facts of the case, we may reiterate that the Respondent was statutorily required to keep share application money in the separate account till the allotment of shares was completed. Interest earned on such separately kept amount was to be adjusted towards expenditure for raising share capital.

We are, therefore, of the opinion that interest earned was inextricably linked with requirement of company to raise share capital and was thus adjustable towards the expenditures involved for the share issue. Though learned counsel for the Appellant contended that 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, insofar as present case is concerned, we do not see how this factor would make any significant difference. Interest earned from share application money statutorily required to be kept in separate account was being adjusted towards the cost of raising share capital. In that view of the matter, we are of the opinion that the High Court was right in allowing such deduction.

In light of the above developments in the case, the question of law has been decided by this Court in case in Bokaro Steel Ltd. (supra), wherein the company was set up to produce steel. When the construction of plant was yet not completed, company earned interest on advances to contractor, rent from quarters let out to employees of the contractor as well as other income such as hire charges on plant and machinery let out to contractor, royalty on stones removed from its land. It was in this background that this Court held that the amounts were directly connected to and incidental to construction of plant by the company, amounts were capital receipts and not income from any independent source.

Further, the rationale of judgment of Bokaro Steel Ltd. (supra) was followed in Commissioner of Income Tax vs. Karnal Cooperative Sugar Mills Ltd. (2000) 243 ITR 2 (SC). In this case, the company had deposited certain amount with the bank to open letter of credit for purchase of machinery for setting up plant. On the money so deposited, it earned interest. In that background, this Court observed that this is not a case where any surplus shares capital money which was lying idle had been deposited in the bank for the purpose of earning interest. The deposit of money is directly linked with the purchase of plant and machinery.

The common rationale that is followed in all these judgment is that if there is any surplus money which is lying idle and it has been deposited in the bank for the purpose of earning interest then it is liable to be taxed as income from other sources but if the income accrued is merely incidental and not the prime purpose of doing the act in question which resulted into accrual of some additional income then the income is not liable to be assessed and is eligible to be claimed as deduction. Putting the above rationale in terms of the present case, if the share application money that is received is deposited in the bank in light of the statutory mandatory requirement then the accrued interest is not liable to be taxed and is eligible for deduction against the public issue expenses.

The issue of share relates to capital structure of the company and hence expenses incurred in connection with the issue of shares are to be capitalized because the purpose of such deposit is not to make some additional income but to comply with the statutory requirement, and interest accrued on such deposit is merely incidental. In the present case, the Respondent was statutorily required to keep the share application money in the bank till the allotment of shares was complete.

In that sense, we are of the view that the High Court was right in holding that the interest accrued to such deposit of money in the bank is liable to be set-off against the public issue expenses that the company has incurred as the interest earned was inextricably linked with requirement of the company to raise share capital and was thus adjustable towards the expenditure involved for the share issue.

CONCLUSION :

Interest income earned out of the share application money is liable to be set off against the public issue expenses.

4. CIT VS. CHAPHALKAR BROTHERS PUNE (SUPREME COURT)

ISSUE INVOLVED :

Taxability of subsidies : Whether a subsidy granted by the Govt to achieve the objects of acceleration of industrial development and generation of employment is of capital in nature or revenue nature.

The aforesaid object is clear and unequivocal. The object of the grant of the subsidy was in order that persons come forward to construct Multiplex Theatre Complexes, the idea being that exemption from entertainment duty for a period of three years and partial remission for a period of two years should go towards helping the industry to set up such highly capital intensive entertainment centers. This being the case, it is difficult to accept Mr. Narasimha's argument that it is only the immediate object and not the larger object which must be kept in mind in that the subsidy scheme kicks in only post construction, that is when cinema tickets are actually sold

(i) Applying the aforesaid test contained in both Sahney Steel & Press Works Ltd., Hyderabad Vs. Commissioner of Income-Tax, A.P.-I, Hyderabad 1997 (7) SCC 765 and Commissioner of Income Tax, Madras Vs. Ponni Sugars and Chemicals Limited 2008 (9) SCC 337, we are of the view that the object, as stated in the statement of objects and reasons, of the amendment ordinance was that since the average occupancy in cinema theatres has fallen considerably and hardly any new theatres have been started in the recent past, the concept of a Complete Family Entertainment Centre, more popularly known as Multiplex Theatre Complex, has emerged. These complexes offer various entertainment facilities for the entire family as a whole. It was noticed that these complexes are highly capital intensive and their gestation period is quite long and therefore, they need Government support in the form of incentives qua entertainment duty. It was also added that government with a view to commemorate the birth centenary of late Shri V. Shantaram decided to grant concession in entertainment duty to Multiplex Theatre Complexes to promote construction of new cinema houses in the State.

(ii) The aforesaid object is clear and unequivocal. The object of the grant of the subsidy was in order that persons come forward to construct Multiplex Theatre Complexes, the idea being that exemption from entertainment duty for a period of three years and partial remission for a period of two years should go towards helping the industry to set up such highly capital intensive entertainment centers. This being the case, it is difficult to accept Mr. Narasimha's argument that it is only the immediate object and not the larger object which must be kept in mind in that the subsidy scheme kicks in only post construction, that is when cinema tickets are actually sold. We hasten to add that the object of the scheme is only one -there is no larger or immediate object. That the object is carried out in a particular manner is irrelevant, as has been held in both Ponni Sugar and Sahney Steel.

(iii) Mr. Ganesh, learned Senior Counsel, also sought to rely upon a judgment of the Jammu and Kashmir High Court in Shri Balaji Alloys vs. C.I.T. (2011) 333 I.T.R. 335. While considering the scheme of refund of excise duty and interest subsidy in that case, it was held that the scheme was capital in nature, despite the fact that the incentives were not available unless and until commercial production has started, and that the incentives in the form of excise duty or interest subsidy were not given to the assessee expressly for the purpose of purchasing capital assets or for the purpose of purchasing machinery. After setting out both the Supreme Court judgments referred to hereinabove, the High Court found that the concessions were issued in order to achieve the twin objects of acceleration of industrial development in the State of Jammu and Kashmir and generation of employment in the said State. Thus considered, it was obvious that the incentives would have to be held capital and not revenue.

(iv) Mr. Ganesh, learned Senior Counsel, pointed out that by an order dated 19.04.2016, this Court stated that the issue raised in those appeals was covered, inter alia, by the judgment in Ponni Sugars, and the appeals were, therefore, dismissed. We have no hesitation in holding that the finding of the Jammu and Kashmir High Court on the facts of the incentive subsidy contained in that case is absolutely correct. In that once the object of the subsidy was to industrialize the State and to generate employment in the State, the fact that the subsidy took a particular form and the fact that it was granted only after commencement of production would make no difference.

CONCLUSION :

Subsidy granted by the Govt to achieve the objects of acceleration of industrial development and generation of employment is of capital in nature. The fact that the incentives are not available unless and until commercial production has started, and that the incentives are not given to the assessee expressly for the purpose of purchasing capital assets or for the purpose of purchasing machinery is irrelevant. The object has to be seen and not the form in which it is granted.

5. HINDUSTAN COCA COLA BEVERAGES PVT. LTD VS. CIT (RAJASTHAN HIGH COURT)

ISSUE INVOLVED :

Whether TDS u/s 194H will be applicable when the relationship between the assessee and the distributor was that of "principal to principal" and whether the "discount" amount to a "payment" for the purpose of deduction of TDS

Taking into account the provisions of Section 182 of the Contract Act and the arrangement which has been entered into between the company and the distributor and taking into account the provisions of Section 194H, the Tribunal while considering the evidence on record, in our considered opinion, has misdirected itself in considering the case from an angle other than the angle which was required to be considered by the Tribunal under the Income Tax Act. The Tribunal has travelled beyond the provisions of Section 194H where the condition precedent is that the payment is to be made by the assessee and thereafter he is to make payment. In spite of our specific query to the counsel for the department, it was not pointed out that any amount was paid by the assessee company. It was only the arrangement by which the amount which was to be received was reduced and no amount was paid as commission

The High Court had to consider the following questions of law in appeals filed by the assessee:

"(i) Whether in the facts and circumstances of the case the learned Tribunal was right and justified in holding that assessee was liable to withhold tax at source under S.194H of the Income Tax Act, 1961 amounting to Rs.19,74,842/- (including interest) in respect of sales to its distributors, which are on a principal to principal basis and wherein property in the goods is transferred to the distributors?

(ii) Whether the Tribunal was justified in ignoring the statutory books of accounts, the auditors report and the certificate issued by the auditors and merely relying on the internal Management Information System records in coming to the conclusion on the nature of the dealings with the distributors?

(iii) Whether on the facts and in the circumstances of the case the Tribunal erred in law in holding that interest under Sec.201(1A) and Sec.220(2) of the Income Tax Act, 1961 should be levied on the appellant when the taxes due had already been paid by the distributor(s)/ when a valid stay of recovery has been obtained?

HELD by the High Court allowing the appeals:

(a) Now, the first question which has come up for our consideration is, 'whether in the facts and circumstances of the case the learned Tribunal was right and justified in holding that assessee was liable to withhold tax at source under S. 194H of the Income Tax Act, 1961 amounting to Rs.19,74,842/- (including interest) in respect of sales to its distributors, which are on principal to principal basis and wherein property in the goods is transferred to the distributor'.

(b) Taking into account the provisions of Section 182 of the Contract Act and the arrangement which has been entered into between the company and the distributor and taking into account the provisions of Section 194H, the Tribunal while considering the evidence on record, in our considered opinion, has misdirected itself in considering the case from an angle other than the angle which was required to be considered by the Tribunal under the Income Tax Act. The Tribunal has travelled beyond the provisions of Section 194H where the condition precedent is that the payment is to be made by the assessee and thereafter he is to make payment. In spite of our specific query to the counsel for the department, it was not pointed out that any amount was paid by the assessee company. It was only the arrangement by which the amount which was to be received was reduced and no amount was paid as commission.

(c) In that view of the matter, if we look at the provisions of Section 194H and even if explanation is taken into consideration, there is no occasion of invoking provisions of Section 194H, since the amount is not paid by the assessee.

(d) Taking into account the conclusion which has been arrived at by the Tribunal is misdirected in view of the arrangement which has been arrived at between the company and the Distributor. Assuming without admitting, if the contention which has been raised before the Tribunal is accepted, the same can be at the most expenses which are not allowable under the Income Tax Act, if at all claimed without proper basis but to conclude that they are covered under Section 194H and the income tax or the TDS is required to be deducted is not correct and accordingly disallowance on that basis is not correct.

(e) In our considered opinion, from which amount of tax is to be deducted is a doubtful proposition inasmuch as the Management Information System which has been sought to be relied upon for alleging that expenditure has been claimed could not have been relied upon by the Tribunal or the authorities under the Income Tax Act.

    (i) The findings which are given by the Tribunal regarding Distributor being Agent in view of the discussion made here-inabove, the arrangement which has been made between the Company and the Distributor is on Principal to Principal basis and the responsibility is on the basis of agreement entered into between the parties

    (ii) Regarding MRP, the findings which are arrived at is a price which has been fixed by the assessee company and other expenses, namely; commission given to the retailer and everything is to be managed by the Distributor. In that view of the matter, the restrictions which are put forward will not decide the relation-ship of Principal and Agent.

(iii) The Distributor has all rights to reduce his margin. He can increase the margin of retailer and will reduce the margin from 10% to anything between 1% to 10%. There is no restriction by the assessee to give commission amount to the retailer.

(iv) Regarding area of operation, it is the business policy of the assessee to give Distributor-ship for a particular area. Only on that basis, it will be erroneous to held that it is on Principal to Principal basis. For deciding the relation-ship on Principal to Principal basis, the criteria will not be of area of operation but agreement entered into between the parties.

(v) Regarding the change in price it is always between the assessee or the company and the Distributor to decide who will absorb the loss. In that view of the matter, the findings arrived at by the Tribunal is erroneous.

(vi) Regarding the return of goods after expiry date, it is always the understanding between the manufacturer and company that the product is not for preparation or consumed before expiry date, the consumed items cannot be allowed otherwise manufacturer will invite criminal liability. To avoid any criminal liability or any criminal act is done for taking back the goods, will not deter the relation-ship of Principal to Principal basis.

(vii) Regarding supervision, it is always for the manufacturer and the company to look into the matter that his Distributor or Sub- Distributor or Retailer will not induct in mal practice.

(viii) Regarding goods sold to the Distributor, it is always a matter of contract how further goods will be distributed. Restriction on sub-distributor will not change the transaction from Principal to Principal.

(ix) Regarding expenses which are described by the Tribunal and one of the reason is that it is always for the assessee to allow any special allowance or expenses to promote the sale. In a competitive world to promote the sale, if the Distributor is not given any encouragement, the business will not grow.

In that view of the matter, in view of the observations of the Supreme Court, the Income Tax Officer cannot enter into the shoes of the assessee. (S.A. Builders Vs. Commissioner of Income Tax- (2007) 288 ITR 1 (SC).

(x) Regarding providing a vehicle it was very clear that by providing vehicle and getting list of expenses will not decide the relation-ship of Principal and Agent.

(f) In our considered opinion, Section 194H pre-supposes the payment to be made to the third party namely, Distributor or the Agency and if on a close scrutiny of Section 182, Distributor is not an agent, therefore, in our considered opinion, the provisions of Section 194H have wrongly been invoked, and therefore, the first issue is answered in favour of assessee and against the Department.

(g) The second issue which has been raised for our consideration, as discussed hereinabove, the Management Information System was not a part of their books of accounts nor could have been relied upon by the Income Tax Authorities. The basis on which the proceedings were initiated, in our considered opinion, the Statutory Audit Report is final conclusion over the authorities under the Income Tax Act, therefore, the second issue is required to be answered in favour of the assessee.

(h) Regarding third issue whether 201A or 201(1A), in view of the decisions of different High Courts, the argument canvassed by counsel for the appellant pre-supposes deduction out of the payment. In our conclusion in issue No.1, the amount was not required to be deducted since they have not made any payment. In that view of the matter any proceedings under Section 201 or 201(1A) are misconceived. In that view of the matter, this issue is also answered in favour of assessee.

(i) Contention regarding provisions of Section 271 of the Act,in view of our answer in favour of assessee, this issue is also required to be answered in favour of assessee. Even otherwise as rightly held by the Supreme Court in CIT Vs. Eli Lilly & Co. (India) P. Ltd. (supra), the penalty could not have been levied in all the appeals filed by assessee Coca Cola.

CONCLUSION :

Sec 194H : An obligation to deduct TDS u/s 194H arises only if the relationship is that of "principal and agent" and if a "payment" is made. As the relationship between the assessee and the distributor was that of "principal to principal" and as the "discount" did not amount to a "payment", there was no liability to deduct TDS on discounts provided.

6. CIT VS. MADHUR HOUSING AND DEVELOPMENT CO (SUPREME COURT)

ISSUE INVOLVED :

Whether Any payment by a closely-held company by way of advance or loan to a concern in which a substantial shareholder is a member holding a substantial interest is deemed to be "dividend" u/s 2(22)(e) in hands of the receiver of loan or in hands of the substantial shareholder.

In CIT vs. Ankitech Pvt Ltd (2012) 340 ITR 14, the Delhi High Court was concerned with a case where the assessee, a company, received advances of Rs. 6.32 crores by way of book entry from Jacksons Generators Pvt. Ltd, a closely held company. The shareholders having substantial interest in the assessee company were also having 10% of the voting power in Jacksons Generators. The AO & CIT(A) held that as the shareholders who held substantial interest in Jacksons Generators also had substantial interest in the assessee company, for purposes of s. 2(22)(e), the amount received by the assessee from Jacksons constituted "advances and loans" and was assessable as deemed dividend.

On appeal, the Tribunal, relying on Bhaumik Colour 313 ITR 146 (Mum) (SB), deleted the addition on the ground that though the amount received by the assessee by way of book entry was "deemed dividend" u/s 2(22)(e), it was not assessable in the hands of assessee company as it was not a shareholder of Jacksons Generators. On appeal by the department to the High Court, the High Court dismissed the appeal on the basis that:

(i) U/s 2(22)(e), any payment by a closely-held company by way of advance or loan to a concern in which a substantial shareholder is a member holding a substantial interest is deemed to be "dividend" on the presumption that the loans or advances would ultimately be made available to the shareholders of the company giving the loan or advance. The legal fiction in s. 2(22)(e) enlarges the definition of dividend but does not extend to, or broaden the concept of, a "shareholder". As the assessee was not a shareholder of the paying company, the "dividend" was not assessable in its hands (Bhaumik 313 ITR 146 (Mum) (SB), approved in Universal Medicare 324 ITR 363 (Bom) & Hotel Hilltop 313 ITR 116 (Raj) followed);

(ii) As the conditions stipulated in s. 2(22)(e) treating the loan and advance as deemed dividend are established in these cases, it is open to the Revenue to take corrective measure by treating this dividend income at the hands of the shareholders and tax them accordingly as otherwise it amounts to escapement of income at the hands of those shareholders.

On appeal by the department to the Supreme Court, HELD dismissing the appeal

CONCLUSION:

Any payment by a closely-held company by way of advance or loan to a concern in which a substantial shareholder is a member holding a substantial interest is deemed to be "dividend" u/s 2(22)(e) in hands of the shareholder on the presumption that the loans or advances would ultimately be made available to the shareholders of the company giving the loan or advance.

Note: After Amendment by FA,2019 now Deemed dividend u/s 2(22)(e) would be chargeable to CDT and not taxable .

7. B. A. MOHOTA TEXTILES TRADERS PVT. LTD VS. DCIT (BOMBAY HIGH COURT)

ISSUE INVOLVED :

Whether a family arrangement/settlement amount to a "transfer" u/s 2(47) on account of transfer of shares made by a company

The assessee contended that transfer of shares in M/s. Rekhchand Mohota Spinning and Weaving Mills Ltd. and M/s. Vaibhav Textiles Pvt. Ltd. to members of Group 'A' and 'C' was done in pursuance of family arrangement/ settlement as reflected in the Arbitration Award dt.30.4.1995. Therefore, it was contended that no Capital gains would be attracted as there was no transfer as it was working out of family settlement/arrangement. However, the Assessing Officer negatived the same and inter alia held that the Company being a separate legal entity distinct from it's share holders, cannot be as part of family settlement/arrangement. Thus, transfer of shares done by independent entity such as the assessee would not be covered by the 'Family Settlement' and consequently, brought the transfer of 25,650 shares for consideration of Rs.225/- per share of M/s. Rekhchand Mohota Spinning and Weaving Mills Ltd. and 1,22,000 shares for consideration of Rs.10/- per share of M/s. Vaibhav Textiles Pvt. Ltd. to Capital Gains Tax.

On appeal, the CIT accepted the position in law that family settlement cannot amount to transfer or create any interest and it is binding upon all the members of the family. However, the same can only be applied to members of the family who are parties to the settlement. In this case, the assessee was a Company incorporated under the Companies Act having a distinct and independent entity from it's share holders. Thus, while holding that the Award dt.30.4.1994 is a family settlement, the same can only be applied to members of Mohota family, who were party to the proceedings before the Arbitrator and not to a Limited Company such as the Appellant/ Company. Therefore, notwithstanding the fact that the Appellant/assessee was under control and management of the members of Mohota family, who were part of family settlement, yet the transfer of shares by the Company would be covered within the meaning of Section 2(47) of the Act so as to be assessable to Capital Gains Tax. On further appeal, the Tribunal upheld the view of the lower Authorities by holding that a family settlement would not amount to transfer as it only recognizes pre-existing rights. However, it held that the assessee (even if controlled by members of a family), on incorporation as a Limited Company becomes a separate legal entity and the members who own shares in the Company and the Company are in law different persons. It held that there exists a veil between the members of the Company and the Company. Thus, the family settlement arrived at between the members of a family will not inure to the benefit of the Appellant/assessee as it is not a member of the family. Consequently, the Tribunal dismissed the assessee's appeal. On further appeal by the assessee to the High Court HELD dismissing the appeal:

(i) There is no dispute before us that a family arrangement/settlement would not amount to a transfer. In fact, all the three Authorities under the Act have not disputed the aforesaid position in law. So far as the members of Mohota family are concerned, who are parties to the family settlement, any transfer inter se between them on account of family settlement would not result in a transfer so as to attract the provisions of the Capital gain tax under the Act. However, in the present case, we are not concerned with the members of Mohota family who were parties to the family settlement, but with transfer of share done by the Company incorporated under the Companies Act having separate/independent corporate existence, perpetual succession and common seal. This Company is independent and distinct from it's members. In fact, this principle dates back to the decision of House of Lords in Saloman .vs. Saloman & Co. Ltd., 1897 AC 22. Our Court in T.R. Pratt (Bombay) Ltd. vs. E.D. Sassoon and Co. Ltd., AIR 1936 (Bombay) 62 has observed as under

"*As held in 1897 A.C. 22 (23), under the law, an incorporated Company is a distinct entity and although shares may be practically controlled by one person, in law a Company is a distinct entity and it is not relevant to enquire whether the directors' belonged to the same family or whether it is compendiously described 'a one-man Company*'.

(ii) However, the Courts have permitted the lifting of corporate veil to prevent injustice. One such class of cases, where the Court has disregarded the corporate entity is where it is used for tax evasion. A classic illustration of this is found In Re. Dinshaw Maneckjee Petit, AIR 1927 (Bombay) 371, where the Court lifted the corporate veil as it found that "the Company in this case was formed by the assessee purely and simply as a means of avoiding super tax and that the Company was nothing more than the Assessee himself. It did no business but was created purely and simply as a legal entity to ostensibly receive dividends and interest and handed them over to the assessee as pretended loan". In the present case, the Revenue does not seek to lift the corporate veil. It is not the case of the Revenue that the Corporate identity is a sham and it has been formed only to circumvent the law. In this case, it is the Assessee which seeks to lift the corporate veil so as to identify the members of the Assessee/Company as those who entered into family settlement as reflected in the Arbitration Award dt.30.4.1994 and call upon the authority to ignore the corporate existence of the Appellant. This lifting of the corporate veil is not allowed when it is not for the benefit of the Revenue. The Apex Court in the case of M/s. Bacha F. Guzdar vs. CIT, 27 ITR 1 has inter alia observed that

"*A shareholder has no interest in the property of the Company…… It has only a right to participate in the profits of the Company as and when the Company decides to divide them. The Company is a juristic person and is distinct different from it's share holders. It is the Company which owns the property and not the share holders.*"

Therefore, the attempt of the share holder to lift the corporate veil at the instance of the share holder was rejected. In this case also, shares in M/s. R.S. Rekhchand Mohota Spinning and Weaving Mills Ltd. and M/s. Vaibhav Textiles Pvt. Ltd. are held by the appellant/assessee and not it's members. The members, therefore, cannot claim any rights to the property of appellant/assessee Company i.e. shares of M/s. R.S. Rekhchand Mohota Spinning and Weaving Mills Ltd. and M/s. Vaibhav Textiles Pvt. Ltd. as rightly held by the Authorities under the Act.

(iii) The submission that the entire transaction should be looked at wholistically bearing in mind the purpose and object of the settlement as recorded in the Arbitration Award dt.30.4.1994 so as to settle the dispute between members of the family and it was to achieve aforesaid objective that the shares in the appellant/assessee were directed to be transferred is not acceptable. The objective/purpose of family settlement would restrict itself only to the persons who entered into the family arrangement and are part of the settlement. It cannot extend to the persons who are strangers to the settlement. In this case, admittedly, the assessee is not a member of Mohota family so as to be a part of the family settlement. The assessee having been formed under the Companies Act have certain advantages and disadvantages attached to it. But once a Company comes into existence under the provisions of the Companies Act and it is considered to be an independent entity, then it's obligation under the law as a separate legal entity has to be complied with and settlement arrived at between it's members cannot discharge the assessee from complying with it's obligations under the Law.

(iv) The submission that the assessee had no volition in transferring the shares overlooks the fact that an artificial entity such as a Company only acts through it's Directors and in no case, does the Company has a mind of it's own to decide the course of action to be adopted.

(v) The submission that no consideration was received by the assessee for the transfer of shares and that the fair market value of M/s. R.S. Rekhchand Mohota Spinning and Weaving Mills Ltd. arrived at Rs.225/- per share and that of M/s. Vaibhav Textiles Pvt. Ltd. arrived at Rs.10/- per share by the Arbitrator was only for the purposes of adjustment of rights amongst the parties overlooks the fact that the Arbitration Order annexed to the decree (Page 62 of the Appeal memo) itself records that the shares in M/s. R.S. Rekhchand Mohota Spinning and Weaving Mills Ltd. and M/s. Vaibhav Textiles Pvt. Ltd. are to be transferred at a consideration of Rs.225/- and Rs.10/- per share respectively. Thus, the consideration has been determined and accepted by the members of the family, who are in management of the Assessee/Company.

(vi) The decision of the Calcutta High Court in the case of Shaw Wallace and Company Ltd. vs. Commissioner of Income Tax 119 ITR 399 that one is entitled to lift corporate veil and look behind to find out who are the real persons in control of the incorporated Company is distinguishable because in the aforesaid case, the issue was with regard to amalgamation of 100% subsidiary company to it's holding company. The question which arose for consideration before the Calcutta High Court was whether an amalgamation between holding and subsidiary Companies would amount to transfer of capital asset in terms of Section 45 r/w. 2 (47) of the Act. The Calcutta High Court specifically referred to Section 47 of the Act and in particular, to Section 47, sub-clause (v) of the Act to hold that a transfer by a subsidiary company to the holding Company of the whole of it's share capital will not be regarded as transfer for the purposes of computing capital gains under Chapter IV-E of the Act. Further observations made by the Calcutta High Court to the effect that, on looking behind the facade of the Company, one would notice that all the assets of the subsidiary company are held by it's parent company which owns 100 % of it's shares. The aforesaid observations of the Calcutta High Court seems to provide the rationale for Section 47(v) of the Act in excluding a transfer of the entire share capital of a subsidiary to it's holding company which owns 100% of it's shares from being considered a transfer. In the present facts, we are not concerned with transfer between holding and subsidiary companies. It is not the case of the appellant that Section 47 of the Act is applicable.

(vii) Further, lifting of corporate veil at the instance of the assessee would mean that it is denying it's corporate existence. This, after taking advantage of the separate existence of a Company under the Act. Therefore, after having incorporated the Limited Company and given it separate existence from it's share holders, it is not open to the Company to urge "Please ignore my separate existence and look at the persons behind me." If that be so, the Appellant/Company must opt for voluntarily winding up and then the shares being allotted to the individual members on liquidation would be governed by the family arrangement/settlement.

(viii) In the above view, the Tribunal was correct in holding that the transaction of transfer of shares by the independent corporate entity was assessable to capital gain tax. Therefore, the substantial questions of law which arise for our consideration are all decided in favour of the respondent/ revenue and against the appellant/assessee. Accordingly, the appeal is dismissed. No order as to costs

CONCLUSION:

A family arrangement/settlement does not amount to a "transfer" u/s 2(47) as it only recognizes "pre-existing rights" between the parties, the same applies only to members of the families and not to transfers made by corporate entities. Therefore transfer of shares of a company under family settlement will be chargeable under Capital Gains. The fact that the Company is wholly owned by the members of the family is irrelevant

8. CIT VS. EQUINOX SOLUTION PVT. LTD (SUPREME COURT)

ISSUE INVOLVED :

If an undertaking is sold as a running business with all assets and liabilities for a slump price, whether capital gain chargeable u/s 50 or provisions of slump sale will apply.

The assessee claimed that as it had sold their entire running business in one go with its assets and liabilities at a slump price, the provisions of Section 50 (2) of the Act could not be applied to such sale. It was claimed that it was not a case of sale of any individual or one block asset which may attract the provisions of Section 50 (2) of the Act. It was also claimed that that since the undertaking itself is a capital asset owned by the assessee nearly for six years and being in the nature of long term capital asset and the same having been sold in one go as a running concerned, it cannot be termed a "short terms capital gain" so as to attract the provisions of Section 50 (2) of the Act as was held by the Assessing Officer. This plea was upheld by the e CIT (Appeals), Tribunal and the High Court. On appeal by the department to the Supreme Court HELD dismissing the appeal:

(i) In our considered opinion, the case of the respondent (assessee) does not fall within the four corners of Section 50 (2) of the Act. Section 50 (2) applies to a case where any block of assets are transferred by the assessee but where the entire running business with assets and liabilities is sold by the assessee in one go, such sale, in our view, cannot be considered as "short-term capital assets". In other words, the provisions of Section 50 (2) of the Act would apply to a case where the assessee transfers one or more block of assets, which he was using in running of his business. Such is not the case here because in this case, the assessee sold the entire business as a running concern.

(ii) As rightly noticed by the CIT (appeal) that the entire running business with all assets and liabilities having been sold in one go by the respondent-assessee, it was a slump sale of a "long-term capital asset". It was, therefore, required to be taxed accordingly.

(iii) Our view finds support with the law laid down by this Court in Commissioner of Income Tax, Gujarat vs. Artex Manufacturing Co. [1997(6) SCC 437 CIT].

(iv) In Premier Automobiles Ltd. vs. Income Tax Officer & Anr., 264 ITR 193 (Bombay) also, the Division Bench of the Bombay High Court examined this question in detail on somewhat similar facts and has taken the same view. The Learned Judge S.H Kapadia – (as His Lordship then was as Judge of the Bombay High Court and later became CJI) speaking for the Bench aptly explained the legal position to which we concur as it correctly summarized the legal position applicable to such facts.

(v) Learned Counsel for the appellant (Revenue) was not able to cite any decision taking a contrary view nor was he able to point out any error in the decisions cited at the Bar by the assessee's counsel referred supra.

CONCLUSION :

If an undertaking is sold as a running business with all assets and liabilities for a slump price, then provisions of slump sale will apply and 50(2) will not apply. Therefore capital gain will not be always deemed as short term but if undertaking sold after 36 months ,can also be treated as long term.

9. HONDA SIEL CARS INDIA LTD. V. CIT [2017] (SC)

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?

Facts of the case: The assessee, Honda Siel Cars India Ltd., is a joint venture company between Honda Motors, a Japanese company and Siel Ltd., an Indian company. The assessee and Honda Motors entered into a technical collaboration agreement (TCA) on May 21, 1996 under which a technical fee of 30.5 million USD was payable by the assessee in five equal instalments on a yearly basis. Under the agreement, TCA Honda Motors had to provide manufacturing facilities, know-how, technical information, information regarding intellectual property rights to the assessee which the assessee was entitled to exploit only as a licensee, without any proprietary rights. The assessee treated the technical fees as revenue while the Revenue authorities contended that it is capital in nature.

Issue: Whether the technical fee of 30.5 million USD payable by the assessee is in the nature of revenue expenditure or capital expenditure?

Appellate Authorities' views: The Tribunal held that the assessee had acquired only a limited right to use and not a proprietary right, and hence, the expenditure was revenue in nature. It did not matter that the agreement was entered into at the time of setting up the business. The High Court, however, held that though the rights were in the nature of a right to use, the joint venture's business was set up pursuant to the agreement, and hence, the expenditure was capital in nature.

Supreme Court's Observations: From a review of relevant precedents, the Court observed that 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. There is no single principle or test for determining the nature of expenditure; it is a question to be answered based on the circumstances in each case.

In the given facts, the very purpose of the TCA was to set up the Joint Venture. The collaboration included not only transfer of technical information, but, complete assistance, actual, factual and on the spot, for establishment of plant, machinery, etc. so as to set up a manufacturing unit. Upon termination of TCA, the joint venture itself would come to an end. Though the TCA is framed in a manner to look like a licence for a limited period having no enduring nature but a close scrutiny into the said agreement shows otherwise.

Supreme Court's Decision: Affirming the decision of the High Court, the Supreme Court held that, in this case, technical fee is capital in nature since upon termination of TCA, the joint venture itself would come to an end.

10. UNION OF INDIA V. TATA TEA AND OTHERS (SC)

Can dividend distribution tax under Section 115-O of Income-tax Act, 1961 be levied in respect of the dividend declared out of agricultural income?

Facts of the case: The petitioner is a tea company engaged in cultivating and processing tea in its factory for marketing. The cultivation of tea is an agricultural process while the processing of tea in the factory is an industrial process. The petitioners contend that when the company distributes dividend, it is taxed under Section 115-O. The tax on dividend declared by it in this case is nothing but a tax on agricultural income. The legislative competence for taxing agricultural income lies with the State Government and not the Central Government.

Issue: Can dividend distribution tax be levied on dividend income of a tea company under section 115-O?

Supreme Court's Observations: As per entry 82 of List I the Union Parliament has the competence to tax "income other than agricultural income." Section 115-O pertains to additional tax at the stage of distribution of dividend by domestic company which is covered by entry 82 in List I. When dividend is declared to be distributed and paid to a company's shareholders it is not impressed with character of the source of its income. The Court relied on Mrs. Bacha F Guzdar v. CIT AIR 1955 SC 74 which looked into the nature of the dividend income in the hands of the shareholders. Dividend is derived from the investment made in the company's shares and the foundation rests on the contractual relations between the company and the shareholder.

Dividend is not 'revenue derived from land' and hence cannot be termed as agricultural income in the hands of a shareholder. Hence, despite the petitioner's company being involved in agricultural activities, in the shareholder's hands, the income is only dividend and not agricultural income.

The Calcutta High Court had upheld the vires of section 115-O but put a qualification that additional tax levied under section 115-O shall be only to the extent of 40% which is the taxable income of the tea company. The Supreme Court overturned this cap placed by the Calcutta High Court. Section 115-O is within the competence of the Parliament and hence, no limits can be placed on the same.

Supreme Court's Decision: When dividend is declared to be distributed and paid to a company's shareholders, it is not impressed with character of the source of its income. Section 115-O is within the competence of the Union Parliament and therefore dividend distribution tax can be levied in respect of the entire dividend declared and distributed by a tea company.

11. INCOME-TAX OFFICER V. VENKATESH PREMISES CO-OPERATIVE SOCIETY LTD. (SC)

Whether certain receipts by co-operative societies from its members (non-occupancy charges, transfer charges, common amenity fund charges) are exempt based on the doctrine of mutuality?

Supreme Court's observations: The doctrine of mutuality is based on the common law principle that a person cannot make a profit from himself. The income of a co-operative society from business is taxable under section 2(24)(vii) and will stand excluded based on the principle of mutuality. The essence of the principle of mutuality lies in the commonality of the contributors and the participants who are also the beneficiaries. The contributors to the common fund must be entitled to participate in the surplus and the participators in the surplus are contributors to the common fund. Any surplus in the common fund shall, therefore, not constitute income but will only be an increase in the common fund meant to meet sudden eventualities.

The Supreme Court made the following observations:

- If for convenience, part of the transfer charges were paid by the transferee, they would not partake of the nature of profit. The amount is appropriated only after the transferee was inducted as a member. In the event of non-admission, the amount was returned. The moment the transferee was inducted as a member the principles of mutuality would apply.
- Non-occupancy charges were levied by the society and were payable by a member who did not himself occupy the premises but let them out to a third person. The charges were utilised only for common benefit of facilities and amenities to the members.
- Contribution to the common amenity fund taken from a member disposing of property was utilized for meeting heavy repairs to ensure hazard-free maintenance of the properties of the society which ultimately benefitted the members. Membership forming a class, the identity of the individual member not being relevant, induction into membership automatically attracted the doctrine of mutuality.
- If a society had surplus floor space index available, it was entitled to utilise it by making fresh construction in accordance with law. Naturally, such additional construction would entail extra maintenance charges. If the society first inducted new members who were required to contribute to the common fund for availing of the common facilities, and then granted only occupancy rights to them by draw of lots, the ownership remaining with the society, the receipts could not be bifurcated into two segments of receipt

and costs, so as to hold the former to be outside the purview of mutuality classifying it as income of the society with commerciality.

Supreme Court's Decision: 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 are exempt owing to application of the doctrine of mutuality.

12. K. LAKSHMANSA AND CO. V. COMMISSIONER OF INCOME-TAX (SC)

Is an assessee receiving refund consequent to waiver of interest under sections 234A to 234C of the Income-tax Act, 1961 by the Settlement Commission, also entitled to interest on such refund under section 244A?

Facts of the case: The assessee had approached the Settlement Commission for waiver of interest under sections 234A to 234C of the Income-tax Act, 1961. The Settlement Commission partially waived the interest but refused to grant interest on refund on the grounds that section 244A does not provide for payment of interest in such cases. Further, the Settlement Commission's power to waive interest does not enable the Commission to provide for payment of interest under section 244A.

The High Court held that since waiver of interest was at the discretion of the Settlement Commission, no right flowed to the assessee to claim refund as a matter of right under law.

Issue: When refund is awarded by the Settlement Commission at its discretion under section 244A, is there a right to receive interest on the same?

Supreme Court's observations: The Supreme Court observed that the right to claim refund is automatic once the statutory provisions have been complied with. The statutory obligation to refund, being non-discretionary, carries with it the right to interest. Section 244A is clear and plain – it grants a substantive right of interest and is not procedural.

Under section 244A, it is enough if the refund becomes due under the Income-tax Act, 1961 in which case the assessee shall, subject to the provisions of that section, be entitled to receive simple interest. The expression "due" only means that a refund becomes due pursuant to an order under the Act which either reduces or waives tax or interest. It does not matter that the interest being waived is discretionary in nature; the moment that discretion is exercised and refund becomes due consequently, a concomitant right to claim interest springs into being in favour of the assessee.

The Supreme Court, thus, did not agree with the High Court opinion that when discretionary power has been exercised, no concomitant right to claim interest on refund arises in favour of the assessee.

Supreme Court's Decision: Overruling the High Court Decision, the Supreme Court held that the assessee has a right to interest on refund under section 244A.

13. RAJ DADARKAR AND ASSOCIATES V. ASSISTANT COMMISSIONER OF INCOME TAX (SC)

Whether rental income earned from letting out of premises is to be treated as business income or as income from house property?

Facts of the case: The assessee had acquired the right to conduct a market on certain land from Municipal Corporation, Greater Bombay under an auction on May 28, 1993. The premises allotted to the appellant was a bare structure and it was for the appellant to make the premises fit to be used as a market. The appellant spent substantial sums to construct 95 shops and 30 stalls. From the years 1999 to 2004, the assessee treated income from sub-letting of such shops and stalls as business income. The return of the assessee for assessment year 2000-2001 was reopened by Assessing Officer by issuing notice under section 148.

Issue: Whether the income earned by the appellant is to be taxed under the head 'Income from house property' or 'Profits and gains from the business or profession'?

Supreme Court's Observations: The Supreme Court held that wherever there is an income from leasing out of premises, it is to be treated as income from house property. However, it can be treated as business income if letting out of the premises itself is the business of the assessee. The question has to be decided based on the facts of each case as was held in Sultan Brothers Pvt Ltd. v. CIT [1964] 51 ITR 353 (SC).

In the given facts, it was an undisputed fact that the assessee would be considered to be a deemed owner under section 27(iiib) read with section 269UA(f) as it had a leasehold right for more than 12 years. The only evidence adduced for proving that letting out and earning rents is the main business activity of the appellant was the object clause of the partnership deed. The clause provided that "The Partnership shall take the premises on rent to sub-let or do any other business as may be mutually agreed by the parties from time to time." The Supreme Court held the clause to be inconclusive and observed that the assessee had failed to produce sufficient material to show that its entire or substantial income was from letting out of the property.

Supreme Court's Decision: The Supreme Court, accordingly, held that, in this case, the income is to be assessed as "Income from house property" and not as business income, on account of lack of sufficient material to prove that the substantial income of the assessee was from letting out of the property.

Note - 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 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. In this case, however, 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"

14. PALAM GAS SERVICE V. CIT (SC)

Whether section 40(a)(ia) is attracted when amount is not 'payable' to a sub-contractor but has been actually paid?

Facts of the case: The assessee, Palam Gas Service, is engaged in the business of purchase and sale of LPG cylinders. The assessee had arranged for the transportation to be done through three sub-contractors within the meaning of section 194C. During the relevant assessment year, when the assessee made freight payments of Rs.20,97,689 to the sub-contractors, it did not deduct tax at source. The Assessing Officer disallowed the freight expenses as per section 40(a)(ia) on account of failure to deduct tax. The assessee contended that section 40(a)(ia) did not apply as the amount was not 'payable' but had been actually paid.

Issue: Whether the provisions of Section 40(a)(ia) would be attracted when the amount is not 'payable' to a sub-contractor but has been actually paid? Would the obligation to deduct tax depend on the method of accounting followed by an assessee?

Supreme Court's Observations: The Supreme Court noted the difference in opinion amongst the various High Courts. On the one hand, the High Courts of Punjab & Haryana, Madras, Calcutta and Gujarat held that Section 40(a)(ia) extended to amounts actually paid. The Allahabad High Court had, however, held otherwise. The Supreme Court agreed with the observations of the majority High Courts and held that section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid. Accordingly, the judgment of the Allahabad High Court in CIT v. Vector Shipping Services (P.) Ltd. [2013] 357 ITR 642 stands overruled.

The Supreme Court reaffirmed that the obligation to deduct tax at source is mandatory and applicable irrespective of the method of accounting adopted. If the assessee follows the mercantile system of accounting, then, the moment amount was credited to the account of the payee on accrual of liability, tax was required to be deducted at source. If the assessee follows cash system of accounting, then, tax is required to be deducted at source at the time of making payment.

Supreme Court's Decision : The Supreme Court, accordingly, upheld the decision of the majority High Courts that section 40(a)(ia) would be attracted for failure to deduct tax in both cases i.e., when the amount is payable or when the amount is paid, as the case may be, depending on the system of accounting followed by the assessee.

15. FAURECIA AUTOMOTIVE HOLDING VS DCIT (ITA NO. 784/PUN/2015)

Whether Salary cost reimbursement and payment towards Global Information Support Services to French Company, taxable in India or not?

Facts of the case: Faurecia Automotive Holding (the taxpayer), a Company being tax resident of France, is into the business of designing and building various interior components (such as dashboards, door panels, etc.) of passenger cars. During the fiscal year 2010-11, the taxpayer had received following sums from Faurecia Technology Center India Limited (Faurecia India):

- INR 4.73 million towards reimbursement of salary cost, in respect of an employee (i.e. Mr. Franck Euvrard) seconded to India
- INR 266.72 million towards support services

While the taxpayer treated both these amounts as not taxable, the Tax Officer brought them to tax.

Issue: To have a uniformity across location, support its establishments in India etc., MNCs send their employees to India either on deputation or secondment. Depending upon the terms of agreement, either the Indian entity or the Foreign Company pays salary to the said employees. Where the Foreign Company pays salary to such employee, such cost is reimbursed by the Indian entity. Indian Revenue Authorities at times tries to bring such payment within the ambit of Fees for Technical Service (FTS) and hence the taxability of such payment has always been litigative.

Further, some of the Double Taxation Avoidance Agreement (DTAA) entered by India contains Most Favoured Nation (MFN) clause. This clause grants access to the favourable DTAAs that are entered post signing of the concerned DTAA.

With respect to taxing reimbursement of employee cost, the brief facts are as under:

- As per the secondment agreement, Mr. Franck was to render services to Faurecia India. For this purpose, Mr. Franck was appointed as Faurecia India's CEO in 2006 and was CEO till 2011.

- His salary consisted basic Salary, housing allowance, conveyance allowance, child education allowance and special allowance etc. He had to become member of Employees' Provident Fund
- Mr. Franck's leave entitlements were governed by the rules of Faurecia India
- The taxpayer paid INR 47.30 million directly to Mr. Franck, which was subsequently reimbursed by Faurecia India.
- For fiscal year 2010-11, the Tax Officer proposed to tax this amount by treating that the taxpayer rendered managerial, consultancy or technical services to Faurecia India and the amount paid as quid pro quo represents payment towards technical services as covered under section 9(1)(vii) of the Income-tax Act, 1961 (the IT Act).

With respect to taxing support services, the brief facts are as under:

- The taxpayer provided services to Faurecia India in one or several of the following areas:
  - o General management
  - o Communication
  - o Sales and marketing
  - o Program management
  - o Accounting, controlling and tax
  - o Treasury
  - o Legal, insurance, real estate
  - o General management of information system organisation
  - o Information system
  - o Human resources
  - o General management of purchasing organisation
  - o Production purchasing
  - o Non production purchasing
  - o Manufacturing
  - o Quality
- For the above, it received INR 26.6 million from Faurecia India. The taxpayer treated this amount as not taxable claiming it did not make available any technical knowledge, experience, skill or know how etc. to Faurecia India and hence, the same did not fall within the meaning of FTS under Article 13 of the DTAA with France read with para 7 of the Protocol.
- The Tax Officer taxed this amount by treating it to be royalty as defined in section 9(1)(vi) of the IT Act and also covered by Explanation 2 to section 9(1)(vii) of the IT Act as FTS.

Accordingly, the Tax Officer passed a draft order proposing to add the above amounts. The taxpayer filed objections against the draft order, which were dismissed by the Dispute Resolution Panel.

Tribunal's Observations:

For concluding that the payment towards support services is also not in the nature of FTS, the Tribunal observed that:

As per para 7 of the Protocol, if India has entered into a DTAA with a third state which is a member of the OECD and the scope of the term FTS under such DTAA with a third state is limited vis-à-vis its scope given in the DTAA with France, then such limited scope as per the DTAA with the third state shall stand substituted in place of para 4 of Article 13 of the DTAA with France.

- India has entered into a DTAA with UK, which is a member of the OECD. Article 13 of such DTAA with UK has a narrower definition of the term FTS.
- In view of the MFN clause in the Protocol, Article 13(4) of the DTAA with UK shall overshadow Article 13(4) of the DTAA with France and limit the scope of the DTAA with France to the extent provided in the DTAA with UK.
- The term managerial is missing so far as the scope of FTS under the DTAA with UK is concerned.
- The second departure in the DTAA with UK from the DTAA with France is that the 'scope' of technical consultancy services in the DTAA with UK has been restricted to 'make available' any technical knowledge, experience, skill knowhow or processes etc.
- Thus, Article 13(4)(c) of the DTAA with UK, when read in place of Article 13(4) of the DTAA with France, deciphers that FTS shall mean any payment for rendering of any technical or consultancy services which 'make available' technical knowledge, experience or skill etc. to the recipient.
- The services rendered by the taxpayer to Faurecia India are in the nature of managerial and also technical in nature. In so far as the managerial services are concerned, the consideration for them goes out of the purview of FTS as the term 'managerial' is absent in Article 13(4) of the DTAA with UK.
- As far as the remaining Technical services are concerned, these are of coordinating the information system and assisting Faurecia India in computerisation of systems, office automation and utilisation of personal computers which fall into three categories namely Operations, Technical Support and Studies. On going through the nature of such services, it manifests that these do not result in making available any technical knowhow etc to Faurecia India.
- In view of the above, payment towards support services should not be taxable as FTS under the DTAA.

Tribunal's Decision : Salary cost reimbursement and payment towards Global Information Support Services to French Company, not taxable in India

16. PR.CIT VS MARUTI SUZUKI INDIA LIMITED (CIVIL APPEAL NO. 5409 OF 2019) (SLP NO. 4298 OF 2019) (SC)

Whether Assessment in the name of amalgamating company is valid or not?

Facts of the case: Suzuki Powertrain India Limited (SPIL or amalgamating company) had amalgamated with Maruti Suzuki India Limited (MSIL or amalgamated company) by a scheme of amalgamation approved by the High Court (HC) on January 29, 2013, with effect from fiscal year commencing on April 1, 2012. The scheme provided that all the assets, liabilities and duties of the amalgamating company be transferred to the MSIL and that the SPIL would stand dissolved without winding up. Subsequent chain of events is summarised hereunder:

- April 2, 2013 - the taxpayer intimates the Tax Officer (TO) about the amalgamation
- September 26, 2013 – TO issues notice for scrutiny under section 143(2) of the Income-tax Act, 1961 (the IT Act) for fiscal year 2011-12
- September 4, 2015 - the TO calls for various information. The TO's communication was addressed to:

  The Principal Officer

M/s Suzuki Powertrain India Limited

(Now known as M/s Maruti Suzuki India Limited)

- March 11, 2016 – TO passes draft assessment order in the name of SPIL
- April 12, 2016 – Objections are filed before the Dispute Resolution Panel (DRP). The objections were filed by MSIL as successor in interest of erstwhile SPIL.
- October 14, 2016 - DRP passes its order
- October 31, 2016 – TO passes final order in the name of SPIL (amalgamated with MSIL).
- April 6, 2017 – Tax Tribunal set asides the assessment order on the ground that it was void ab initio having been passed in the name of a non-existent entity by the TO
- January 9, 2018 – Delhi HC affirms Tribunal's order. While approving Tribunal's order, Delhi HC followed its own decision rendered in MSIL's case for fiscal year 2010-11.

The TO has filed a Special Leave Petition (SLP) before Supreme Court against the decision of HC.

Issue: In case of amalgamation of two or more entities, the amalgamating entity ceases to exist post the appointed date. As the amalgamation process generally takes time to complete, the scheme document contains appointed date – i.e. date from which the scheme shall be effective. Hence, once the scheme is approved, the same is effective retrospectively.

As a result, there are instances where the tax return is filed by the amalgamating company in its own name. Further, the assessment for earlier year(s) (i.e. tax years prior to the year in which amalgamation took place), could be underway and would get concluded post the amalgamation. In such cases, it is a contentious issue as to whether the assessment should be done in the name of amalgamating company or resulting / amalgamated company. Recently, Hon'ble Supreme Court had an occasion to delve into this issue.

Supreme Court's Observations: For this case, SC observed that:

- Under the approved scheme of amalgamation, the amalgamated company had assumed the liabilities of the transferor company including the tax liabilities.
- Upon scheme of amalgamation getting approved, the amalgamating company ceases to exist. This principle has been formulated by SC in case of Saraswati Industrial Syndicate Ltd.
- Once amalgamating company ceases to exist, it cannot be termed as a "person" under section 2(31) of the IT Act against whom assessment proceedings can be initiated or an order can be passed.
- The TO assumed jurisdiction to make an assessment in pursuance to the notice under section 143(2) of the IT Act. Prior to the date on which the jurisdictional notice under section 143(2) of the IT Act was issued, the scheme of amalgamation had been approved and this fact was already communicated to the TO.
- The jurisdictional notice issued under section 143(2) of the IT Act in the name of amalgamating company, a non-existent entity, was invalid and thereby the initiation of assessment proceedings was void ab initio. The mere fact that the amalgamated company participated in the assessment proceedings would not operate as estoppel.

Supreme Court's Decision : The Supreme Court, accordingly, upheld the decision of the majority High Courts that the assessment done in the name of amalgamating company was void ab initio.

17. Regional Provident Fund Commissioner (II) West Bengal versus Vivekananda Vidyamandir and Others, Civil Appeal No(s). 6221 of 2011, Transfer Case No. (C) No(s). 19 0f 2019

Whether the special allowances paid by an establishment to its employees would fall within the expression "basic wages" under Section 2(b)(ii) read with Section 6 of the Act for computation of deduction towards Employees' Provident Fund"?

Facts of the case: The common submission on behalf of the appellants was that basic wages defined under Section 2(b) contains exceptions and will not include what would ordinarily not be earned in accordance with the terms of the contract of employment. Even with regard to the payments earned by an employee in accordance with the terms of contract of employment, the basis of inclusion in Section 6 and exclusion in Section 2(b)(ii) is that whatever is payable in all concerns and is earned by all permanent employees is included for the purpose of contribution under Section 6. But whatever is not payable by all concerns or may not be earned by all employees of a concern are excluded for the purposes of contribution. Dearness allowance was payable in all concerns either as an addition to basic wage or as part of consolidated wages. Retaining allowance was payable to all permanent employees in seasonal factories and was therefore included in Section 6. But, house rent allowance is not paid in many concerns and sometimes in the same concern, it is paid to some employees but not to others, and would therefore stand excluded from basic wage. Likewise overtime allowance though in force in all concerns, is not earned by all employees and would again stand excluded from basic wage. It is only those emoluments earned by an employee in accordance with the terms of employment which would qualify as basic wage and discretionary allowances not earned in accordance with the terms of employment would not be covered by basic wage. The statute itself excludes certain allowance from the term basic wages. The exclusion of dearness allowance in Section 2(b)(ii) is an exception but that exception has been corrected by including dearness allowance in Section 6 for the purpose of contribution.

Issue: The division bench at Supreme Court was considering 4 appeals in which the issue was **"whether the special allowances paid by an establishment to its employees would fall within the expression "basic wages" under Section 2(b)(ii) read with Section 6 of the Act for computation of deduction towards Employees' Provident Fund".**

Supreme Court's Observations: For this case, SC observed that:

- Any variable earning which may vary from individual to individual according to their efficiency and diligence will stand excluded from the term "basic wages" (as held in Muir Mills Co. Ltd., Kanpur Vs. Its Workmen, AIR 1960 SC 985);
- The basic principles as laid down in Bridge Roof's case (supra) on a combined reading of Sections 2(b) and 6 are as follows:
- Where the wage is universally, necessarily and ordinarily paid to all across the board such emoluments are basic wages.
- Where the payment is available to be specially paid to those who avail of the opportunity is not basic wages. By way of example it was held that overtime allowance, though it is generally in force in all concerns is not earned by all employees of a concern. It is also earned in accordance with the terms of the contract of employment but because it may not be earned by all employees of a concern, it is excluded from basic wages.
- Conversely, any payment by way of a special incentive or work is not basic wages." [Manipal Academy of Higher Education vs. Provident Fund Commissioner, (2008) 5 SCC 428, relying on Bridge and Roof Co. (India) Ltd. vs. Union of India, (1963) 3SCR 978.]

Supreme Court's Decision : The Supreme Court, has held that

"In order that the amount goes beyond the basic wages, it has to be shown that the workman concerned had become eligible to get this extra amount beyond the normal work which he was otherwise required to put in. There is no data available on record to show what were the norms of work prescribed for those workmen during the relevant period. It is therefore not possible to ascertain whether extra amounts paid to the workmen were in fact paid for the extra work which had exceeded the normal output prescribed for the workmen. The wage structure and the components of salary have been examined on facts, both by the authority and the appellate authority under the Act, who have arrived at a factual conclusion that the allowances in question were essentially a part of the basic wage camouflaged as part of an allowance so as to avoid deduction and contribution accordingly to the provident fund account of the employees."

18. TATA CONSULTANCY SERVICE LTD. VS ACIT (ITA NO. 5713/MUM/2016)

Whether there is possibility of claiming Foreign Tax Credit on the income pertaining to section 10A / section 10AA eligible units (i.e. SEZ / EOU etc.)?

Facts of the case: Taxpayer, IT and ITeS Company, is a Company resident in India. The Company earns income which is entitle for exemption under section 10A / 10AA of the IT Act. The tax officer, after examining Company's claim and verifying the details, denied relief for FTC in respect of income subjected to tax abroad but exempt from tax in India. The taxpayer contested the tax officer's action before the appellate authority [i.e. Commissioner of Income-tax (Appeals) ('CIT(A)')]. Relying on the decision of Karnataka High court in case of Wipro Ltd., the CIT(A) allowed taxpayer's claim in respect of income earned from USA. However, in respect of income earned from other DTAA countries and non-DTAA countries, CIT(A) rejected taxpayer's claim. Hence, the taxpayer filed second appeal before the Mumbai Tribunal. Similarly, the tax department filed appeal before the tribunal against the CIT(A)'s order in respect of relief granted to the tax payer.

The taxpayer contended that section 90 of the IT Act empowers the Central Government to enter into Double Taxation Avoidance Agreement ('DTAA') with the Government of any other country for granting relief in respect of cases where the income tax is chargeable. The taxpayer further contended that the income covered by section 10A/10AA of the IT Act is chargeable to tax in India as per section 4 and 5 of the IT Act. Furthermore, the exemption is for a specified period and after expiry of that period such income would otherwise be chargeable to tax. It was further contended that Article 25 of India-USA DTAA mandates that if any income derived and tax paid in USA on such income then tax relief / credit shall be granted in India of such tax paid in USA. Thus, the Article does not say anything about income tax being paid by the resident taxpayer under the IT Act as a condition precedent for claiming the benefit of tax credit under the DTAA. It was contended that a similar clause is there in the DTAAs entered by India (i.e. Denmark, Finland, Hungary, Norway, Oman, South Africa, Saudi Arabia and Taiwan).

The Revenue Authorities contended that since entire income of section 10A / 10AA eligible units are exempt and not subjected to tax in India, the taxpayer would not get tax credit for taxes paid on such income in overseas countries, except USA.

Issue: A resident tax payer is eligible to claim Foreign Tax Credit ('FTC') if any tax has been paid by him in a country or specified territory outside India. As per the FTC Rules notified by the Central Board of Direct Taxes (CBDT), proportionate tax credit method is to be followed for claiming relief of foreign taxes paid. In other words, credit for foreign taxes cannot exceed the tax liability on such income in India.

A question generally arises as to whether the foreign tax credit is available in respect of income which has suffered tax in overseas jurisdiction but is not taxable in India. Recently, Mumbai Bench of Income-tax Appellate Tribunal (Mumbai Tribunal), along with other grounds of appeal, had an occasion to delve on this aspect.

Tribunal's Observations: For this case, Tribunal observed that:

- The provision of section 90(1)(a)(ii) of the IT Act applies to a case where the income of the taxpayer is eligible to tax under the IT Act as well as in the corresponding law in force in the other country
- Though income tax is chargeable under the IT Act, it is open to the Parliament to grant exemption under the IT Act from payment of tax for any specified period, normally, to incentivize the taxpayer to carry on manufacturing activities or providing services
- It is not the requirement of law that the taxpayer before he claims credit under the Indo-US convention or under the provision of IT Act must pay tax in India on such income.
- As per the embargo placed in the DTAA, the taxpayer is entitled to such tax credit only in respect of that income which is taxed in USA

Tribunal's Decision : The Tribunal, has held that

Where the respective tax treaty provides for benefit for foreign tax paid even in respect of income on which the taxpayer has not paid tax in India, still, it would be eligible for tax credit under section 90 of the IT Act. As India's treaties with other countries such as Denmark, Hungary, Norway, Oman, Saudi Arabia and Taiwan have similar provision providing for benefit of foreign tax credit even in respect of income not subjected to tax in India, the foreign tax credit would be available to the taxpayer in respect of foreign taxes paid in such countries.

19. NATIONAL CO-OPERATIVE DEVELOPMENT CORPORATION VS. COMMISSIONER OF INCOME TAX (SUPREME COURT DATED SEPTEMBER 29, 2020)

Deduction - Refund of grants - Section 13(1) of Income Tax Act, 1961

Fact of the Case: The Assessing Officer opined that the non-refundable grants were in the nature of capital expense and not a revenue expense and, thus, disallowed the same as a deduction. An appeal was preferred before the Commissioner which opined that the grants made by the Appellant undisputedly fall within its authorised activities, which were interlinked and interconnected with its main business of advancing loans on interest to State Governments and cooperative societies. These grants were intended to be utilised for various projects which were admittedly of capital nature and resulted in the acquisition of capital assets, but not by the Appellant itself. The Commissioner found that the approach adopted by the AO was fallacious as the functions and activities of the Appellant-Corporation included giving loans and grants which, in fact, was the very purpose for which it had been set up. The net deduction, however, allowed was limited on account of refund of the grants to the extent of amount which had remained unutilised.

The Revenue Department to prefer an appeal before the Income Tax Appellate Tribunal which, however, accepted the view taken by the AO and did not agree with the approach of the Commissioner, setting aside the order of the Commissioner. Thereafter, an appeal as preferred before the High Court. The High Court opined that since the business of the Appellant-Corporation was to receive funds and to then advance them as loans or grants, the interest income earned which was so applied would also fall under the head of profits and gains of business or profession being a part of its normal business activity. The High Court held that the monies which were advanced from the Fund cannot be distinctly identified as forming part of the interest income. The other aspect the High Court opined on was that in order to claim deduction as a revenue expenditure, the Appellant-Corporation had to first establish that it incurred an expenditure. The advancement of loans to the State Governments and cooperative societies could not be claimed as expenditure as the same did not leave the hands of the Appellant-Corporation irretrievably.

Order/Judgement: The functions of the Appellant-Corporation was to advance loans or grant subsidies to State Governments for financing cooperative societies, etc. There was no other function which the Appellant-Corporation carries out nor did it generate any funds of its own from any other business. In a sense the role is confined to receiving funds from the Central Government and appropriately advancing the same as loans, grants or subsidies. In a larger canvas the Appellant-Corporation plans, promotes and makes financial programmes for the benefit of these societies and other entities to which such loans, grants and subsidies were advanced. It was really in the nature of an intermediary with expertise in the financial sector to carry forward the intent of the Central Government to assist State Governments, Cooperative Societies, etc. Since this was the business activity, that was what had persuaded to opine that the income generated in the form of interest on the unutilised capital was in the nature of business income. The objectives were wholly socio-economic and the amounts received including grants come with a prior stipulation for the funds received to be passed on to the downstream entities. This was the reason they have been treated as capital receipts. However, Since this is a pass-through entity on the basis of a statutory obligation, the advancement of loans and grants is not a business activity, when really it was the only business activity. Once it was business activity, the interest generated on the unutilised capital had been held to be the business income.

The contention of the Revenue Department that merely because the interest income received had merged with the monies in the common Fund it loses its revenue character and becomes a capital receipt is not correct. This line of argument was inconsistent with the position where interest money was received, it was held to be of revenue character, and chargeable to tax under the head Profits and Gains of Business or Profession. This amount while lying in the same fund could not acquire the character of a capital receipt. The interest having been treated as revenue receipt on which taxes were paid, it must continue to retain the character of revenue receipt. If the nature of receipt was treated as capital receipt then consistent with the aforesaid approach, no taxes would have been payable on the amount. The corollary was that all expenses incurred in connection with the business were deductible.

This court also find really no force in the submission of the Revenue Department that the direct nexus of monies given as outright grants from the taxable interest income could not be distinctly identified. This was a question of fact. The plea of the Respondents was based on a pure conjecture. It was the case of the Appellant-Corporation throughout that it could easily demonstrate the direct and proximate nexus of interest earned through grants made, as its accounts were duly audited. In fact, Commissioner allowed the business expenditure only to a certain amount on the basis of the facts and figures as emerged from the balance sheet. This was a burden which was to be discharged by the Appellant-Corporation and the Commissioner had been satisfied with the nexus of interest income with the disbursement of grants made, as having been established.

This court unable to agree with the findings arrived at by the AO, Appellate Tribunal and the High Court albeit for different reasons and concur with the view taken by the Commissioner.

20. BASIR AHMED SISODIYA V/S. INCOME TAX OFFICER (SUPREME COURT DATED APRIL 24, 2020)

Cash credits - Deletion of addition - Section 68 of Income Tax Act, 1961

Facts of the Case: The Appellant / Assessee was served with a notice under section 143(2) of the Income Tax Act, 1961 by the Assessing Officer pursuant to which an assessment order was passed. The Officer, inter alia, while relying on the Balance Sheet and the books of account, took note of the credits. The Officer treated that amount as Cash credits under Section 68 of the Income tax Act, 1961 and added the same in declared income of the Assessee. The Officer then proceeded to compute the income of the Assessee for the concerned assessment year. Aggrieved, the Appellant / Assessee preferred an appeal before the Commissioner.

The Commissioner upheld addition as regards the Trading Account and Credits in question. The Appellant/ Assessee then preferred further appeal to the Tribunal. Having noted the issues and objections raised by the Department and the Appellant/Assessee, the Tribunal upheld addition made towards cash credits. The Appellant/Assessee then filed an appeal before the High Court. The High Court dismissed the appeal vide impugned judgment and order, as being devoid of merits. The High Court opined that the amount shown as credits was nothing but bogus entries and was justly added to the income of the Appellant/Assessee.

Order/ Judgement: It had now come on record that the Appellant/Assessee in penalty proceedings offered explanation and caused to produce affidavits and record statements of the concerned unregistered dealers and establish their credentials. That explanation had been accepted by the Commissioner. In the said decision, it had been noted that the Officer recorded statements of unregistered dealers and their identity was also duly established. After analysing the evidence so produced by the Appellant/Assessee, the appellate authority noted that the Officer had neither doubted the identity of those dealers nor any adverse comments were offered in reference to their version regarding sale of marble slabs by them to the Appellant/Assessee in the financial year relevant to assessment year and receipt of payments after two to three years. Further, there was no denial of purchase of marbles by the Assessee and sale with closing stock as disclosed in the trading account. The appellate authority thus found that without purchases of marbles, there could be no sale and disclosure of closing stock in the trading account. In other words, the materials on record would clearly suggest that the concerned unregistered dealers had sold marble slabs on credit to the Appellant/Assessee, as claimed. As a consequence of this finding, the appellate authority concluded that there was neither any concealment of income nor furnishing of inaccurate particulars of income by the Assessee. These observations were made by the competent forum (appellate authority) in penalty proceedings under Section 271 of the Income Tax Act, 1961 in favour of the Assessee. However, what needs to be noted was that the stated penalty proceedings were the outcome of the assessment order in question concerning assessment year. Indeed, at the time of assessment, the Appellant/Assessee had failed to produce any explanation or evidence in support of the entries regarding purchases made from unregistered dealers. In the penalty proceedings, however, the Appellant/Assessee produced affidavits of thirteen unregistered dealers out of whom twelve were examined by the Officer. The Officer recorded their statements and did not find any infirmity therein including about their credentials. The dealers stood by the assertion made by the Appellant/Assessee about the purchases on credit from them and which explanation had been accepted by the appellate authority.

The factual basis on which the Officer formed his opinion in the assessment order in regard to addition stands dispelled by the affidavits and statements of the concerned unregistered dealers in penalty proceedings. That evidence fully supports the claim of the Appellant/Assessee. The appellate authority had not only accepted the explanation offered by the Appellant/Assessee but also recorded a clear finding of fact that there was no concealment of income or furnishing of any inaccurate particulars of income by the Appellant/Assessee. That now being the indisputable position and therefore the addition of amount could not be justified.

21. MEDLEY PHARMACEUTICALS LTD VS. CIT (ITAT MUMBAI DATED JULY 29, 2020)

The disallowance under the Explanation to section 37(1) of the Income Tax Act, 1961 "the Act" of "freebies" to doctors by relying on CBDT Circular No. 5 dated 01.08.2012 & the IMC (Professional Conduct, Etiquettes & Ethics) Regulation, 2002 is not justified.

Facts of the Case: The assessee company were engaged in the business of manufacturing and trading of pharmaceutical products had filed its Return of Income for A.Y. 2012-13 on 27.09.2012, declaring its total income of Rs.29,29,14,990. Original assessment in the case of the assessee was framed by the A.O, vide his order passed under Section 143(3), dated 27.03.2015, and the income of the assessee was assessed at Rs.49,23,59,750. Subsequently, the case of the assessee was reopened under Section 147 of the Act. In compliance to the notice issued under Section 148 of the Act, the assessee filed its return of income on 20.04.2017, declaring a total income of Rs. 29,29,14,990.

In the course of the assessment proceedings the assessee was supplied the copy of the "reasons to believe" on the basis of which its case was reopened under Section 147 of the Act for the reason, that sales promotion expenses booked by the assessee company revealed that it had inter alia claimed deduction for various expenses which were clearly prohibited as per the MCI guidelines, and thus, disallowable as per the Explanation to Section 37(1) of the Act and therefore disallowed the same.

Order/Judgement: The code of conduct prescribed by the Medical Council is applicable only to medical practitioners/ doctors registered with the Medical Council of India and does not apply to pharmaceutical companies & the healthcare sector in any manner. The CBDT has no power to extend the scope of the MCI regulation to pharmaceutical companies without any enabling provision either under the Income tax Act or the Indian Medical Regulations. The circulars which are issued by the Central Board of Direct Taxes must confirm to the tax laws and though are meant for the purpose of giving administrative relief or for clarifying the provisions of law, but the same cannot impose a burden on the assessee, leave alone creating a new burden by enlarging the scope of a regulation issued under a different act so as to impose any kind of hardship or liability on the assessee.

22. INCOME TAX OFFICER VS. M/S TECHSPAN INDIA PRIVATE (SUPREME COURT DATED APRIL 24, 2018)

Whether an assessment could be reopened on the issue of excess deductions claimed under section 10A of the Income tax Act, 1961, where during the original assessment proceedings, the question of allocation of expenses was considered?

Facts of the Case: The assessee was engaged in the business of development and export of computer software and human resource services. Assessee is also eligible for deduction under Section 10A of the Income Tax Act, 1961. Assessee filed its return declaring a loss after claiming deduction common expenses from its two sources of income, namely, software development and human resource development. The assessee also claimed deduction under section 10A for the income from software development. The return was selected for assessment under section 143(2) and a specific query was raised regarding the allocation of common expenses between the two heads, viz., software development and human resource development. The issue was duly explained and an order passed assessing the income as 'Nil'.

Subsequently a notice under section 148 was issued on the ground that an excess deduction under section 10A had been allowed. The assessee filed objections against the proposed reopening. The objections of the assessee were rejected. On writ, the High Court set aside reassessment notice.

Order/Judgement: Before interfering with the proposed re-opening of the assessment on the ground that the same is based only on a change in opinion, the court ought to verify whether the assessment earlier made has either express or necessary implication expressed an opinion on a matter which is the basis of the alleged escapement of income. If the assessment order is non-speaking, cryptic or perfunctory in nature, it may be difficult to attribute to the assessing officer any opinion on the questions that are raised in the proposed re-assessment proceedings.

In the present case, a bare perusal of the notice made it clear that the point on which the re-assessment proceedings were initiated, was well considered in the original proceedings. Initiation of the re-assessment proceedings under section 147, merely because of the fact that now the AO is of the view that the excess deduction was allowed, was based on nothing but a change of opinion on the same facts and circumstances which were already in his knowledge even during the original assessment proceedings.

23. KACHWALA GEMS VS. JT. CIT (SUPREME COURT DATED DECEMBER 14, 2006)

Whether there is necessarily some estimation involved in a best judgment assessment?

Facts of the Case: The assessee deals in precious and semi-precious stones. The assessee has not maintained and kept any quantitative details/stock register for the goods traded in by the assessee. There is no evidence on record or document to verify the basis of the valuation of the closing stock shown by the assessee. The assessee is not able to prepare such details even with the help of books of accounts maintained, purchase bills & Sale Invoices.

The Assessing Officer 'AO' noticed various defects in the books of account of the assessee. The AO therefore rejected the books of account and proceeded to make a best judgement assessment under section 144 of the Income tax Act, 1961. The Assessing Officer in the assessment order mentioned some comparable cases and was of the view that the case of the assessee is more or less having similar facts as that of M/s. Gem Plaza where the Gross Profit has been taken as 35.48%. The Assessing Officer estimated the Gross Profit of the assessee as 40%.

In appeal, the Commissioner of Income Tax (Appeals) upheld most of the findings of the Assessing Officer, but reduced the Gross Profit from 40% to 35%. In further appeal, the Tribunal had given further relief to the assessee and reduced the Gross Profit rate to 30%.

Order/ Judgement: The authorities concerned should try to make an honest and fair estimate of the income even in a best judgment assessment, and should not act totally arbitrarily, but there is necessarily some amount of guess work involved in a best judgment assessment, and it is the assessee himself who is to blame as he did not submit proper accounts.

Even though there is always a certain degree of guess work in a best judgment assessment, the authority should try to make an honest and fair estimate of the income and should not act totally arbitrarily.

LESSON ROUNDUP

- Loan waiver would not be taxable as

  a) Business Income u/s 28(iv) of the Income Tax Act as receipts should be in the nature of cash or money.

  b) Deemed Business Income u/s 41(1) of the Income Tax Act as it does not apply since waiver of loan does not amount to cessation of trading liability because no deduction was claimed under business in any previous year.

  CIT vs. Mahindra and Mahindra Ltd (Supreme Court)

- Amount received on account of Stock Appreciation Rights (SAR) would be taxable as perquisite under head salary and not under Capital Gain or Business. ACIT vs. Bharat V. Patel (Supreme Court).

- Interest income earned out of the share application money is liable to be set off against the public issue expenses. CIT vs. Shree Rama Multi Tech Ltd (Supreme Court).

- Subsidy granted by the Govt to achieve the objects of acceleration of industrial development and generation of employment is of capital in nature. The fact that the incentives are not available unless and until commercial production has started, and that the incentives are not given to the assessee expressly for the purpose of purchasing capital assets or for the purpose of purchasing machinery is irrelevant. The object has to be seen and not the form in which it is granted. CIT vs. Chaphalkar Brothers Pune (Supreme Court).

- Section 194H : An obligation to deduct TDS u/s 194H arises only if the relationship is that of "principal and agent" and if a "payment" is made. As the relationship between the assessee and the distributor was that of "principal to principal" and as the "discount" did not amount to a "payment", there was no liability to deduct TDS on discounts provided. Hindustan Coca Cola Beverages Pvt. Ltd vs. CIT (Rajasthan High Court).

– Salary cost reimbursement and payment towards Global Information Support Services to French Company, not taxable in India. Faurecia Automotive Holding vs DCIT

– Assessment in the name of amalgamating company is void ab inito. Pr.CIT vs Maruti Suzuki India Limited (Civil Appeal No. 5409 of 2019) (SLP No. 4298 of 2019)

– Special allowances paid by an establishment to its employees would fall within the expression “basic wages” under Section 2(b)(ii) read with Section 6 of the Act for computation of deduction towards Employees’ Provident Fund - Regional Provident Fund Commissioner (II) West Bengal versus Vivekananda Vidyamandir and Others, Civil Appeal No(s). 6221 of 2011, Transfer Case No. (C) No(s). 19 0f 2019

– Possibility of claiming Foreign Tax Credit on the income pertaining to section 10A / section 10AA eligible units (i.e. SEZ / EOU etc.) Tata Consultancy Service Ltd. Vs ACIT (ITA No. 5713/Mum/2016)

– Any payment by a closely-held company by way of advance or loan to a concern in which a substantial shareholder is a member holding a substantial interest is deemed to be “dividend” u/s 2(22)(e) in hands of the shareholder on the presumption that the loans or advances would ultimately be made available to the shareholders of the company giving the loan or advance.

  Note: After Amendment by Financial Act, 2019 now Deemed dividend u/s 2(22)(e) would be chargeable to CDT and not taxable.

  CIT vs. Madhur Housing And Development Co (Supreme Court)

– A family arrangement/settlement does not amount to a “transfer” u/s 2(47) as it only recognizes “pre-existing rights” between the parties, the same applies only to members of the families and not to transfers made by corporate entities. Therefore transfer of shares of a company under family settlement will be chargeable under Capital Gains. The fact that the Company is wholly owned by the members of the family is irrelevant. B.A. Mohota Textiles Traders Pvt. Ltd vs. DCIT (Bombay High Court).

– If an undertaking is sold as a running business with all assets and liabilities for a slump price, then provisions of slump sale will apply and 50(2) will not apply. Therefore capital gain will not be always deemed as short term but if undertaking sold after 36 months , can also be treated as long term. **CIT vs. Equinox Solution Pvt. Ltd (Supreme Court).**

– **Important website for Information on Direct Tax Matters**

  www.incometaxindia.gov.in

  www.itatonline.org

  www.indiabudget.gov.in

  www.nsdl.co.in

  www.taxmann.com

  www.incometaxindiaefiling.gov.in

TEST YOURSELF

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

Discuss the points with the help of decided case laws:

1. Income from letting out of properties by a company, whose main object as per its memorandum of association is to acquire and let out properties, be taxable as its business income or income under the head of house property, considering the fact that the entire income of the company as per its return of income was only from letting out of properties.

2. Can the commission paid to doctors by a diagnostic center for referring patients for diagnosis be allowed as business expenses u/s 37 or would it be treated as illegal expenses and against public policy to attract disallowance.
3. Can payment to police personnel and thief to keep away from the cinemas theatres run by the assessee be allowed as deduction?
4. Would the winning of prize money on unsold lottery tickets held by a distributors of lottery tickets be assessed as business income and be subjects to normal rates of tax instead of the rates prescribed under section 115BB.
5. Can discount given to stamp vendors on purchase of stamp papers be treated as 'commission or brokerage' to attract the provision of TDS u/s 194H

Answer Hints:

1. Chennai properties and investments ltd v/s CIT (2015) 373 ITR 673 (SC)
2. CIT v/s Kap Scan and Diagnostic Centre P. Ltd. (2012) 344 ITR 476 (P&H)
3. CIT v/s Neelavathi & Others (2010) 322 ITR 643 (Karn)
4. CIT v/s Manjoo and Co. (2011) 335 ITR 527 (Kerala)
5. CIT v/s Ahmedabad Stamp Vendors Associations (2012) 348 ITR 378 (SC)

Note: Students are advised to keep updated with the recent case laws on Direct Tax.

SUGGESTED READINGS

1. Taxmann's – Yearly Tax Digest and Referencer
2. Dr. Vinod K. Singhania & Dr. Kapil Singhania – Direct Tax Laws and Practice
3. Dr. Girish Ahuja & Dr. Ravi Gupta – Direct Tax Laws and Practice
4. Dr. Vinod K Singhania – Direct Taxes Ready Reckoner
5. Circular's – https://www.incometaxindia.gov.in/Pages/communications/circulars.asp
6. Notification's – https://www.incometaxindia.gov.in/Pages/communications/notifications.aspx

PROFESSIONAL PROGRAMME

DIRECT TAX LAW & PRACTICE

PP-DTL&P

WARNING

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

“27. Suspension and cancellation of examination results or registration.

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or any Committee formed by the Council in this regard, may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity of being heard, suspend or debar him from appearing in any one or more examinations, cancel his examination result, or registration as student, or debar him from re-registration as a student, or take such action as may be deemed fit.

PROFESSIONAL PROGRAMME

DIRECT TAX LAW & PRACTICE – TEST PAPER

(*This Test Paper is for recapitulate and practice for the students. Students need not to submit responses/ answers to this test paper to the Institute*)

All questions are compulsory

Time allowed: 3 hours *Maximum Mark: 100*

Question 1.

i) Mr. A daughter stays in USA. She owns a house in India and has let it out. She has asked tenants to pay rent to her father i.e. Mr. A. She has not received any rent. Is she still liable to tax? What if she transfers the house to Mr. A?

ii) Mr. A transferred his residential house to Mr. B for Rs 10 lakh on 1st April, 2020. The value of the said house as per Stamp Valuation Authority was Rs 16 lakh. Mr. B is a childhood friend of Mr. A. Mr. A gifted a plot of land (purchased by him on 1st August, 2007) to Mr. B on 1st July, 2020. The value as per Stamp Valuation Authority is Rs 8 lakh. Mr. B sold the land on 1st March, 2020 at Rs 14 lakh. Compute the income of Mr. B chargeable under the heads "Capital Gains" and "Income from other sources" for AY 2021-22.

iii) Following are the details of income and investments for financial year 2020-21 (Assessment Year 2021-22):-

Particulars	**Amount (In Rupees)**
Income from house property (Net Annual Value)	3,00,000
Income from Business	9,00,000
Income from other sources (Taxable at normal rate)	1,00,000
Deductions Under Chapter VI-A	1,00,000

Calculate the income tax liability for Financial Year 2020-21 (Assessment Year 2021-22) if the tax payer is:-

a) 45 years old male

b) 45 years old female

c) 61 years old male

d) 61 years old female

e) 81 years old male

iv) Mr. A a resident individual age 35 years earned the following income during the previous year 2020-21.

Income from playing cricket in UK – Rs. 12 lakhs

Tax paid in UK Rs. 1.8 lakhs

Income from playing cricket in India Rs. 19.20 lakhs

LIC premium paid – Rs. 1.10 lakhs

Medical insurance premium paid for his father age 65 year Rs. 32000

Compute his tax liability assuming Mr. A. has not opted for Section 115BAC of the Income Tax Act, 1961?

v) X Ltd, a non-resident UK company, do not have a permanent establishment in India, entered into an agreement for execution of technical work in India. Separate payments were made towards designs which were described as engineering fees. The assessee contended that such business profits should be taxable in UK as there is no business connection within the meaning of section 9(1)(i) of Income tax Act, 1961. Discuss?

(***10 Marks Each***)

Question 2.

i) ABC Ltd. is engaged in the business of warehousing, handling and transportation along with the relevant auxiliary services like pest control, rodent control, fumigation and security etc. Statement of profit and loss of company shows that the main source of income is storage charges and maintenance or user charges. The substantial part of expenses relate to salaries of employees engaged in maintenance and upkeep of warehouses. The company has filed return of income showing income from letting out of buildings and godown space as "Income from Business". The Assessing Officer rejected the view of the assessee and assessed the same as "Income from House Property". Comment on the validity of action taken by Assessing Officer.

ii) XYZ Ltd., a non-banking finance company was engaged in the business of leasing and hire purchase. It purchased motor cars from Yamaha motors and leased out these vehicles to its customers. The lease agreement with the customer stated that XYZ Ltd. was empowered to repossess the vehicle, in case the lessee committed a default. Registration of the vehicle in the name of lessee, during the period of lease is mandatory as per the Motor Vehicles Act, 1988. XYZ Ltd. Claimed Rs. 10,00,000 as depreciation on the vehicles leased out for the year ending 31.3.2019. The claim was rejected by the Assessing Officer on the ground that the assessee had merely financed the purchase of motor cars and was neither the owner nor the user of these assets. Is the action of the Assessing Officer valid? Discuss.

iii) Mr. Aman is proprietor of M/s. Kunal Textile which is engaged in garment manufacturing business. The entire block of Plant & Machinery chargeable to depreciation @ 15%, has 15 different machinery items as at 31-03-2020. One of the machinery used for packing had become obsolete and was discarded by Mr. Aman in July 2017. Assessee filed its return for AY 2021-22 claiming total depreciation of Rs. 50 lacs which includes Rs 5.00 lacs being the depreciation claimed on the machinery item discarded by Mr. Aman. The A.O. disallowed the claim of depreciation of Rs 5.00 lacs during the course of scrutiny assessment. Comment on the validity of action taken by A.O.

(***10 Marks Each***)

Question 3. How the residential status of company would be determined as per the provisions of the Income Tax Act, 1961.

(***5 Marks***)

Question 4. Discuss the provisions related to Minimum Alternate Tax 'MAT' under Income Tax Act, 1961.

(***5 Marks***)

Question 5. Briefly discuss the provisions related to deduction of tax at source u/s 194C of the Income tax Act, 1961.

(**5 Marks**)

Question 6. Discuss Best Judgement Assessment u/s 144 of Income Tax Act, 1961

(***5 Marks***)

REFERENCES – DIRECT TAXATION

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